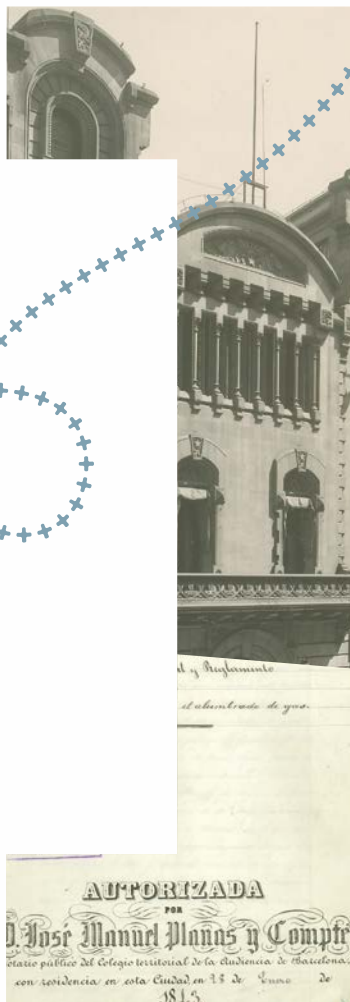


Done and said

Gas Natural SDG
2017 Annual Report

1843-2018





1843
2018

years full of history and
energy

How much energy fits into one hundred and seventy five years!

This is a tale in which journeys, cities, technology, nature and people cross paths. Everything grows, evolves and expands. Like the histories of cities and the people that live there thanks to energy.

There are many parties involved... entire communities have lit up a large part of their life with the energy produced by the company. And that same innovative spirit that has guided us through almost 175 years, day by day, continues to do so for the purpose of offering our customers the best solutions and providing them with every comfort and well-being with the utmost efficiency and sustainability.



175

1843
2018

years of facts





Contents

Annual Accounts Report and Director's Report of Gas Natural SDG

Annual Accounts. Page 07

Audit Report. Page 08

Balance sheet. Page 14

Income statement. Page 16

Statement of recognised income and expenses. Page 17

Statement of changes in equity. Page 17

Cash flow statement. Page 18

Notes to the annual accounts. Page 20

Director's report Page 83

Company situation. Page 84

Business evolution and results. Page 92

Sustainability. Page 96

Main risks and uncertainties. Page 105

Forecast Group performance. Page 111

Sustainable innovation. Page 113

Additional information. Page 115

Annual Corporate Governance Report. Page 116





Gas Natural SDG 2017 Annual Report

Annual Accounts

Audit Report. Page 08

Balance sheet. Page 14

Income statement. Page 16

Statement of recognised
income and expenses. Page 17

Statement of changes
in equity. Page 17

Cash flow statement. Page 18

Notes to the annual accounts. Page 20

Audit Report



This version of our report is a free translation of the original, which was prepared in Spanish. All possible care has been taken to ensure that the translation is an accurate representation of the original. However, in all matters of interpretation of information, views or opinions, the original language version of our report takes precedence over this translation

Independent auditor's report on the annual accounts

To the Shareholders of Gas Natural SDG, S.A.:

Report on the annual accounts

Opinion

We have audited the annual accounts of Gas Natural SDG, S.A., which comprise the balance sheet as at December 31, 2017, and the income statement, statement of other comprehensive income, statement of changes in equity, cash flow statement and related notes for the year then ended.

In our opinion, the accompanying annual accounts present fairly, in all material respects, the equity and financial position of the Company as at December 31, 2017, as well as its financial performance and cash flows for the year then ended, in accordance with the applicable financial reporting framework (as identified in Note 2 of the notes to the annual accounts), and, in particular, with the accounting principles and criteria included therein.

Basis for opinion

We conducted our audit in accordance with legislation governing the audit practice in Spain. Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the annual accounts* section of our report.

We are independent of the Company in accordance with the ethical requirements, including those relating to independence, that are relevant to our audit of the annual accounts in Spain, in accordance with legislation governing the audit practice. In this regard, we have not rendered services other than those relating to the audit of the accounts, and situations or circumstances have not arisen that, in accordance with the provisions of the aforementioned legislation, have affected our necessary independence such that it has been compromised.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key audit matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the annual accounts of the current period. These matters were addressed in the context of our audit of the annual accounts as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

PricewaterhouseCoopers Auditores, S.L., Torre PwC, Pº de la Castellana 259 B, 28046 Madrid, España
Tel.: +34 915 684 400 / +34 902 021 111, Fax: +34 915 685 400, www.pwc.es

1



Gas Natural SDG, S.A

Key audit matter**How our audit addressed the key audit matter***Assessment of the recoverability of the carrying amount of investments in group companies and associates*

The accompanying annual accounts recognise investments in group companies and associates amounting to €13,400 million (Note 6).

The recoverability of the carrying amount of those assets was determined on the basis of the present value of the cash flows they are expected to generate in the future. These cash flows were calculated on the basis of the business plans approved by Management. The key assumptions are detailed in Note 3.3 of the accompanying annual accounts.

Elsewhere, Management carried out a sensitivity analysis, varying the most significant inputs which, based on historical experience, are reasonably likely to suffer changes.

As a result of the above analyses, the Company's Management has recognised an impairment loss of €133 million (Note 6) against these assets.

This is a key audit matter because it implies the use of significant estimates regarding the key assumptions made (which depend on market conditions) in the calculations performed by Management to assess the recoverability of the carrying amount of those assets; were these estimates to differ, the revised estimates could have a significant impact on the Company's annual accounts.

Our analysis began by identifying which investments should be tested for impairment according to prevailing accounting standards.

We also checked that the cash flow projections prepared by the Company in the past have been consistently borne out by reality; this included monitoring delivery of the various business plans.

In addition, we evaluated the calculation process, concluding that the process used to prepare the calculations is subject to the opportune level of supervision and cross-checking by Management.

Elsewhere, with the assistance of our valuation experts, we assessed the appropriateness of the valuation models used, the assumptions and estimates used in the calculations, specifically including short- and long-term forecasts for energy prices, tariffs and future regulated income, electricity output volumes, the cost of natural gas supplies, the volume of gas to be procured from suppliers, operation and maintenance costs, required capital expenditure levels, long-term growth expectations and discount rates.

We similarly confirmed the mathematical accuracy of the calculations and models prepared and the sensitivity analyses performed by Management and checked the estimated magnitude of change in the key inputs required for the assets to become impaired, factoring in the probability of such change.

Lastly, we evaluated the sufficiency of the information disclosed in the annual accounts with respect to the testing of these assets for impairment.

Based on the procedures performed, we can conclude that the approach taken and information disclosed by Management is reasonable and consistent with the obtained evidence.



Gas Natural SDG, S.A

Key audit matter
How our audit addressed the key audit matter
Evaluation of derivative financial instruments

As indicated in Notes 3.5.3 and 26 of the accompanying annual accounts, the Company is contractually committed to the purchase of natural gas under long-term arrangements. In keeping with customary practice in the gas sector, those contracts have terms of between 20 and 25 years, involve minimum purchase commitments (take-or-pay clauses under which the buyer undertakes to pay for the minimum volume of gas contracted regardless of whether or not it takes receipt of it) and price review mechanisms indexed to international natural gas prices and natural gas prices in destination markets.

These contracts are entered into and maintained with the purpose of covering the Company's expected need to physically receive or deliver natural gas in keeping with regular purchase and sales estimates. As a result, the Company classifies these contracts as 'own use' contracts, thus removing them from the scope of the financial instrument measurement standard. At 31 December 2017, the Company had entered into commitments for the purchase €8,056 million of natural gas (Note 26).

Evaluation of the long-term natural gas supply contracts and specifically concluding whether they can be classified as 'own use' contracts, requires the use of judgement by the Company's Management with respect to supply and demand estimates over the short, medium and long term, the impact of price renegotiation processes, the trend in market prices for natural gas and compliance with the clauses embedded in the contracts. As a result, this is a key audit matter.

In addition, as detailed in Note 13, the Company has arranged a number of financial derivative instruments, amounting to €182 million on the asset side of the balance sheet and €213 million on the liability side. The designation of these instruments as accounting hedges and their measurement requires the use of judgement, documentation and estimates on the part of Management.

Our audit response to this matter included the performance of the following procedures:

- Procuring, reading and analysing the natural gas supply contracts entered into by the Company.
- Checking that the commitments to buy and sell natural gas in the short and long term are balanced with the aim of confirming that the contracts qualify as 'own use' contracts.
- Evaluating the amounts acquired during the year and checking that they met the minimum volumes contracted for.
- Analysing the price revision and arbitration proceedings to which the Company is party in order to analyse the magnitude of possible impacts on the annual accounts by reading the contracts and the available information in the course of meetings with the Company's Management.
- Together with our experts in financial derivatives, we analysed the designation of the instruments as accounting hedges and the measurement of the main derivatives.
- Lastly, we evaluated the sufficiency of the information disclosed in the annual accounts with respect to the gas purchase agreements and the derivative financial instruments.

Based on the procedures so performed, we can conclude that the measurement and disclosure of the Company's contractual commitments and financial derivative instruments in the accompanying annual accounts are reasonable.



Gas Natural SDG, S.A

Other information: management report

The other information comprises exclusively the management report for the year 2017, the formulation of which is the responsibility of the directors of the Company and is not an integral part of the annual accounts.

Our audit opinion on the annual accounts does not cover the management report. Our responsibility for the information contained in the management report is defined in the regulations governing the audit activity, which establishes two different levels of the same:

- a) A specific level that is applicable to the status of non-financial information, as well as to certain information included in the Annual Corporate Governance Report, as defined in art. 35.2. b) of Law 22/2015, on Audit of Accounts, which consists of verifying only that the aforementioned information has been provided in the management report and, if not, informing about it.
- b) A general level applicable to the rest of the information included in the management report, which consists of evaluating and reporting on the concordance of the aforementioned information with the annual accounts, based on the knowledge of the entity obtained in the execution of the audit of the aforementioned annual accounts and without including information other than that obtained as evidence during the same, as well as evaluating and reporting whether the content and presentation of this part of the management report are in accordance with the regulations that result from application. If, based on the work performed, we conclude that there are material misstatements, we are obliged to report them.

Based on the work performed, as described previously, we have verified that the specific information mentioned in section a) above is provided in the management report and that the rest of the information contained in the management report agrees with the information of the annual accounts for the year 2017 and its content and presentation are in accordance with the applicable regulations.

Responsibility of the directors and the audit committee for the annual accounts

The Company's directors are responsible for the preparation of the accompanying annual accounts, such that they fairly present the equity, financial position and financial performance of Gas Natural SDG, S.A., in accordance with the financial reporting framework applicable to the entity in Spain, and for such internal control as the directors determine is necessary to enable the preparation of annual accounts that are free from material misstatement, whether due to fraud or error.

In preparing the annual accounts, the Company's directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The audit committee is responsible for overseeing the process of preparation and presentation of the annual accounts.



Gas Natural SDG, S.A

Auditor's responsibilities for the audit of the annual accounts

Our objectives are to obtain reasonable assurance about whether the annual accounts as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with legislation governing the audit practice in Spain will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these annual accounts.

As part of an audit in accordance with legislation governing the audit practice in Spain, we exercise professional judgment and maintain professional scepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the annual accounts, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Company's directors.
- Conclude on the appropriateness of the directors' use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the annual accounts or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the annual accounts, including the disclosures, and whether the annual accounts represent the underlying transactions and events in a manner that achieves fair presentation.

We communicate with the Company's audit committee regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide the Company's audit committee with a statement that we have complied with relevant ethical requirements, including those relating to independence, and we communicate with the audit committee those matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.



Gas Natural SDG, S.A

From the matters communicated with the Company's audit committee, we determine those matters that were of most significance in the audit of the annual accounts of the current period and are therefore the key audit matters.

We describe these matters in our auditor's report unless law or regulation precludes public disclosure about the matter.

Report on other legal and regulatory requirements

Report to the Company's audit committee

The opinion expressed in this report is consistent with the content of our additional report to the Company's audit committee dated 14 February 2018.

Appointment period

The General Ordinary Shareholders' Meeting held on April 20, 2017 appointed us as auditors of the Company for a period of one year, for the year ended December 31, 2017.

Previously, we were appointed by resolution of the General Shareholders' Meeting of June 12, 1990 for the period of 9 years (1990 - 1998), we have been re-elected annually by the General Shareholders' Meeting since then, and we have been performing the work of audit of accounts in an uninterrupted form since the year ended on December 31, 1990.

Services provided

Services provided to the Company for services other than the audit of the accounts, are disclosed in Note 27 to the annual accounts.

In relation to services other than the audit of the accounts, which have been provided to the subsidiaries of the Company, refer to the audit report of 14 February 2018 on the consolidated annual accounts of Gas Natural SDG, S.A. and its subsidiaries in which they are integrated.

PricewaterhouseCoopers Auditores, S.L. (S0242)


Juan Manuel Anguita Amate (20367)

14 February 2018

Gas Natural SDG, S.A. Balance sheet

(million euro)	31/12/17	31/12/16
Non-current assets	29,453	29,993
Intangible assets <i>(Note 4)</i>	114	195
Goodwill	109	190
Other intangible assets	5	5
Property, plant and equipment <i>(Note 5)</i>	151	153
Land and buildings	134	140
Other property, plant and equipment	17	13
Long-term investments in group companies and associates <i>(Note 6)</i>	29,015	29,443
Equity instruments	13,400	13,688
Loans to companies	15,615	15,755
Long-term investments <i>(Note 7)</i>	40	74
Equity instruments	5	5
Derivatives	8	59
Other financial assets	27	10
Deferred income tax assets <i>(Note 16)</i>	133	128
Current assets	4,512	2,084
Trade and other receivables <i>(Note 8)</i>	650	670
Trade receivables	121	145
Trade receivables, group companies and associates	345	368
Sundry receivables	155	153
Current tax assets	29	–
Public Administrations	–	4
Short-term investments in group companies and associates <i>(Note 6)</i>	2,223	883
Loans to companies	1,480	816
Other financial assets	743	67
Short-term investments <i>(Note 7)</i>	85	27
Derivatives	56	–
Other financial assets	29	27
Short-term prepayments and accrued expenses	1	2
Cash and cash equivalents <i>(Note 9)</i>	1,553	502
Cash at banks and in hand	1,453	502
Other cash equivalents	100	–
Total assets	33,965	32,077

Gas Natural SDG, S.A. Balance sheet

(million euro)	31/12/17	31/12/16
Equity (Note 10)	13,466	13,444
Shareholders' funds	13,473	13,431
Capital	1,001	1,001
Authorised capital	1,001	1,001
Share premium	3,808	3,808
Reserves	7,971	7,898
Legal and statutory	300	300
Other reserves	7,671	7,598
Treasury shares	–	(13)
Profit for the year	1,023	1,067
Interim dividend	(330)	(330)
Adjustments for changes in value	(7)	13
Hedging operations	(7)	13
Non-current liabilities	16,113	14,626
Long-term provisions (Note 11)	465	467
Long-term post-employment obligations	272	285
Other provisions	193	182
Long-term borrowings (Note 12)	3,912	3,300
Bank borrowings	3,851	3,190
Derivatives	47	93
Other financial liabilities	14	17
Amounts owing to group companies and associates falling due in more than one year (Note 14)	11,508	10,627
Deferred income tax liabilities (Note 16)	227	231
Long-term accruals	1	1
Current liabilities	4,386	4,007
Short-term borrowings (Note 12)	328	297
Bank borrowings	270	270
Derivatives	44	15
Other financial liabilities	14	12
Amounts owing to group companies and associates falling due in less than one year (Note 14)	3,307	3,000
Trade and other payables (Note 15)	751	710
Trade payables	194	242
Payables with group companies and associates	289	311
Sundry payables	140	93
Personnel (outstanding remuneration)	45	23
Current tax liabilities	–	24
Other amounts payable to Public Administrations	83	17
Total equity and liabilities	33,965	32,077

Gas Natural SDG, S.A. Income statement

(million euro)	2017	2016
Revenue (Note 17)	5,053	5,062
Sales	3,139	3,088
Income from equity instruments of group companies and associates (Note 6)	1,470	1,560
Income from marketable securities and other financial instruments of group companies and associates	444	414
Supplies (Note 18)	(3,148)	(3,118)
Consumption of goods	(3,142)	(3,113)
Raw materials and other consumables	(6)	(5)
Other operating income (Note 21)	383	444
Supplementary income and other operating income	383	443
Operating grants released to the income statement	–	1
Personnel costs (Note 19)	(234)	(201)
Wages, salaries and related expenses	(180)	(152)
Social Security	(39)	(34)
Provisions	(15)	(15)
Other operating expenses (Note 20)	(344)	(337)
External services	(342)	(330)
Taxes	(2)	(2)
Impairment loss and variation in trade provisions	–	(5)
Amortisation expense (Notes 4 and 5)	(91)	(94)
Impairment and results on disposals of fixed assets	(123)	(139)
Gain/(loss) on disposals of tangible fixed assets (Note 5)	3	36
Impairment and losses from equity instruments of group companies and associates (Note 6)	(133)	(206)
Gain/(loss) on disposals of equity interests in group companies and associates (Note 6)	7	31
Operating profit	1,496	1,617
Financial income	31	30
Negotiable securities and other financial instruments	31	30
In third parties	31	30
Financial expenses	(586)	(664)
Borrowings from group companies and associates	(482)	(569)
Borrowings from third parties	(104)	(95)
Variation in fair value of financial instruments	1	(1)
Investments	1	(1)
Exchange differences	(1)	1
Net financial income (Note 22)	(555)	(634)
Profit before taxes	941	983
Income tax (Note 16)	82	84
Profit for the year	1,023	1,067
Basic and diluted earnings per share in euro	1.02	1.07

Gas Natural SDG, S.A. Statement of changes in equity

A) Statement of recognised income and expenses

(million euros)	2017	2016
Profit for the year	1,023	1,067
Income and expense recognised directly in equity	(17)	20
Cash flow hedges	(31)	24
Actuarial gains and losses and other adjustments (Note 11)	8	3
Tax effect (Note 16)	6	(7)
Releases to income statement	3	8
Cash flow hedges	4	10
Tax effect (Note 16)	(1)	(2)
Total income and expense recognised in equity	1,009	1,095

B) Total statement of changes in equity

(million euro)	Share capital	Share premium	Reserves	Treasury shares	Profit or loss brought forward	Profit for the year	Interim dividend	Adjustments for changes in value	Total
Balance at 01/01/2016	1,001	3,808	7,873	-	-	1,024	(408)	(13)	13,285
Total recognised revenues and expenses	-	-	2	-	-	1,067	-	26	1,095
Operations with shareholders or owners									
Dividend distribution (Note 10)	-	-	-	-	(593)	-	(330)	-	(923)
Trading in treasury shares (Note 10)	-	-	-	(13)	-	-	-	-	(13)
Other changes in equity (Note 10)	-	-	23	-	593	(1,024)	408	-	-
Balance at 31/12/2016	1,001	3,808	7,898	(13)	-	1,067	(330)	13	13,444
Total recognised revenues and expenses	-	-	6	-	-	1,023	-	(20)	1,009
Operations with shareholders or owners									
Dividend distribution (Note 10)	-	-	-	-	(671)	-	(330)	-	(1,001)
Trading in treasury shares (Note 10)	-	-	1	13	-	-	-	-	14
Other changes in equity (Note 10)	-	-	66	-	671	(1,067)	330	-	-
Balance at 31/12/2017	1,001	3,808	7,971	-	-	1,023	(330)	(7)	13,466

Gas Natural SDG, S.A. Cash flow statement

(million euro)	2017	2016
Profit for the year before tax	941	983
Adjustments to results	(1,124)	(1,112)
Fixed asset depreciation/amortisation <i>(Notes 4 and 5)</i>	91	94
Impairment adjustments	133	211
Change in provisions	8	6
Profit/(loss) on write-offs and disposals of fixed assets	(3)	(36)
Profit/(loss) on write-offs and disposals of financial instruments	(7)	(31)
Financial income	(1,945)	(2,004)
Financial expenses	586	664
Exchange differences	1	(1)
Variation in fair value of financial instruments	(1)	1
Other income and expenses	13	(16)
Changes in working capital	160	28
Debtors and other receivables	114	10
Other current assets	–	(1)
Creditors and other payables	46	19
Other cash flows from operating activities	695	1,529
Interest paid	(593)	(640)
Dividends received	812	1,560
Interest collected	478	447
Income tax collections/(payments)	(2)	162
Cash flows from operating activities	672	1,428

Gas Natural SDG, S.A. Cash flow statement (continued)

(million euro)	2017	2016
Amounts paid on investments	(1,304)	(2,071)
Group companies and associates	(1,283)	(2,047)
Property, plant and equipment	(16)	(16)
Other financial assets	(5)	(8)
Amounts collected from divestments	1,032	1,639
Group companies and associates	658	1,571
Property, plant and equipment	12	66
Other financial assets	362	2
Cash flows from investing activities	(272)	(432)
Collections and payments on equity instruments	14	(13)
Acquisition of own equity instruments	–	(13)
Disposal of own equity instruments	14	–
Collections and payments financial liability instruments	1,638	(394)
Issuance	8,983	6,347
Bank borrowings	969	801
Payables to group companies and associates	8,014	5,546
Repayment/redemption of	(7,345)	(6,741)
Bank borrowings	(261)	(531)
Payables to group companies and associates	(7,057)	(6,187)
Other payables	(27)	(23)
Dividend payments	(1,001)	(1,331)
Cash flow from financing activities	651	(1,738)
Net increase/decrease in cash or cash equivalents	1,051	(742)
Cash and cash equivalents at the beginning of the year	502	1,244
Cash and cash equivalents at the year end	1,553	502

Notes to the Annual Accounts of Gas Natural SDG, S.A. for the year ended 31 December 2017

Note 1. General information

Gas Natural SDG, S.A. ("the Company"), the parent company of the Gas Natural Fenosa group ("Gas Natural Fenosa"), was incorporated as a public limited company in 1843 and its registered office for corporate purposes is in Avda. de San Luis 77, Madrid.

The company's corporate purposes, as per its articles of association, comprise the following activities:

- a) All types of activities related to the gas and electricity business and any other type of existing energy source, the production and selling of electrical, electro-mechanical and electronic equipment and components, management of architectural projects, civil engineering works, public services and gas and hydro-carbon distribution in general; management of communications and telecommunications networks and maintenance of electro- and gas-related appliances; as well as consulting, business and energy planning services and the rationalisation of energy use, research, development and exploitation of new technologies, communications, computer and industrial security systems; training and selection of human resources and real estate management and development.
- b) The activity as a holding company, incorporating companies or holding shares as a stakeholder or shareholder in other companies no matter what their corporate purposes or nature, by subscribing, acquiring or holding shares, stakes or any other securities deriving from the same, subject to compliance with the legal requirements in each and every case.

The Company's most relevant ordinary activity is the administration and management of its shareholdings in subsidiaries. It also has gas supply contracts for other Gas Natural Fenosa companies and in the electricity area it acts as representative of the Gas Natural Fenosa generation and supply companies before the Electricity Market.

The Company's shares are listed on the four Spanish stock exchanges, the continuous market and form part of the Ibex 35 stock index.

Note 2. Basis of presentation

The Company's Annual Accounts for 2016 were approved by the annual general meeting of shareholders on 20 April 2017.

The Annual Accounts for 2017, which were drawn up and signed by the Company's Board of Directors on 6 February 2018, will be submitted to the general shareholders' meeting for approval; they are expected to be approved without any changes.

The accompanying Annual Accounts have been prepared on the basis of the Company's accounting records and are presented in accordance with prevailing commercial legislation and the provisions of the Chart of Accounts introduced under Royal Decree 1514/2007 (16 November), as amended by Royal Decree 1159/2010 (17 September) and Royal Decree 602/2016 (2 December), so as to present fairly the Company's equity and financial position at 31 December 2017, and the results, changes in equity and cash flows of Gas Natural SDG, S.A. for then ended.

The figures set out these Annual Accounts are expressed in million euros, unless otherwise stated.

The consolidated Annual Accounts of Gas Natural Fenosa for 2017 have been prepared in accordance with the International Financial Reporting Standards adopted by the European Union (IFRS-EU), in accordance with Regulation (EU) 1606/2002 of the European Parliament and the Council. The main figures disclosed in the consolidated Annual Accounts, which have been audited, are as follows:

Total assets	47,322
Equity attributed to the parent company	14,734
Non-controlling interests	3,571
Revenue	23,306
Net income after tax attributed to the parent Company	1,360

Note 3. Accounting policies

The main accounting principles applied by the Company to prepare these Annual Accounts are described below.

3.1. Intangible assets

Intangible assets are carried at acquisition price or production cost, or at fair value in the case of assets acquired through a business combination, less accumulated amortisation and any recognised impairment losses.

a) Goodwill

Goodwill represents the excess, on the date of acquisition, of the cost of a business combination over the fair value of the net identifiable assets acquired at the date of the operation. Consequently, goodwill is only recognised when it has been acquired for valuable consideration and relates to the future economic profits from assets that have not been identified individually and recognised separately.

Goodwill is amortised over ten years using the straight-line method. Goodwill is tested annually to analyse possible impairment losses. It is recognised in the consolidated balance sheet at cost value less amortisation and any cumulative impairment adjustments.

The impairment of goodwill cannot be reversed.

b) Other intangible assets

Research expenditure is recognised in the income statement when incurred.

Costs associated directly with the production of computer software programs that are likely to generate economic profits greater than the costs related to their production are recognised as intangible assets. The direct costs include the personnel costs that has developed the computer programs.

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

The Company has no intangible assets with an indefinite useful life.

3.2. Property, plant and equipment

a) Cost

Property, plant and equipment are carried at acquisition price or production cost, or at the value attributed to the asset if it is acquired as part of a business combination.

Financial costs relating to financing for plant projects during the plant construction period to the date the asset is ready for use form part of property, plant and equipment.

Renewal, extension or improvement costs are capitalised as an increase in the asset's value only when its capacity, productivity or useful life increases.

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

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

When such costs entail additions to property, plant and equipment the purpose of which is to minimise the environmental impact and to protect and improve the environment, they are accounted for as an increase in the value of property, plant and equipment.

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

b) Depreciation

The assets are depreciated on a straight-line basis over their useful lives or the concession term, if shorter. Estimated useful lives are as follows:

	Estimated useful life years
Buildings	33-50
Computer hardware	4
Vehicles	6
Other	3-20

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

When the carrying value of an asset is greater than its estimated recoverable amount or when it is no longer useful, its value is written down immediately to its recoverable amount (Note 3.3).

3.3. Impairment of assets

Assets are tested for impairment provided that an event or change in circumstances indicates that their carrying amount might not be recoverable. Additionally, investments in group companies and associates, long-term investments, goodwill and intangible assets that are not in use are tested annually for impairment.

When the recoverable amount is less than the asset's carrying amount, an impairment loss is recognised through profit and loss for the amount of the difference between the two. The recoverable amount is calculated at the higher of an asset's fair value less costs of sale and value in use calculated by applying the discount cash flow method. The Company considers value in use as the recoverable amount, calculated as described below.

For the purposes of assessing impairment losses, assets are grouped together at the lowest level for which there are separately identifiable cash flows. Assets and goodwill are assigned to these cash-generating units (CGUs).

In the case of investments in group companies, barring investments the recoverable amount of which is determined based on the investee's equity (Note 3.4) and goodwill, the cash flows employed are based on the Strategic Plan approved by the Company, updated by the most recent budgets possible, extended to five years on the basis of regulations and expected market evolution, drawing on available industry forecasts and historical experience of price trends and volumes produced.

The cash flows after the projected period are extrapolated using the growth rates estimated for each CGU or group of CGUs, and in no case exceed the average long-term growth rate for the business in which they operate. In all cases, they are lower than the growth rates stated in the strategic plan. Additionally, in order to estimate future cash flows in the calculation of residual values, all maintenance investments have been considered and, if applicable, renewal investments necessary to maintain the CGUs' production capacity.

The nominal growth rates used for each CGU or financial assets are as follows:

	Growth 2017 (%)	Growth 2016 (%)
Gas distribution in Spain	1.0	1.0
Gas distribution Latin America	1.2-3.0	2.6-3.0
Electricity distribution Spain	1.2	1.2
Electricity distribution Latin America	1.6 -3.0	1.6 -3.0
Unión Fenosa Gas	1.8	1.8
Electricity Spain	2.2	2.2
International electricity	1.0-4.0	1.0-4.6

The parameters taken into account to determine the above growth rates, which represent the long-term growth of each line of business, are in line with the long-term growth of the country, obtained from estimated inflation for the period 2021 to 2045 according to the Economist Intelligence Unit (EIU).

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

	Rates 2017 (%)	Rates 2016 (%)
Gas distribution in Spain	6.2	6.2
Gas distribution Latin America	10.0-17.0	10.0-17.0
Electricity distribution Spain	5.2	5.2
Electricity distribution Latin America	8.8-11.5	8.8-16.6
Unión Fenosa Gas	13.4	11.9
Electricity Spain	6.3	6.1
International electricity	6.5-12.8	5.8-12.8

The parameters used in the breakdown of the above discount rates have been:

- > Risk free bond: 10-year Bond reference market for the CGU, obtained from Bloomberg.
- > Market risk premium: Estimate of the variable interest of each country at 10 years.
- > Deleveraged Beta: According to average of each sector in each case, obtained from Bloomberg.
- > Local current interest rate swaps: 10-year swap, obtained from Bloomberg.
- > Equity-debt ratio: Sector average.

The Unión Fenosa Gas discount rate, using the same parameters as the above, is calculated taking into account the contribution of each line of business to the consolidated figure of Unión Fenosa Gas.

Apart from the discount rates, the most sensitive aspects that are included in the projections used and are based on industry forecasts and historical experience are as follows:

In the case of the investment in Gas Natural Fenosa Generación, S.L.U. and Gas Natural Fenosa Renovables, S.L.U.:

- > Electricity generated. Market demand evolution has been estimated based on the consensus expressed by several international bodies. The share has been estimated based on Gas Natural Fenosa's market share in each technology and on the expected evolution of each technology's share of the total market.
- > Electricity price. Market electricity prices used have been calculated using models that cross expected demand with supply forecasts, taking into account the foreseeable evolution of generation capacity in Spain, based on sector forecasts.
- > Fuel costs. Estimated by reference to long-term supply contracts concluded by Gas Natural Fenosa, the forecast evolution of price curves and market experience.
- > Operation and maintenance costs. Estimated from historical costs of managed park.
- > Taxes established by Law 15/2012.

For the investment in Unión Fenosa Gas, S.A.:

- Gas supply costs in accordance with the prices of the long-term contracts entered into by Unión Fenosa, S.A. 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 Unión Fenosa Gas, S.A. operates.

As a result of the above process, in 2017 the recoverable values of the CGUs' assets, calculated using the methodology described, were, except for the interest in Unión Fenosa Gas higher than the carrying amounts recognised in these consolidated Annual Accounts, with the exception, basically, of the holding in Unión Fenosa Gas, S.A. (Note 6).

In 2016, impairment analyses did not reveal the need to post additional impairment losses or to reverse the impairments made in the previous year, except for the shares in Unión Fenosa Gas, S.A., in which an impairment losses was recognised. (Note 6).

The Company 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 relevant sensitivity analyses performed are as follows:

	Increase	Decrease
Discount rate	50 basis points	-
Growth rate	-	50 basis points
Electricity generated (%)	-	5
Electricity price (%)	-	5
Fuel and gas supply costs (%)	5	-
Operating and maintenance costs (%)	5	-

These sensitivity analyses performed separately for each basic assumption would not affect the conclusions drawn to the effect that the recoverable amount exceeds the carrying amount, except for Unión Fenosa Gas, S.A., the recoverable value of which is roughly equivalent to its carrying amount. So that, an increase of 50 basis points in the discount rate, keeping the rest of the hypothesis unchanged, would imply a deterioration in the value of Unión Fenosa Gas, S.A. of 58 million euros.

3.4. Financial assets and liabilities

Investments in the equity of group and multi-group companies and associates

These are stated at the lower of cost of acquisition or fair value, if the investments are acquired through a business combination, and the recoverable value. The recoverable value is determined as the larger of fair value minus cost of sale and the current value of the cash flows generated by the investment. If there is no better evidence of recoverable value, recoverable value will be the equity of the investee company adjusted by any tacit capital gains subsisting at the valuation date. The value adjustment, and as the case may be, its reversal, is recorded on the income statement in which it takes place.

In non-cash contributions of a business to a group company, the investment is measured at the carrying amount of the assets and liabilities contributed, as per the consolidated Annual Accounts on the transaction date.

The consolidated Annual Accounts of the largest group or subgroup into which the assets and liabilities are integrated, where the parent is a Spanish company, are used.

In mergers and spin-offs between group companies that involve the group's parent, directly or indirectly, the assets and liabilities acquired are measured at the amount that would be reflected in the group's Consolidated Annual Accounts following the transaction. The difference between the cost of the shares handed over and the carrying amount of the assets and liabilities acquired, in the group's Consolidated Annual Accounts, is recognised under "Reserves" in the balance sheet.

Investments

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

a) Loans and receivables

These are non-derivative financial assets, with fixed or determinable pay outs, that are not listed on an active market, and for which there is no plan to trade in the short-term. They include current assets, except for those maturing after twelve months as from the balance sheet date that 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 the Company 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 fair value. Unrealised gains and losses that arise from changes in fair value are recorded in equity. When these assets are sold or impaired over a lengthy period of time, the accumulated adjustments to the reserves due to valuation adjustments are included in the Income statement as gains and losses.

The fair values of quoted investments are based on current bid prices. 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. If none of these techniques can be used to determine fair value, investments are carried at cost less any impairment loss.

Financial assets are written off when the contractual rights to the asset's cash flows have expired or they have been transferred; in the latter case, the risks and rewards of ownership must have been substantially transferred. Financial assets are not written off, and a liability is recognised in the same amount as the payment received, in asset assignments where the risks and rewards of ownership are retained.

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 an original maturity no longer than three months as from the acquisition date.

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 the Company.

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 twelve months are considered non-current payables.

3.5. Financial derivatives and other financial instruments

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising 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.

The Company 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.
- > 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.

Fair values 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.

The embedded derivatives in other non-financial instruments are booked separately as derivatives only when their economic characteristics and tacit risks are not closely related to the instruments in which they are embedded and when the whole is not being booked at fair value through profit and loss.

For accounting purposes, the operations are classified as follows:

Derivatives eligible for hedge accountings

a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualified as fair value hedges are recognised 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 qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the Income statement.

Amounts accumulated in equity are reclassified to the Income statement in the periods when the hedged item will affect profit or loss.

c) Hedges of net foreign investments

Fair value hedge accounting is applied to the differences arising from the exchange rates on loans in foreign currency for financing foreign investments in group and multi-group companies and associates made in the same functional currency.

d) 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 recognised immediately in the Income statement.

e) Energy purchase and sale agreements

During the normal course of its business the Company 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 the buyer 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 the Company 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, lie beyond the standards on valuation of financial instruments.

3.6. Non-current assets held for sale and discontinued operations

The Company classifies as held-for-sale assets those assets for which, at the year end, active initiatives have been initiated for their sale, which is estimated to take place within the next twelve months.

These assets are stated at the lower of their carrying value and fair value minus the costs necessary for their sale and are not subject to depreciation, since the date they are classified as non-current assets held for sale.

Additionally, the Company 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. Entities acquired solely for resale are also classed as discontinued operations.

3.7. Share capital

Share capital is represented by ordinary shares.

Incremental costs directly attributable to the issue of new shares or options, net of taxes, are deducted from equity as a deduction from Reserves or share premium in the case of issues of capital with premiums.

Dividends on ordinary shares are recognised as a deduction from equity in the period 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 recognised under "Reserves" in the Balance sheet.

3.8. Earnings per share

Basic earnings per share are calculated as a quotient between profit or loss for and the average weighted number of ordinary shares in circulation during this period excluding the average number of treasury stock held by the Company.

Diluted earnings per share are calculated as a quotient between profit or loss for attributable to the ordinary shareholders 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.

3.9. Provisions for employee obligations

a) Post-employment pension obligations and the like

> Defined contribution plans

The Company, 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 assured.

Additionally, there is a defined contribution plan for a group of executives, for which the Company 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 recognised in "Staff costs" in the Income statement.

> Defined benefit plans

For certain groups of employees there are commitments for defined benefit schemes in relation to the payment of supplements on retirement, death and disability pensions, in accordance with the benefits agreed by the entity, which have been transferred out of the company in the form of single premium insurance policies under Royal Decree 1588/1999, 15 October, which adopted the Regulations on the instrumentation of pension commitments.

The liability recognised on the Balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the Balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial losses and gains arising from changes in actuarial assumptions or from differences between assumptions and reality are recognised entirely in the period in which they arise, directly in equity reserves.

Past service costs are recognised immediately in the Income statement, in "Staff costs".

b) Other post-employment benefit obligations

The Company provides post-employment benefits to its retirees. 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 to income in "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. The Company 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 the Company has decided to give its consent to voluntary redundancies once they have been requested by the employees.

3.10. Provisions

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

Provisions are measured at the present value of the Company's 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.

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 provisions are recognised in the amount of the current value of the existing difference.

3.11. Leases

a) Finance leases

Leases of property, plant and equipment where the lessee substantially bears all the risks and rewards of ownership are classified as finance leases.

These leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the lease payments, including the purchase option. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term liabilities except for those falling due more than twelve months. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the asset's useful life.

b) Operating leases

Leases in which substantially all the risks and rewards of ownership are retained by the lessor are classified as operating leases.

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

3.12. Corporate income tax

Corporate 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 Annual Accounts used the tax rates that are expected to be in force when the assets and liabilities are realized.

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

Deferred tax assets and tax credits are recognised only to the extent that it is probable that future taxable income will be available against which to offset temporary differences and apply tax credits.

When tax rates change, deferred tax assets and liabilities are reestimated. These amounts are charged or credited to losses or profits, or to reserves, depending on the account to which the original amount was charged or credited.

3.13. Recognition of income and expenses

a) General

Sales are recognised when products are delivered to the customer and have been accepted by the customer, even if they have not been invoiced, or if applicable, services are rendered, and it is probable that the economic benefits associated with the transaction will flow to the entity. Net turnover for the year includes the estimate of the energy supplied that has not yet been 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.

b) Other income and expenses

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 Income statement for the year.

Interest incomes and expenses are recognised using the effective interest method.

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

The holding of shares in group companies and associates is deemed to be the Company's most relevant ordinary activity from which periodic revenue is obtained. In accordance with the stance adopted by the Spanish Institute of Accounting and Auditing ("ICAC") in connection with the calculation of net revenue in holding companies (Reply number 2 in ICAC Official Gazette number 79), dividends from group companies and associates, and interest received on loans granted to group companies and associates, are recognised as "Revenue". Additionally, the item "Impairment and results on disposal of equity instruments of group companies and associates" is included in "Operating profit/(loss)".

3.14. Foreign currency transactions

Foreign currency transactions are translated to euro using the exchange rates in force at the transaction dates. Gains and losses resulting from the settlement of these transactions and translation at the year-end exchange rates of monetary assets and liabilities denominated in foreign currency are recognised in the income statement.

3.15. Transactions between related parties

In general, transactions between related parties are recorded initially at their fair value. If the agreed price differs from its fair value, the difference is recorded taking into account the economic reality of the operation. The later valuation is made in accordance with the provisions of the respective legislation.

Notwithstanding the above, in merger, de-merger or non-cash contribution operations of a business, the assets that make up the acquired business are stated at the amount corresponding to the same once the operation takes place in the Consolidated Annual Accounts of Gas Natural Fenosa.

In these cases, the difference that could arise between the net value of the assets and liabilities of the acquired company, adjusted by the balance of the groupings of grants, donations and bequests received, or any value adjustments or capital or share premiums, as the case may be, issued by the merging company, is recorded under "Reserves" in the balance sheet.

3.16. Business combinations

Business combinations are recorded using the acquisition method. The cost of an acquisition is calculated using the fair value of the assets given, the equity instruments issued and the liabilities incurred or borne on the transaction date plus the costs directly attributable to the acquisition. The valuation process required in order to use the acquisition method is completed within the period of one year as from the acquisition date.

The identifiable assets acquired and the liabilities or contingent liabilities incurred or borne as a result of the transaction, are initially stated at their fair value at the date of acquisition, provided that this can be reliably measured.

The surplus cost of the acquisition in relation to the fair value of the shareholding of the Company 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 acquired, the difference is recognised directly in the Income statement.

3.17. Cash flow statement

The cash flow statements has 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 Company 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.

3.18. Significant accounting estimates and judgments

The preparation of Annual Accounts requires the formulation of estimates and judgments. The valuation standards that require a large number of estimates are set out below:

a) Intangible assets and Property, plant and equipment (Notes 3.1 and 3.2)

The determination of useful life of intangible assets and property, plant and equipment requires estimates of their degree of use, as well as expected technological evolution. The assumptions regarding the degree of use, technological framework and future development involve a significant degree of judgement, insofar as the timing and nature of future events are difficult to foresee.

b) Impairment of assets (Note 3.3)

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

c) Derivatives or other financial instruments (Note 3.5)

The fair value of financial instruments traded in active markets is based on quoted market prices at the Balance sheet date. The quoted market price used for financial assets 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. The Company 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 interest rate 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 derivatives is calculated by using forward prices curves. The recoverable value of the investments in the equity of group and multi-group companies and associates is determined as the greater of their fair value less costs of sale and the current value of the cash flows from the investment.

The carrying value less impairment provision of trade receivables and payables are 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 the Company for similar financial instruments.

d) Provisions for employee benefits (Note 3.9)

A number of assumptions must be used to calculate pension costs, other costs of post-retirement benefits and other post-retirement liabilities. The Company 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 affecting such assumptions may result in the recording of different amounts and liabilities. 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. Social security coverage assumptions are also essential to determine other post-retirement benefits. Future changes to these assumptions will have an impact on future pension costs and liabilities.

e) Provisions (Note 3.10)

The Company makes an estimate of the amounts to be settled in the future, including amounts relating to contractual obligations, outstanding litigation, 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 3.12)

The calculation of the income tax expense requires interpretations of tax legislation in the jurisdictions in which the Company operates. The determination of expected outcomes of outstanding disputes and litigation requires the preparation of significant estimates and judgment. The Company evaluates the recoverability of the deferred income tax assets based on estimates of future taxable income. Deferred tax liabilities are recognised based on estimates of the net assets that will not be tax deductible in the future.

Note 4. Intangible assets

Set out below there is an analysis of movements in intangible assets:

	Computer software	Other intangible assets	Subtotal	Goodwill	Total
Cost	2	–	2	815	817
Accumulated amortization	(2)	–	(2)	(543)	(545)
Carrying value at 01/01/2016	–	–	–	272	272
Investment	4	1	5	–	5
Amortisation charge	–	–	–	(82)	(82)
Carrying value at 31/12/2016	4	1	5	190	195
Cost	6	1	7	815	822
Accumulated amortization	(2)	–	(2)	(625)	(627)
Carrying value at 01/01/2017	4	1	5	190	195
Amortisation charge	–	–	–	(81)	(81)
Carrying value at 31/12/2017	4	1	5	109	114
Cost	6	1	7	815	822
Accumulated amortization	(2)	–	(2)	(706)	(708)
Carrying value at 31/12/2017	4	1	5	109	114

Goodwill derives from the vertical merger of Unión Fenosa, S.A. completed in 2009 and is attributable to the benefits and synergies arising from the integration with the Gas Natural Fenosa Group. In 2016, due to changes in accounting regulations, the amortisation of this goodwill commenced and the option was chosen to calculate the effect of the change in the goodwill amortisation from the acquisition date of the assets concerned against the goodwill reserve.

Intangible assets include, at 31 December 2017, fully amortised assets still in use totalling Euros 2 million (Euros 2 million at 31 December 2016).

Note 5. Property, plant and equipment

Set out below is an analysis showing movements in Property, plant and equipment during 2017 and 2016:

	Land and buildings	Other PPE	Total
Cost	248	34	282
Accumulated depreciation	(81)	(22)	(103)
Carrying value at 01/01/2016	167	12	179
Investment	12	3	15
Divestment	(23)	–	(23)
Depreciation charge	(10)	(2)	(12)
Reclassifications and transfers	(6)	–	(6)
Carrying value at 31/12/2016	140	13	153
Cost	201	33	234
Accumulated depreciation	(61)	(20)	(81)
Carrying value at 01/01/2017	140	13	153
Investment	12	4	16
Divestment	(8)	–	(8)
Depreciation charge	(7)	(3)	(10)
Reclassifications and transfers	(3)	3	–
Carrying value at 31/12/2017	134	17	151
Cost	197	40	237
Accumulated depreciation	(63)	(23)	(86)
Carrying value at 31/12/2017	134	17	151

In November 2017, the Company sold the building located in calle Lérida, Madrid, for Euros 12 million, generating a capital gain before income tax of Euros 3 million. The Company has entered into an operating lease without a purchase option for a period of ten years which may be extended for a further five-year period with the acquiring company. At the date of the transaction the remaining useful life of the property transferred was considerably greater than the maximum lease period.

In December 2016, Gas Natural SDG, S.A., General de Edificios y Solares, S.L. and Unión Fenosa Distribución, S.A., 100% owned subsidiaries of Gas Natural Fenosa, sold four buildings located in Madrid (Avenida San Luis, 77, Antonio López, 193, Acanto, 11-13 and Avenida América, 38). Gas Natural SDG, S.A. sold the building located in Avenida América 38, for Euros 64 million, generating a pre-tax capital gain of Euros 36 million. The Company and the acquiring companies entered into operating lease agreements without any purchase option for a term of 10 years for each of these properties, which may be extended for a further five years except for the building in Avenida América 38 (Note 26). At the date of the transaction, the remaining useful lives of the properties was considerably greater than the maximum lease period, in all cases.

In 2017 there have been disposals of fully-depreciated assets totalling Euros 4 million (Euros 7 million at 31 December 2016).

Property, plant and equipment include fully-depreciated assets still in use totalling Euros 15 million at 31 December 2017 (Euros 16 million in 2016).

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

At 31 December 2017 and 31 December 2016, the Company had no investment commitments.

Note 6. Investments in group companies and associates

A breakdown of the investments in group companies and associates is as follows:

	At 31/12/17	At 31/12/16
Equity instruments	13,400	13,688
Loans	15,615	15,755
Non-current	29,015	29,443
Loans	1,480	816
Other financial assets	743	67
Current	2,223	883
Total	31,238	30,326

Movements during the year in non-current investments in group companies and associates are as follows:

	Shareholdings in group companies	Loans to group companies	Shareholdings in associates	Total
Balance at 01/01/2016	14,602	14,695	11	29,308
Additions	40	1,584	–	1,624
Divestments	(759)	(259)	–	(1,018)
Reclassification	–	(266)	–	(266)
Charge/reversal provisions	(206)	–	–	(206)
Exchange differences	–	1	–	1
Balance at 31/12/2016	13,677	15,755	11	29,443
Additions	26	2	–	28
Divestments	(180)	(12)	(1)	(193)
Reclassification	–	(124)	–	(124)
Charge/reversal provisions	(133)	–	–	(133)
Exchange differences	–	(6)	–	(6)
Balance at 31/12/2017	13,390	15,615	10	29,015

2017

The most significant movements in the item "Shareholdings in group companies and associates" in 2017 relate to:

- > Capital contribution to offset losses in Gas Natural S.U.R. SDG, S.A. in the amount of Euros 26 million.
- > Capital reduction through a reimbursement of contributions in Clover Financial and Treasury Services, D.A.C in the amount of USD 75 million. The reduction in the shareholding has generated a Euros 7 million profit due to the effect of the exchange rate.
- > Decrease in the carrying amount of the holding due to the distribution of reserves by Global Power Generation, S.A. in the amount of Euros 17 million.
- > In August 2017, it made up the sale of 20% of the Gas Distribution Spain business to a long-term infrastructure investor consortium made up of Allianz Capital Partners (ACP) and Canada Pension Plan Investment Board (CPPIB) was agreed in the amount of Euros 1,500 million. The operation is expected to be completed during the year 2018, once the corresponding authorizations are obtained. It involves a transfer without any loss of control for Gas Natural Fenosa.

2016

The most significant movements in the heading "Shareholdings in group companies and associates" in 2016 related to:

- > Capital contribution to offset losses posted by the company Gas Natural Exploración, S.L. in the amount of Euros 30 million.
- > Capital contribution to offset losses in Gas Natural S.U.R. SDG, S.A. in the amount of Euros 10 million.
- > Capital reduction through the reimbursement of contributions in Clover Financial and Treasury Services, D.A.C. in the amount of USD 825 million. The reduction in the shareholding has generated a Euros 33 million profit due to the effect of the exchange rate.
- > Sale of the 50% shareholding in Nueva Generadora del Sur, S.A. to Gas Natural Generación, S.L.U. at its carrying amount of Euros 1 million.
- > Capital reduction in Natural Re, S.A. in the amount of Euros 4 million.
- > The distributions of reserves by Global Power Generation, S.A. and Gasifica, S.A. amounting to Euros 64 million and Euros 1 million, respectively, has been recorded as a decrease in the carrying value of shareholdings.
- > During the year Gasifica, S.A. was dissolved, leading to a reduction in the investment of Euros 3 million and a loss of Euros 2 million.

The cumulative provision for the impairment of shareholdings in group companies and associates totals Euros 1,620 million at 31 December 2017 (Euros 1,487 million at 2016), relating basically to the following companies:

- > Gas Natural Exploración, S.L.: the recoverable amount has been calculated on the basis of its equity. No impairment has been recognised during 2017. The provision at 31 December 2017 totals Euros 213 million (Euros 213 million at 31 December 2016).
- > Unión Fenosa Gas, S.A.: in 2017 impairment was recognised with respect to the interest in Unión Fenosa Gas, S.A. amounting to Euros 109 million due to the change in the contribution to the consolidated figure of the holding in said company. Note 3.3. provides details of the assumptions relating to the discount and growth rates. The other assumptions have not been altered.

In 2016 an impairment of Euros 174 million was recognised with respect to the interest in Unión Fenosa Gas, S.A. due to the need to update the assumption concerning the supply cost in view of the forecast evolution of the energy scenario for Unión Fenosa Gas, S.A. and the change in the contribution to consolidation.

In previous years an impairment of the interest in Unión Fenosa Gas, S.A. amounting to Euros 1,088 million had been recognised basically due to the substantial failure of the Egyptian supplier to comply with the agreements to re-establish supplies of gas to the Damietta (Egypt) liquefaction plant and the change in the contribution to the consolidated figure of the interest in that company.

The provision at 31 December 2017 totals Euros 1,371 million (Euros 1,262 million at 31 December 2016).

Financial income for dividends received from investments in equity instruments of group companies and associates during the years 2017 and 2016, correspond to the following companies:

	2017	2016
Sagane, S.A.	335	177
Gas Natural Servicios SDG, S.A.	179	62
Gas Natural Distribución Latinoamérica, S.A.	178	–
Nedgia, S.A.	156	354
Gas Natural Aprovisionamientos SDG, S.A.	155	242
Gas Natural Comercializadora, S.A.	134	326
Unión Fenosa Distribución, S.A.	133	241
Gas Natural Fenosa Internacional, S.A.	88	–
Global Power Generation, S.A.	41	58
Clover Financial And Treasury Services, D.A.C.	40	45
General de Edificios y Solares, S.L.	19	2
Gas Natural Capital Markets, S.A.	8	2
Gas Natural Almacenamientos Andalucía, S.A.	1	8
Gas Natural Fenosa Engineering, S.L.U.	1	3
Compañía Española de Industria Electroquímica, S.A.	1	–
Others	1	–
Unión Fenosa Preferentes, S.A.	–	29
Gas Natural Informática, S.A.	–	5
Gas Natural Fenosa Finance, B.V.	–	3
Gasifica, S.A.	–	2
Unión Fenosa Minería, S.A.	–	1
Total	1,470	1,560

The breakdown of shareholdings in group companies is set out below:

Company	Registered Office	Activity	Carrying value 2017	Carrying value 2016	Data at 31 December 2017							
					% interest			Equity				
					Direct	Indirect	Total	Capital	Reserves ¹	Profit/(loss)	Interim dividend	Other ²
Gas Natural Aprovisionamientos SDG, S.A.	Spain	Gas marketing	18	18	100.0	–	100.0	1	19	128	(120)	7
Gas Natural Fenosa LNG, S.L.	Spain	Gas marketing	2	2	100.0	–	100.0	2	–	–	–	–
La Energía, S.A.	Spain	Gas marketing	11	11	100.0	–	100.0	11	5	–	–	–
Sagane, S.A.	Spain	Gas marketing	42	42	100.0	–	100.0	95	22	192	(190)	(1)
Unión Fenosa Gas, S.A.	Spain	Gas marketing	1,065	1,179	50.0	–	50.0	33	660	(57)	–	9
Gas Natural Comercializadora, S.A.	Spain	Gas and electricity marketing	121	121	100.0	–	100.0	3	102	(17)	–	24
Gas Natural S.U.R. SDG, S.A.	Spain	Gas and electricity marketing	70	44	100.0	–	100.0	2	27	(22)	–	(2)
Gas Natural Servicios SDG, S.A.	Spain	Gas and electricity marketing	106	106	100.0	–	100.0	3	51	10	(10)	(1)
Unión Fenosa Distribución, S.A.	Spain	Electricity distribution	1,630	1,630	100.0	–	100.0	833	440	154	(125)	337
Holding de Negocios de Gas, S.A.U.	Spain	Gas distribution	–	–	100.0	–	100.0	–	–	–	–	–
Gas Natural Fenosa Generación, S.L.U.	Spain	Electricity generation	3,897	3,897	100.0	–	100.0	552	1,280	(456)	–	4
Gas Natural Fenosa Renovables, S.L.U.	Spain	Electricity generation	397	397	100.0	–	100.0	90	115	13	–	–
Global Power Generation, S.A.	Spain	Electricity generation	1,514	1,556	75.0	–	75.0	20	1,850	54	(51)	(48)
P.H. La Perla, S.A.	Costa Rica	Electricity generation	–	–	100.0	–	100.0	–	–	–	–	–
Toledo PV A.I.E.	Spain	Electricity generation	–	–	33.3	–	33.3	–	1	1	–	–
Gas Natural Almacenamientos Andalucía, S.A.	Spain	Gas infrastructures	8	8	100.0	–	100.0	–	8	2	–	–
Gas Natural Exploración, S.L.	Spain	Gas infrastructures	9	9	100.0	–	100.0	15	(5)	1	–	–
Petroleum, Oil & Gas España, S.A.	Spain	Gas infrastructures	41	41	32.3	67.7	100.0	4	20	(4)	–	2
Natural Re, S.A.	Luxembourg	Insurance	9	9	100.0	–	100.0	4	63	(11)	–	11

Company	Registered Office	Activity	Carrying value 2017	Carrying value 2016	Data at 31 December 2017							
					% interest			Equity				
					Direct	Indirect	Total	Capital	Reserves ¹	Profit/(loss)	Interim dividend	Other ²
Compañía Española de Industrias Electroquímicas, S.A.	Spain	Services	4	4	98.5	–	98.5	3	13	1	–	–
General de Edificios y Solares, S.L.	Spain	Services	63	63	100.0	–	100.0	34	35	11	–	–
Clover Financial and Treasury Services, D.A.C.	Ireland	Financial services	542	680	100.0	–	100.0	–	355	33	–	204
Gas Natural Capital Markets, S.A.	Spain	Financial services	–	–	100.0	–	100.0	–	–	6	–	–
Gas Natural Fenosa Finance, B.V.	Netherlands	Financial services	7	7	100.0	–	100.0	–	6	1	–	(2)
Unión Fenosa Financiación, S.A.	Spain	Financial services	11	11	100.0	–	100.0	1	–	–	–	–
Unión Fenosa Preferentes, S.A.U.	Spain	Financial services	–	–	100.0	–	100.0	–	1	1	–	109
Gas Natural Informática, S.A.	Spain	IT services	20	20	100.0	–	100.0	20	8	(2)	–	–
Gas Natural Fenosa Engineering, S.L.	Spain	Engineering services	24	24	100.0	–	100.0	–	18	(1)	–	1
Nedgia S.A.	Spain	Holding company	1,981	1,981	100.0	–	100.0	300	1,682	372	(140)	–
Gas Natural Distribución Latinoamérica, S.A.	Spain	Holding company	558	558	100.0	–	100.0	402	236	173	(149)	–
La Propagadora del Gas, S.A.	Spain	Holding company	10	10	100.0	–	100.0	10	1	–	–	–
Gas Natural Fenosa Internacional, S.A.	Spain	Holding company	944	944	100.0	–	100.0	250	332	93	(88)	37
Unión Fenosa Minería, S.A.	Spain	Holding company	286	305	100.0	–	100.0	11	169	2	–	–
Total			13,390	13,677								

Appendix I to Gas Natural Fenosa's consolidated Annual Accounts provides a breakdown of other indirect shareholdings.

¹ Includes the share premium, reserves, prior-year losses and retained earnings.

² Includes measurement adjustments, other equity instruments and grants, donations and bequests.

The non-current loans to group companies which at 31 December 2017 total Euros 15,615 million mature in 2019 (at 31 December 2016, Euros 15,755 million maturing in 2018).

Set out below are movements during 2017 and 2016 in loans and other current financial assets:

	Loans to group companies	Other financial assets	Total
Balance at 01/01/2016	727	3	730
Additions	424	64	488
Divestments	(673)	–	(673)
Reclassifications	338	–	338
Balance at 31/12/2016	816	67	883
Additions	882	740	1,622
Divestments	(594)	(64)	(658)
Reclassifications	376	–	376
Balance at 31/12/2017	1,480	743	2,223

There are no significant differences between carrying values and fair values in the balances under Loans to group companies and other receivables.

The heading Loans to group companies includes loans to group companies amounting to Euros 962 million (Euros 84 million in 2016) and cash pooling balances with investee companies, as manager of the Group's centralised cash system amounting to Euros 481 million (Euros 700 million in 2016). It also includes accrued unmatured interest of Euros 37 million (Euros 32 million in 2016).

At 31 December 2017, loans to group companies and associates have borne interest at a rate of 2.66% (2.54% in 2016) in the case of non-current amounts, and 1% (1% in 2016) in the case of current amounts.

Dividends pending collection at 31 December 2017 amounted to Euros 739 million, recorded under "Other current financial assets" (Euros 64 million at 31 December 2016).

Note 7. Investments

The breakdown of investments by category is as follows:

At 31 December 2017	Available-for-sale financial assets	Loans and receivables	Assets at fair value through profit or loss	Hedging derivatives	Total
Equity instruments	5	–	–	–	5
Derivatives (<i>Note 13</i>)	–	–	–	8	8
Other financial assets	–	27	–	–	27
Non-current investments	5	27	–	8	40
Derivatives (<i>Note 13</i>)	–	–	43	13	56
Other financial assets	–	29	–	–	29
Current investments	–	29	43	13	85
Total	5	56	43	21	125

At 31 December 2016	Available-for-sale financial assets	Loans and receivables	Assets at fair value through profit or loss	Hedging derivatives	Total
Equity instruments	5	–	–	–	5
Derivatives (<i>Note 13</i>)	–	–	31	28	59
Other financial assets	–	10	–	–	10
Non-current investments	5	10	31	28	74
Other financial assets	–	27	–	–	27
Current investments	–	27	–	–	27
Total	5	37	31	28	101

Available-for-sale financial assets

All available-for-sale financial assets relate to unlisted shareholdings at 31 December 2017 and 31 December 2016.

Loans and receivables

The breakdown of Loans and other receivables is as follows:

	At 31/12/17	At 31/12/16
Loans to companies	2	2
Gas system income deficit financing	19	-
Deposits and guarantee deposits	6	8
Non-current	27	10
Deposits and guarantee deposits	29	27
Current	29	27
Total	56	37

The heading "Gas system revenue deficit financing" includes temporary mismatches between gas system revenues and costs accumulated in 2017, funded by Gas Natural Fenosa pursuant to Law 18/2014 of 17 October. This amount has been acquired by the Company from the distribution companies of Gas Natural Fenosa and will be recovered through gas system settlements as the right to the recovery of this amount is generated in the following five years, recognising a market interest rate. The amount of this financing has been recognised based on the estimated recovery period.

Note 8. Trade and other receivables

The breakdown of this account is as follows:

	At 31/12/17	At 31/12/16
Trade receivables	145	169
Trade receivables, group companies and associates	345	368
Sundry receivables	38	77
Provision	(24)	(24)
Derivatives (Note 13)	117	76
Current income tax asset	29	-
Public Administration	-	4
Total	650	670

In general, amounts billed pending collection do not bear interest, being the average maturity period less than 20 days.

Movements in the bad debt provision are as follows:

	2017	2016
At 1 January	(24)	(21)
Net charge for the year (Note 20)	–	(5)
Other	–	2
At 31 December	(24)	(24)

Note 9. Cash and cash equivalents

Cash and cash equivalents include:

	At 31/12/17	At 31/12/16
Cash at banks and in hand	1,453	502
Other cash equivalents	100	–
Total	1,553	502

At 31 December 2017, investments in Cash equivalents mature in less than three months at a weighted effective interest rate of 0.073%.

Nota 10. Equity

The main items of Equity are as follows:

Share capital and share premium

The variations during the years 2017 and 2016 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 01 January 2016	1,000,689,341	1,001	3,808	4,809
Changes	–	–	–	–
At 31 December 2016	1,000,689,341	1,001	3,808	4,809
Changes	–	–	–	–
At 31 December 2017	1,000,689,341	1,001	3,808	4,809

All issued shares are fully paid up and carry equal voting and dividend rights.

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

The most relevant holdings in the Company’s share capital at 31 December 2017 and 2016, in accordance with the public information available or the communication issued by the Company itself, are as follows:

	% interest in share capital	
	2017	2016
Fundación Bancaria Caixa d’Estalvis i Pensions de Barcelona, “la Caixa” ¹	24.4	24.4
Repsol, S.A.	20.1	20.1
Global Infrastructure Partners III ²	20.0	20.0
Sonatrach	4.0	4.0

¹ Through Criteria Caixa S.A.U.

² Global Infrastructure Partners III, whose investment manager is Global Infrastructure Management LLC, holds its interest 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 Company’s capital 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, was terminated and the composition of the Board of Directors and Board committees of Gas Natural Fenosa 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.

The Company’s Board of Directors is empowered, within a maximum period of five (5) years as from 20 April 2017, to increase capital by Euros 500,344,670 for monetary consideration on one or more occasions, when and in the amount it so determines, by issuing voting or non-voting common, preference or redeemable shares, at a premium or otherwise, to be paid in cash, without the need for further shareholder approval, including the power to totally or partially override pre-emptive subscription rights up to 20% of the amount of capital stock at the date of this authorisation, and to amend the Articles of Association as may be required as a result of any capital increase(s) undertaken by virtue of the aforementioned authorisation, allowing for incomplete subscription, all in conformity with the provisions of Article 297.1.b) of the Spanish Capital Companies Act; this power may be sub-delegated to the Executive Committee.

All the Company’s shares are traded on the four official Spanish Stock Exchanges and the “Mercado continuo” and form part of Spain’s Ibex 35 stock index.

The Company’s share price at 31 December 2017 was Euros 19.25 (Euros 17.91 at 31 December 2016).

Reserves

Reserves includes the following:

	2017	2016
Legal reserve	200	200
Statutory reserve	100	100
RD 7/96 revaluation reserve	–	225
Goodwill reserve	191	496
Voluntary reserves	7,200	6,603
Other reserves	280	274
	7,971	7,898

At the annual general meeting held on 20 April 2017, the shareholders agreed to the transfer to voluntary reserves of Euros 305 million from the Goodwill reserve and Euros 225 million from the Royal Decree-Law 7/96 Revaluation reserve.

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 Company's Articles of Association, 2% of net profit 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 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 books of account.

Goodwill reserve

Law 22/2015 on Auditing 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.

Voluntary and other reserves

Relates basically to voluntary reserves for undistributed profits, also including the effects of the measurement of shareholdings in group companies as a result of transactions between group companies recognised in the same amounts stated in Gas Natural Fenosa's Consolidated Annual Accounts.

Treasury shares

Movements during 2017 and 2016 involving the Company's treasury shares are as follows:

	Number of shares	In million euro	% Capital
At 01 January 2016	–	–	–
Acquisitions	3,049,189	53	0.3
Disposals	(2,298,644)	(40)	(0.2)
At 31 December 2016	750,545	13	0.1
Acquisitions	7,623,586	147	0.8
Share Acquisition Plan	(336,625)	(7)	(0.1)
Disposals	(8,037,506)	(153)	(0.8)
At 31 December 2017	–	–	–

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.

In 2017 the profit made on transactions involving treasury shares of Gas Natural Fenosa amounted to Euros 0.5 million, recognised under "Other reserves" (Euros 0.4 million profit in 2016).

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%.

Earnings per share

Basic earnings per share are calculated by dividing profit by the weighted average number of ordinary shares in issue during the year.

	At 31/12/17	At 31/12/16
Profit for the year	1,023	1,067
Weighted average number of ordinary shares in issue	1,000,478,210	1,000,468,342
Earnings per share (in Euros):		
Basic	1.02	1.07
Diluted	1.02	1.07

The average weighted number of ordinary shares used in the calculation of earnings per share in 2017 and 2016 is as follows:

	2017	2016
Weighted average number of ordinary shares	1,000,689,341	1,000,689,341
Weighted average number of treasury shares	(211,131)	(220,999)
Weighted average number of shares in issue	1,000,478,210	1,000,468,342

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

Dividends

Set out below is a breakdown of the payments of dividends made in 2017 and 2016:

	2017			2016		
	% of Nominal	Euros per share	Amount	% of Nominal	Euros per share	Amount
Ordinary shares	100	1.00	1,001	133	1.33	1,331
Other shares (without voting rights, redeemable, etc.)	-	-	-	-	-	-
Total dividends paid	100	1.00	1,001	133	1.33	1,331
a) Dividends charged to income statement	100	1.00	1,001	133	1.33	1,331
b) Dividends charged to reserves or share premium account	-	-	-	-	-	-
c) Dividends in kind	-	-	-	-	-	-

2017

The proposal for the distribution of 2016 profits approved by the Annual General Meeting held on 20 April 2017 included the payment of a supplementary dividend of Euros 0.67 per share, for a total amount of Euros 671 million, paid on 27 June 2017.

On 25 July 2017, the Company's Board of Directors resolved to pay an interim dividend of Euros 0.330 per share out of 2017 results, for a total of Euros 330 million, which was paid on 27 September 2017.

The Company had sufficient liquidity to pay out the dividend at the approval date, with the necessary liquidity to proceed to payment pursuant to the Spanish Companies Act. The provisional liquidity statement drawn up by the Directors on 25 July 2017 as follows:

Profit after tax	449
Reserves to be recognised	-
Maximum amount distributable	449
Forecast interim dividend payment	330
Cash resources	302
Undrawn credit facilities	6,940
Total liquidity	7,242

On 6 February 2018, the Board of Directors approved the following proposal for the distribution of the Company's net profit for 2017, for submission to the Annual General Meeting:

Available for distribution	
Profit/(loss)	1,023
Distribution	
To Voluntary reserve	22
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 share for each qualifying share outstanding at the proposed date of payment, 27 June 2018.

The voting rights attaching to the treasury shares, except for the right to the free assignment of new shares, will be allocated proportionally to the remaining shares.

2016

Included 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 Annual General Meeting held on 4 May 2016 approved the payment of a supplementary dividend of Euros 0.592 per share, for a total amount of Euros 593 million, paid on 30 June 2016.

On 22 July 2016, the Company's Board of Directors approved an interim dividend of Euros 0.330 per share of 2016, for a total of Euros 330 million, which was paid on 27 September 2016.

Note 11. Provisions

The breakdown of provisions at 31 December 2017 and 2016 is as follows:

	At 31/12/17	At 31/12/16
Provisions for employee obligations	272	285
Other provisions	193	182
Non-current provisions	465	467

Provisions for employee obligations

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

	2017			2016		
	Pensions and other similar obligations	Other obligations with personnel	Total	Pensions and other similar obligations	Other obligations with personnel	Total
At 1 January	275	10	285	274	9	283
Contributions charged to profits	6	6	12	8	7	15
Payments during the year	(18)	–	(18)	(10)	–	(10)
Changes recognised directly in equity	(8)	–	(8)	(4)	–	(4)
Transfers and other applications	7	(6)	1	7	(6)	1
At 31 December	262	10	272	275	10	285

Pensions and other similar liabilities

Most of the Company's post-employment obligations consist of the contribution of defined amounts to occupational pension plan systems. Nevertheless, at 31 December 2017 and 31 December 2016, the Company held the following defined benefit obligations for certain groups of workers:

- › Pensions to retired workers, the disabled, widows and orphans and other related groups.
- › 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.
- › Obligations 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.

The amounts recognised in the Balance sheet for pensions and similar obligations, as well as the movement in the current value of the obligations and the fair value of the plan assets are determined as follows:

Present value of obligations	2017	2016
At 1 January	1,080	1,057
Service cost for the year	2	2
Interest cost	13	20
Changes recognised directly in equity	(36)	65
Benefits paid	(71)	(71)
Transfers and other	7	7
At 31 December	995	1,080
Fair value of plan assets		
At 1 January	805	783
Expected yield	9	14
Contributions	7	(2)
Changes recognised directly in equity	(28)	69
Benefits paid	(60)	(59)
Transfers and other	–	–
At 31 December	733	805
Provisions for pensions and similar obligations	262	275

The amounts recognised in the income statement for all the above-mentioned defined benefit plans are as follows:

	2017	2016
Service cost for the year	2	2
Interest cost	13	20
Expected return on plan assets	(9)	(14)
Total charge to the income statement	6	8

Benefits to be paid in the coming years for the above-mentioned commitments are as follows:

	2017	2016
1 to 5 years	1	2
5 to 10 years	22	37
More than 10 years	239	236
Provisions for pensions and similar obligations	262	275

The plan assets expressed as a percentage of total assets are as follows:

% of total	2017	2016
Bonds	100	100

Cumulative actuarial gains and losses, net of the tax effect, recognised directly in equity amount to a positive figure of Euros 3 million in 2017 (negative in the amount of Euros 3 million in 2016).

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

	2017	2016
Financial assumptions	(13)	22
Experience	5	(26)
At 31 December	(8)	(4)

Actuarial assumptions applied are as follows:

	At 31/12/17	At 31/12/16
Discount rate (p.a.)	0.0 a 2.25	0.0 a 1.8
Expected return on plan assets (p.a.)	0.0 a 2.25	0.0 a 1.8
Future salary increases (p.a.)	2.0	2.0
Future pension increases (p.a.)	2.0	2.0
Inflation rate (annual)	2.0	2.0
Mortality table	PERMF 2000	PERMF 2000
Life expectancy:		
Men		
Retired during the year	22.9	22.5
Retiring within 20 years	42.7	42.5
Women		
Retired during the year	27.4	27.0
Retiring within 20 years	48.6	48.4

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

The interest rates used to discount post-employment commitments are applied based on the period of each commitment and the reference curve is calculated applying observable rates for high-credit-quality corporate bonds (AA) issued in the Eurozone.

The costs of health care have been measured on the basis of the expected costs of the premiums of the different medical care policies taken out. A 1% variation in the increase in the cost of these premiums would not have a significant impact on the liability recognised at 31 December 2017 and 31 December 2016, nor would it cause a relevant variation in the normal, financial costs for future years in relation to that recognised in 2017 and 2016.

Other obligations with personnel

The Company 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 their termination.

At 31 December 2017 a provision has been recorded corresponding to the remuneration programmes 2015-2017, 2016-2018 and 2017-2019 amounting to Euros 19 million (Euros 19 million at 31 December 2016), of which Euros 10 million is classified as non-current in 2017 (Euros 9 million 2016).

Other non-current provisions

The movement in other non-current provisions is as follows:

	2017	2016
At 1 January	182	198
Appropriations ¹	2	1
Reversals	–	(10)
Payments	(4)	(7)
Transfers and other	13	–
At 31 December	193	182

¹ Includes Euros 2 million and Euros 1 million in 2017 and 2016, respectively, relating to the financial update of provisions.

“Non-current provisions” mainly includes provisions posted to cover obligations deriving mainly from tax claims (Note 16), litigation and arbitration, and other liabilities.

No provision for onerous contracts was deemed necessary at 31 December 2017 or 2016.

At 31 December 2017, the estimated payment dates for these obligations are between one and five years (Euros 3 million), between five and ten years (Euros 49 million) and more than ten years (Euros 141 million) (2016: Euros 7 million at between one and five years, Euros 0 million at between five and ten years and Euros 175 million at more than ten years).

Note 12. Borrowings

The breakdown of borrowings at 31 December 2017 and 2016 is as follows:

	At 31/12/17	At 31/12/16
Borrowings from financial institutions	3,851	3,190
Derivatives (<i>Note 13</i>)	47	93
Other financial liabilities	14	17
Non-current borrowings	3,912	3,300
Borrowings from financial institutions	270	270
Derivatives (<i>Note 13</i>)	44	15
Other financial liabilities	14	12
Current borrowings	328	297
Total	4,240	3,597

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

	Carrying amount		Fair value	
	At 31/12/17	At 31/12/16	At 31/12/17	At 31/12/16
Bank borrowings, derivatives and other financial liabilities	3,912	3,300	3,912	3,301

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 2017 and 31 December 2016 on borrowings with similar credit and maturity characteristics.

The movement in borrowings is as follows:

	2017	2016
At 1 January	3,597	3,780
Increase	913	859
Decrease	(270)	(1,042)
At 31 December	4,240	3,597

The following tables describe borrowings and maturities at 31 December 2017 and 2016, taking into account the impact of derivative hedges.

	2018	2019	2020	2021	2022	2023 and beyond	Total
At 31 December 2017							
Fixed	200	261	287	170	137	1,263	2,318
Floating	128	250	722	278	527	17	1,922
Total	328	511	1,009	448	664	1,280	4,240

	2017	2018	2019	2020	2021	2022 and beyond	Total
At 31 December 2016							
Fixed	156	232	630	127	84	92	1,321
Floating	141	192	500	348	471	624	2,276
Total	297	424	1,130	475	555	716	3,597

Setting aside the impact of derivatives on borrowings, fixed-rate debt would amount to Euros 337 million of total borrowings at 31 December 2017 (Euros 104 million at 31 December 2016) and variable-rate debt would amount to Euros 3,812 million at 31 December 2017 (Euros 3,385 million at 31 December 2016).

The following tables describe the gross borrowings denominated in foreign currencies at 31 December 2017 and at 31 December 2016 and their maturities, taking into account the impact of the derivative hedges:

	2018	2019	2020	2021	2022	2023 and beyond	Total
At 31 December 2017							
Euro debt	315	400	746	448	664	1,280	3,853
USD debt	13	111	263	–	–	–	387
Total	328	511	1,009	448	664	1,280	4,240

	2017	2018	2019	2020	2021	2022 and beyond	Total
At 31 December 2016							
Euro debt	264	409	705	475	555	716	3,124
USD debt	33	15	425	–	–	–	473
Total	297	424	1,130	475	555	716	3,597

Borrowings bore an average effective interest rate in 2017 of 1.31% (1.53% in 2016) including the derivatives assigned to each transaction.

At 31 December 2017, this includes Euros 9 million in interest pending payment (Euros 6 million at 31 December 2016).

These payables include bank borrowings totalling Euros 1,656 million (Euros 1,169 million at 31 December 2016) that are subject to the fulfilment of certain covenants.

Most of the drawn financial debt includes a clause that relates to the change of control whose trigger depends on some of these events happening at the same time: not belonging to none of the present reference shareholders in a significant percentage; losing the Rating Agencies investment grade or non capacity to fulfil the financial obligations of the contract.

Likewise, there are borrowings amounting to Euros 2,851 million that could be subject to early repayment in case of a change of control. Most of this amount correspond to infrastructure financial funds from de European Inversion Bank than require, apart from the change of control event, a reduction in the rating and have specific repayment terms longer than the early repayment scenarios.

At the preparation date of these Annual Accounts, the Company 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.

We set out below the most relevant financial instruments:

Bank borrowings

Bank borrowings also include other bilateral bank loans of Euros 1,645 million at 31 December 2017 (Euros 1,537 million at 31 December 2016), no amounts having been drawn down on credit lines.

Institutional financing

The Company records balances payable to the Official Credit Institute (ICO) relating to instruments for a total amount of Euros 235 million (Euros 112 million in 2016).

Additionally, financing granted by the European Investment Bank (EIB) to the Company has been drawn down in the amount of Euros 2,240 million (2016: Euros 1,811 million, with Euros 300 million drawable).

Note 13. 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 risk exposure of 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 UK voters supported the departure of their country from the European Union ("Brexit"). Although the exit of the UK will be accompanied by lengthy negotiations the duration of which is currently unknown, the first repercussions have already arisen in both the capital and currency markets. However, Gas Natural Fenosa's exposure to the risk derived from Brexit is practically zero.

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 borrowing costs within the established risk parameters.

The Company employs financial swaps to manage exposure to interest rate fluctuations, swapping floating rates for fixed rates.

The financial debt structure at 31 December 2017 and 2016 (Note 12), after taking into account the hedges arranged through derivatives, is as follows:

	At 31/12/17	At 31/12/16
Fixed interest rate	2,318	1,321
Floating interest rate	1,922	2,276
Total	4,240	3,597

The floating interest rate is mainly subject to the fluctuations of the Euribor and the Libor.

The sensitivity of results and equity (measurement adjustments) to interest rate fluctuations is as follows:

	Increase/decrease in interest rates (basis points)	Effect on profit before tax	Effect on equity before tax
2017	+50	(10)	131
	-50	10	(131)
2016	+50	(11)	80
	-50	11	(80)

Exchange rate risk

The variations in the exchange rates can affect the fair value of:

- > Counter value of cash flows related to the purchase-sale of 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 the Company finances, to the extent possible, its investments in local currency. Furthermore, it tries to match, 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 when its marginal contribution to the risk is relevant and can exceed the risk limits established.

The non-Euro currency with which the Company operates most is the US Dollar. The sensitivity of the Company's profits and consolidated equity ("Adjustments for changes in value") to a 5% variation (increase or decrease) in the US dollar/euro exchange rate is as follows:

	%	2017	2016
Effect on profit before tax	+5	-	-
	- 5	-	-
Effect on equity before tax	+5	-	-
	- 5	-	-

Commodity price risk

The Company purchases gas to be supplied to other group companies.

Due to its activity as a holding company, the Company is exposed to the risk of fluctuations in commodities prices, the determination of which is basically subject to crude oil prices and those of its by-products. Additionally, in the electricity generation business Gas Natural Fenosa is exposed to CO₂ 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, seeking to balance purchase and supply obligations, and the 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.

In electricity and CO₂ emission allowances trading by the Company, risk is insignificant due to the low volume of transactions and the established limits placed, both on the amount and maturity date.

	Increase / decrease in the electricity sale price (%)	Effect on profit before tax	Effect on equity before tax
2017	+10	–	–
	–10	–	–
2016	+10	–	–
	–10	–	–

Gas Natural Fenosa has no relevant investments in upstream businesses or commodities production, therefore a low price scenario in commodities would 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 supply activities are directly affected by commodity prices. In this regard, Gas Natural Fenosa has a risk policy that stipulates the tolerance range, based on applicable risk limits, among other aspects. Measures employed to keep risk within the stipulated limits include active supply management, balanced acquisitions and sales formulae, and specific hedging so as to maximise the risk-profit relationship.

Credit risk

Credit risk is defined as the potential loss resulting from the possible nonfulfillment of the contractual obligations of counterparties with which the Group does business.

Gas Natural Fenosa performs solvency analyses on the basis of which credit limits are assigned and any necessary provisions are determined. Based on these models, the probability of customer default can be measured and the expected commercial loss can be kept under control. In addition, credit quality and portfolio exposure are monitored on a recurring basis to ensure that potential losses are within the limits provided for by internal regulations. This allows a certain capacity to anticipate events in credit risk management.

Furthermore, the outstanding trade receivables are stated on the balance sheet net of provisions for bad debts (Note 8), estimated by the Company based on the age of the debt and the experience of previous years in line with the prior segregation of customer portfolios and the current economic environment.

With respect to other exposures to counterparties in transactions involving financial derivatives and the investment of cash surpluses, credit risk is mitigated by carrying out such operations with reputable financial institutions holding "BB" ratings or higher, in accordance with the credits ratings granted by Moody's, S&P and Fitch. No significant defaults or losses arose in 2017 or 2016.

The ageing analysis of financial assets concluded that there were no unimpaired, past due financial assets at 31 December 2017 and 2016.

The impaired financial assets are broken down in Note 8.

Concerning supplier credit risk, the solvency of each supplier of products and services is guaranteed through the recurring analysis of their financial information, particularly prior to new engagements. To this end, the relevant assessment criteria are applied depending on the supplier's criticality in terms of service or concentration. This procedure is supported by control mechanisms and systems and supplier management.

At 31 December 2017 and 2016 Gas Natural Fenosa does not have significant concentrations of credit risk.

Liquidity risk

The Company 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 sufficient funds to cover credit obligations.

At 31 December 2017, available cash totalled Euros 8,400 million (Euros 7,883 million in 2016), including cash and cash equivalents of Euros 1,553 million (Euros 502 million in 2016), undrawn bank financing and credit lines to the amount of Euros 6,847 million (Euros 7,381 million in 2016). There is also unused capacity to issue debt on the capital markets (Note 14).

Capital management

The main purpose of the Company's capital management 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 objective indicators of capital management: maintaining a long-term leverage ratio of approximately 50%.

The Company's long-term credit rating is as follows:

	2017	2016
Moody's	Baa2	Baa2
Standard & Poor's	BBB	BBB
Fitch	BBB+	BBB+

Derivative financial instruments

The breakdown of derivative financial instruments by category and maturity is as follows:

	At 31/12/17		At 31/12/16	
	Assets	Liabilities	Assets	Liabilities
Hedging derivative financial instruments	8	47	28	61
Fair value hedge				
Interest rate and foreign exchange rate	–	6	–	40
Cash flow hedge				
Interest rate	8	41	28	21
Other financial instruments	–	–	31	32
Interest rate and foreign exchange rate	–	–	31	32
Derivative financial instruments – non current	8	47	59	93
Hedging derivative financial instruments	13	–	–	15
Fair value hedge				
Exchange rate	3	–	–	10
Cash flow hedge				
Interest rate	1	–	–	5
Exchange rate	9	–	–	–
Other financial instruments	161	166	76	82
Price of commodities	117	122	76	82
Interest rate and foreign exchange rate	43	43	–	–
Exchange rate	1	1	–	–
Derivative financial instruments current	174	166	76	97
Total	182	213	135	190

Other financial instruments include the derivatives not qualifying for hedge accounting.

The impact on the Income statement of derivative financial instruments is as follows:

	2017		2016	
	Operating results	Financial results	Operating results	Financial results
Cash flow hedge	–	(4)	–	(10)
Other financial instruments	(1)	(2)	(28)	(2)
Total	(1)	(6)	(28)	(12)

The breakdown of derivatives at 31 December 2017 and 2016, their fair value and maturities of their notional values is as follows:

	Fair value	31/12/17						Total
		2018	2019	2020	2021	2022	Later years	
Interest rate hedges:								
Cash flow hedges:								
Financial swaps (EUR)	(8)	95	95	844	63	91	2,484	3,672
Financial swaps (USD)	1	228	–	–	–	–	–	228
Financial swaps (NOK)	(25)	–	–	–	–	–	101	101
Exchange rate hedges:								
Cash flow hedges:								
Financial swaps (USD)	9	489	–	–	–	–	–	489
Fair value hedges:								
Financial swaps (USD)	(6)	–	–	–	160	–	–	160
Foreign exchange insurance (USD)	3	193	–	–	–	–	–	193
Other:								
Commodities price derivatives (EUR)	(3)	4	–	–	–	–	–	4
Commodities price derivatives (USD)	(2)	–	–	–	–	–	–	–
	(31)	1,009	95	844	223	91	2,585	4,847

	Fair value	31/12/16						Total
		2017	2018	2019	2020	2021	Later years	
Interest rate hedges								
Cash flow hedges								
Financial swaps (EUR)	23	684	–	–	–	–	1,500	2,184
Financial swaps (USD)	–	166	259	–	–	–	–	425
Financial swaps (NOK)	(21)	–	–	–	–	–	101	101
Exchange rate hedges								
Fair value hedges								
Financial swaps (USD)	(40)	–	–	60	–	160	–	220
Foreign exchange insurance (USD)	(10)	219	–	–	–	–	–	219
Other								
Commodities price derivatives (EUR)	(6)	13	–	–	–	–	–	13
Financial swaps (MXN)	(1)	–	–	–	–	–	–	–
	(55)	1,082	259	60	–	160	1,601	3,162

Note 14. Payables to group companies and associates

The breakdown by maturity of borrowings from group companies is as follows:

Maturity	At 31/12/17	At 31/12/16
2017	–	3,000
2018	3,307	1,556
2019	1,311	1,199
2020	1,116	1,639
2021	1,417	1,531
2022	1,743	1,742
2023	872	–
Subsequent years	5,049	2,960
Total	14,815	13,627

Payables to group companies mainly relate to issues of Gas Natural Capital Markets, S.A. and Gas Natural Fenosa Finance, B.V. under the European Medium-Term Notes (EMTN) programme. This programme was created in 1999; following a number of extensions, the latest in November 2017, the programme limit is Euros 15,000 million (Euros 14,000 million in 2016). At 31 December 2017, principal drawn down totalled Euros 11,205 million (Euros 10,205 million in 2016) and the amount of Euros 3,795 million was available (Euros 3,795 million in 2016).

In April 2017, Gas Natural Capital Markets, S.A. issued bonds under the EMTN programme amounting to Euros 1,000 million which was used to carry out a repurchase of obligations amounting to Euros 1,000 million maturing in 2018, 2020 and 2021, so there was no movement of cash.

Specifically, bonds issued amounting to Euros 11,205 million, would be susceptible to early maturing as long as this change of control may produce more than two steps or two full notches falling in at least two of the three ratings it may have as well as all the ratings falling under investment grade and provided that the Rating Agency express that this reduction in the rating is due to the change of control.

Also included is the amount payable to Gas Natural Finance, B.V. for Euro Commercial Paper (ECP) issues, Euros 0 million having been utilised (Euros 100 million in 2016), with Euros 1,000 million remaining available (Euros 900 million in 2016). The balances payable to Gas Natural Fenosa Finance, B.V. in respect of perpetual subordinated debentures amounting to Euros 1,500 million (Euros 1,500 million 2016) and the debt with Unión Fenosa Preferentes, S.A. relating to preferred shares totalling Euros 110 million (Euros 110 million in 2016) are also included.

Borrowings from group companies include interest accrued pending maturity of Euros 288 million (Euros 350 million in 2016).

Cash-pooling balances with group companies amounting to Euros 1,642 million are also included (Euros 1,163 million in 2016).

Borrowings from group companies and associates accrued an average interest rate of 3.51% in 2017 (4.2% in 2016).

There are no significant differences between the carrying amounts and fair values of Payables to group companies and associates.

Note 15. Trade and other payables

The breakdown at 31 December 2017 and 2016 is as follows:

	At 31/12/17	At 31/12/16
Trade payables	194	242
Trade payables, group companies and associates	289	311
Derivatives (<i>Note 13</i>)	122	82
Other payables	18	11
Personnel (outstanding remuneration)	45	23
Public Administrations	83	17
Current tax liabilities	–	24
Total	751	710

Most payables do not accrue interest and have contractual maturity dates of less than 30 days, in the case of gas purchases and within the legal limits, for other suppliers.

At 31 December 2017, Euros 25 million was recognised under the heading Personnel (outstanding remuneration) in relation to termination benefits resulting from agreements with employees to terminate their employment contracts, to be paid in the first quarter of 2018.

Information on average supplier payment period. Additional Provision 3 “Duty of disclosure” of Law 15/2010/5 July

The average payment period is in accordance with Law 15/2010 on measures to combat late payment in business operations.

Information disclosed under the Resolution of 29 January 2016 of the Institute of Accountants and Auditors concerning the details to be included in the notes to the Annual Accounts concerning the average supplier payment period is as follows:

	2017	2016
	Amount	Amount
Total payments (thousand euro)	4,452,183	3,993,686
Total payments outstanding (thousand euro)	79,532	88,041
Average supplier payment period (days) ¹	20	22
Transactions paid ratio (days) ²	20	22
Transactions pending payment ratio (days) ³	23	24

¹ Calculated on the basis of amounts paid and pending payment.

² Average payment period in transactions paid during the year.

³ Average age, suppliers pending payment balance.

The accompanying ratios do not include situations that could distort calculations, such as Trade payables, group companies and associates.

Note 16. Tax situation

The Company 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 2017 is analysed in Appendix I.

Corporate income tax is calculated on the basis of economic or accounting profit obtained by application of generally accepted accounting principles, which do not necessarily coincide with taxable profit, understood as taxable income for corporate income tax purposes.

The reconciliation of accounting profit for the years 2017 and 2016 to taxable income is as follows:

	At 31/12/17	At 31/12/16
Accounting profit before tax	941	983
Permanent differences	(1,264)	(1,278)
Temporary differences		
Arising during current year	43	28
Arising in prior years	(23)	(28)
Taxable income	(303)	(295)

Permanent differences mainly relate to the application of the tax consolidation system and the double taxation exemption for dividends and income derived from the transfer of shares under Article 21 of Law 27/2014 on Corporate Income Tax, which has led to negative permanent differences of Euros 1,264 million resulting mainly from negative adjustments for dividends accruing during the year (Euros 1,560 million in 2016) and impairment of shareholdings in group companies and associates amounting to Euros 133 million (Euros 206 million in 2016).

In 2017 the Company posted a tax loss of Euros 303 million (Euros 295 million in 2016), which is recovered from the Tax group companies due to the taxable income generated by them during the year.

Law 27/2014 maintained the non-tax deductibility of impairment losses on equity interests, which had been introduced under Law 16/2013 with effect from 1 January 2013. In 2017 and 2016 the impairment losses recognised for shareholdings were not treated as tax deductible. Items yet to be included in the tax base after having filed the final corporate income tax return for 2016 are the following:

Company	Amounts pending inclusion in tax base in 2016	Amounts included in 2017	Amounts pending inclusion in tax base in 2017
Other	1	(1)	-
	1	(1)	-

Income tax expense is as follows:

	2017	2016
Current-year tax	(77)	(84)
Deferred tax	(5)	–
Total	(82)	(84)

Current corporate income tax is the result of applying a 25% tax rate to taxable income. In the tax consolidated group, tax credits applied in 2017 amounted to Euros 9 million (Euros 7 million in 2016) and no tax losses were offset. Adjustments are also included for prior-year taxable differences, entailing a decrease in the expense of Euros 13 million (increase of Euros 10 million in 2016).

On 3 December 2016 Royal Decree-Law 3/2016 was published, adopting tax measures for the consolidation of public finances, which introduced relevant changes in the corporate income tax area. Among other matters, with effect from 1 January 2016 the obligation is laid down to reverse provisions for the impairment of shareholdings that would have been deductible before 2013 in a maximum term of five years, the offsetting of tax losses for large companies is limited to 25% of the preliminary tax base and the application of the tax credit for domestic or international double taxation generated or pending application is restricted to 50% of preliminary gross tax payable. Additionally, effective from 1 January 2017, losses on the transfer of shares will not be deductible. In 2017 and 2016 these measures did not have a significant impact on the Company's financial statements.

Incomes that qualify to the tax credit for reinvestment of extraordinary profits provided by Article 42 of the revised Corporate Income Tax Act introduced under Legislative Royal Decree-Law 4/2004 (5 March) and the resulting investments made in previous periods are explained in the Annual Accounts for the relevant years. The relevant breakdown is as follows:

Year of sale	Amount obtained from sale	Amount reinvested	Income qualifying for deduction	Year reinvested
2011	2	2	1	2011
2014	412	412	209	2014
Total	414	414	210	

The reinvestment was made in fixed assets related to economic activities carried out by the Company itself or any other company 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) is explained below:

Year of sale	Amount obtained from sale	Amount reinvested	Initial capital gain	Capital gain included in tax base at year end	Capital gain yet to be included in tax base at year end
2002	917	917	462	19	443
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	752	752	551	–	551
2011	450	450	394	–	394
2012	38	38	32	–	32
Total	3,390	3,390	2,249	29	2,220

The reinvestment has been made in fixed assets used in business activities both by the Company and by the other companies in the tax group, pursuant to Article 75 of the Corporate Income Tax Act.

A breakdown of the tax effect of each item on the Statement of Recognised Income and Expenses is as follows:

	At 31/12/17			At 31/12/16		
	Gross	Tax effect	Net	Gross	Tax effect	Net
Cash flow hedges	(27)	7	(20)	34	(8)	26
Actuarial gains and losses and other adjustments	8	(2)	6	3	(1)	2
	(19)	5	(14)	37	(9)	28

A breakdown of deferred taxes is as follows:

	At 31/12/17	At 31/12/16
Deferred tax assets:	133	128
Non-current	126	118
Current	7	10
Deferred tax liabilities:	(227)	(231)
Non-current	(227)	(231)
Net deferred tax	(94)	(103)

Movements and breakdown of deferred asset accounts are as follows:

Deferred tax assets	Provisions	Tax credits	Valuation of assets and financial instruments	Goodwill	Other	Total
At 01/01/2016	112	4	4	10	3	133
Creation (reversal)	(4)	–	–	1	–	(3)
Movements linked to equity adjustments	(1)	–	(1)	–	–	(2)
Transfers and other	(2)	2	–	–	–	–
At 31/12/2016	105	6	3	11	3	128
Creation (reversal)	4	–	–	1	–	5
Movements linked to equity adjustments	(2)	–	3	–	–	1
Transfers and other	4	(4)	–	(1)	–	(1)
At 31/12/2017	111	2	6	11	3	133

Deferred tax liabilities	Differences in Depreciation	Deferred gains	Other	Total
At 01/01/2016	4	210	20	234
Creation (reversal)	(1)	–	(2)	(3)
Movements linked to equity adjustments	–	–	7	7
Transfers and other	–	–	(7)	(7)
At 31/12/2016	3	210	18	231
Creation (reversal)	–	–	–	–
Movements linked to equity adjustments	–	–	(4)	(4)
Transfers and other	–	(13)	13	–
At 31/12/2017	3	197	27	227

In 2015, the demerger of the nuclear power generation business from the Company to Gas Natural Fenosa Generación, S.L.U. was completed. Pursuant to Article 76.3 of Law 27/2014, this operation was defined as a non-cash contribution of a line of business and was thus subject to the special scheme provided by Title VII, Chapter VIII of that law. The information requirements established by the aforementioned standard are included in the Notes to the Annual Accounts that forms part of the Company's Annual Accounts for the year 2015.

In 2014, the demerger of the thermal and hydraulic generation business from the Company to Gas Natural Fenosa Generación, S.L.U. was completed. Pursuant to Article 83.3 of Royal Decree-Law 4/2004 whereby the Corporate Income Tax Act (CIT Act) was approved, this operation is defined as a non-cash contribution of a line of business and is thus subject to the special scheme provided for in Title VII, Chapter VIII of said Act. The information requirements established by the aforementioned standard are included in the Notes to the Annual Accounts that forms part of the Company's Annual Accounts for the year 2014.

In 2009, the companies Unión Fenosa, S.A. and Unión Fenosa Generación S.A. were merged into the Company under the special tax scheme for mergers, spin-offs, asset contributions, share exchanges and changes of registered address of European companies or European cooperatives from one European Union Member State to another, provided by Title VII, Chapter VIII TRLIS. The information requirements stipulated in the special tax scheme are fulfilled in the notes to the Company's 2009 Annual Accounts.

At 31 December 2017 there are no ongoing inspection proceedings that affect the main government taxes.

The Company's tax group is open to inspection for 2011 and subsequent periods and the taxes to which it is subject.

On 3 November 2017 an unfavourable judgment was received from the Supreme Court in relation to the tax inspection assessments resulting from inspections on corporate income tax for 2003-2005, due to the application of the deduction for export activities. These assessments had been fully provided (Note 11) for and amounted to Euros 4 million, which has been fully offset by balances to be returned by Public Administration.

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. The Company considers, however, that any liabilities that might arise would not significantly affect these Annual Accounts.

Gas Natural Fenosa has recorded provisions for obligations deriving from a number of tax claims. There are no cases in which litigation or uncertain tax treatments are individually significant (Note 11).

Note 17. Revenue

Sales breakdown as follows:

	2017	2016
Electricity sales	1,714	1,460
Natural gas sales	1,420	1,620
Other sales	5	8
Income from equity instruments of group companies and associates (Note 6)	1,470	1,560
Income from marketable securities and other financial instruments of group companies and associates	444	414
Total	5,053	5,062

Electricity and gas sales are made basically in the domestic market and relate to gas and electricity sales to other Gas Natural Fenosa companies.

The Company has gas supply contracts for other Gas Natural Fenosa companies and in the electricity area it acts as representative of the Gas Natural Fenosa generation and supply companies with respect to the Electricity Market.

Note 18. Procurements

This caption includes gas and electricity purchases related to the activity of sales of gas and electricity to other companies of Gas Natural Fenosa.

Note 19. Personnel costs

The breakdown of this account in the income statement for 2017 and 2016 is as follows:

	2017	2016
Wages and salaries	151	144
Termination benefits	29	8
Social security costs	26	22
Defined contribution plans	13	13
Defined benefit plans (<i>Note 11</i>)	2	2
Other	13	12
Total	234	201

The average number of Company employees in 2017 and 2016 is as follows:

	2017	2016
Executives	494	478
Middle managers	204	192
Specialists	738	709
Workers	348	357
Total	1,784	1,736

The average number of Company employees during 2017 and 2016 with a disability equal to or greater than 33% is as follows:

	2017		2016	
	Men	Women	Men	Women
Executives	3	–	3	–
Middle managers	1	1	–	1
Specialists	12	13	11	12
Workers	7	10	8	9
Total	23	24	22	22

The number of Company employees at the end of 2017 and 2016 broken down by category and gender is as follows:

	2017		2016	
	Men	Women	Men	Women
Executives	332	172	323	159
Middle managers	112	102	110	88
Specialists	345	412	340	375
Workers	92	252	94	257
Total	881	938	867	879

Note 20. Other operating expenses

A breakdown of this heading on the income statement account for 2017 and 2016 is as follows:

	2017	2016
Taxes	2	2
Leases, royalties, operation and maintenance	80	79
Professional services and insurance	58	60
Advertising and other commercial services	26	25
Contribution Gas Natural Fenosa Foundation	7	2
Impairment losses and changes in trade provisions (<i>Note 9</i>)	–	5
Other	171	164
Total	344	337

The Company makes contributions to the Gas Natural Fenosa Foundation to enable it to carry out its energy and environmental projects in the community area, as well to fund international initiatives and the activities of the Gas Museum and historical archive.

In the community area, the Gas Natural Fenosa Foundation has broadened its activities to place greater emphasis on its community initiatives, defining new strategic lines for actions aimed at palliating energy vulnerability.

Note 21. Other operating income

This account includes Euros 380 million in transactions with group companies and associates in 2017 (Euros 370 million in 2016).

Note 22. Net financial income/(expense)

The breakdown of this account in the Income statement for 2017 and 2016 is as follows:

	2017	2016
Income from marketable securities and other financial instruments	31	30
Total financial income	31	30
Cost of borrowings	(545)	(633)
Interest expense on pensions (<i>Note 11</i>)	(4)	(6)
Other financial expense	(37)	(25)
Total financial expense	(586)	(664)
Variation in fair value of financial instruments	1	(1)
Trading portfolio and other available-for-sale assets	1	(1)
Net exchange differences	(1)	1
Net financial income/(expense)	(555)	(634)

Note 23. Foreign currency transactions

Transactions effected in foreign currencies are analysed below, the main currency being the US dollar:

	2017	2016
Sales	713	624
Income from equity instruments of group companies and associates	40	46
Income from marketable securities and other financial instruments of group companies and associates	9	4
Purchases	(772)	(886)
Services received	(23)	(23)
Total	(33)	(235)

Nota 24. Information on transactions with related parties

The following are related parties for the purposes of this Note:

- Significant Company shareholders, i.e. those directly or indirectly owning an interest of 5% or more, and those who, though not significant, have exercised the power to propose the appointment of a member of the Board of Directors.

Based on this definition, the Company's significant shareholders are Fundació 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. Operations with directors and executives are disclosed in Note 25.
- Group companies or entities. Transactions effected between group companies form part of the ordinary course of business and they have been done at market conditions.

The aggregated amounts of operations with significant shareholders are as follows (in thousand Euros):

Income and expense (in thousand Euros)	2017			2016		
	"la Caixa"	Repsol	GIP	"la Caixa"	Repsol	GIP*
Financial expenses	1,007	–	–	1,515	–	–
Receipt of services	7,315	1	–	9,378	1	–
Purchases of goods	–	2,408	–	–	2,331	–
Other expenses ¹	20,796	–	–	10,125	–	–
Total expenses	29,118	2,409	–	21,018	2,332	–
Financial income	5	–	–	148	–	–
Provision of services	–	–	–	–	39	–
Total income	5	–	–	148	39	–

Other transactions (in thousand Euros)	2017			2016		
	"la Caixa"	Repsol	GIP	"la Caixa"	Repsol	GIP*
Financing agreements, loans and capital contributions (lender) ²	1,152,621	–	–	341,770	–	–
Financing agreements, loans and capital contributions (borrower) ³	100,000	–	–	100,000	–	–
Warranties and guarantees received	160,000	–	–	100,000	–	–
Dividends and other profits distributed	244,558	200,859	200,138	424,923	367,291	66,045
Other operations ⁴	666,476	–	–	173,884	–	–

* Since 21 September 2016.

¹ Includes contributions to pension plans, group insurance policies, life insurance and other expenditure.

² Includes cash and cash equivalents.

³ At 31 December 2017, credit lines contracted with "la Caixa" amounted to Euros 569,000 thousand (Euros 569,000 thousand at 31 December 2016), of which no amounts having been utilised. "La Caixa" also has shares of other loans totalling Euros 100,000 thousand (Euros 100,000 thousand at 31 December 2016).

⁴ In 2017, the item "Other transactions" with "la Caixa" includes Euros 565,568 thousand in respect of foreign exchange hedges and Euros 100,908 thousand in respect of interest rate hedges (Euros 72,976 thousand and Euros 100,908 thousand at 31 December 2016).

The aggregated amounts of operations with group companies and associates are as follows (in million Euros):

Expenses, income and other transactions	2017		2016	
	Group companies	Jointly-controlled entities and associates	Group companies	Jointly-controlled entities and associates
Financial expenses	(496)	–	(575)	–
Lease expenses	(39)	(6)	(53)	(6)
Receipt of services	(28)	–	(24)	–
Purchases of goods	(2,329)	–	(2,215)	–
Total expenses	(2,892)	(6)	(2,867)	(6)
Financial income	444	–	431	1
Dividends received	1,486	1	1,623	2
Sale of goods	3,533	–	3,154	–
Other income	375	5	369	1
Total income	5,838	6	5,577	4
Sale of Property, plant and equipment, intangible and other assets	–	–	6	–
Other transactions	–	–	6	–

The item "Purchases of goods" relates basically to electricity purchased from the other group companies, since the Company is their market representative.

Under the heading "Dividends received" are included the dividend payments from voluntary reserves, registered as a lower value on investments in group companies (Note 6).

Sales of natural gas under supply contracts and electricity, acting as representative of the group companies for the market, are included under "Sale of goods".

The heading "Other income" includes income from services rendered in accordance with the nature and extent thereof (Note 21).

Costs shared between the Company and other group companies are allocated on the basis of business or cost generation parameters.

Detailed definitions are prepared of services to be provided and of related activities or tasks in order to determine the measurement indicators used to calculate costs allocated. Transactions between companies are objective, transparent, non-discriminatory and always effected at arm's length.

Note 25. Information on members of the Board of Directors and Management Committee

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 by the members the Board of Directors of Gas Natural SDG, S.A., for belonging to the Board of Directors, Executive Committee (EC), Audit Committee (AC) and Appointments and Remuneration Committee (ARC), totalled Euros 4,668 thousand (Euros 4,573 thousand in 2016), broken down in euros as follows:

	Office	Board	EC	AC	ARC	Total
Mr. Isidro Fainé Casas	Chairman	550,000	550,000	-	-	1,100,000
Mr. Josu Jon Imaz San Miguel	First Deputy Chairman	126,500	126,500	-	-	253,000
Mr. William Alan Woodburn	Second Deputy Chairman	126,500	126,500	-	25,000	278,000
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	-	40,000	-	166,500
Mr. Xabier Añoveros Trías de Bes	Director	126,500	-	40,000	-	166,500
Mr. Marcelino Armenter Vidal	Director	126,500	126,500	-	-	253,000
Mr. Mario Armero Montes	Director	126,500	-	-	-	126,500
Mr. Francisco Belil Creixell	Director	126,500	126,500	-	25,000	278,000
Ms. Benita María Ferrero-Waldner	Director	126,500	126,500	-	-	253,000
Mr. Alejandro García-Bragado Dalmau	Director	126,500	-	-	25,000	151,500
Ms. Cristina Garmendia Mendizábal	Director	126,500	-	40,000	25,000	191,500
Ms. Helena Herrero Starkie	Director	126,500	-	40,000	-	166,500
Mr. Miguel Martínez San Martín	Director	126,500	126,500	-	25,000	278,000
Mr. Rajaram Rao	Director	126,500	126,500	40,000	-	293,000
Mr. Luis Suárez de Lezo Mantilla	Director	126,500	-	40,000	-	166,500
		2,574,000	1,688,500	280,000	125,000	4,667,500

As the remuneration for belonging to the Board of Directors and the various Board Committees has remained unchanged, the increase is due solely to the higher number of Committee members as a result of changes in the Company's corporate governance following the alteration in September 2016 of the Company's shareholder structure. In this respect, the Executive Committee has increased by two members, the Audit Committee has increased by four members and the Appointments and Remuneration Committee has increased by two members.

In 2017, as in 2016, no amounts were received for other items.

In 2017, the Chief Executive Officer did not receive any amounts by reason of his membership of investee company Boards of Directors (Euros 37 thousand in 2016). These amounts are deducted from the CEO'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 1,285 thousand, Euros 1,131 thousand, Euros 757 thousand and Euros 16 thousand, respectively, in 2017 (Euros 1,212 thousand, Euros 1,002 thousand, Euros 813 thousand and Euros 18 thousand in 2016).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 321 thousand in 2017 (Euros 318 thousand in 2016). Funds accumulated due to these contributions amount to Euros 3,648 thousand at 31 December 2017 (Euros 3,241 thousand at 31 December 2016).

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. The premium paid in 2017 by Gas Natural SDG, S.A. for the entire policy amounted to Euros 109 thousand (Euros 101 thousand in 2016).

The CEO'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 Gas Natural Fenosa'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 CEO 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 CEO's contract provides for an indemnity of three yearly payments of his full emoluments at the date of the contractual amendment for certain termination events: by decision of the company, excepting a serious and culpable breach of his professional obligations giving rise to serious damage to the interests of Gas Natural SDG, S.A.; by decision of the CEO; or due to the completion 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 provides for the obligation on the Company's part 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 to the Board of Directors that has to be notified.

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 2017 and 2016, 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.

Management Committee remuneration

For the sole purposes of the information contained in this section, "senior management personnel" 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 2017 a total of 11 persons formed part of the Management Committee. One person joined the committee in April.

The amounts accrued to management personnel in respect of fixed remuneration, annual variable remuneration, multi-year variable remuneration and other items totalled Euros 5,507 thousand, Euros 2,595 thousand, Euros 1,641 thousand and Euros 108 thousand, respectively, in 2017 (Euros 4,827 thousand, Euros 2,553 thousand, Euros 1,852 thousand and Euros 120 thousand in 2016).

Contributions to pension plans and group insurance policies, together with life insurance premiums paid, totalled Euros 2,564 thousand in 2017 (Euros 2,389 thousand in 2016). Funds accumulated due to these contributions amount to Euros 26,367 thousand at 31 December 2017 (Euros 22,121 thousand at 31 December 2016).

The executives have received no remuneration in respect of profit sharing or bonuses and no loans have been granted to them. No advances had been granted to management personnel at 31 December 2017 (Euros 175 thousand at 31 December 2016). At 31 December 2017, Gas Natural Fenosa had granted collateral for management personnel loans amounting to Euros 754 thousand. No collateral had been granted at 31 December 2016. No indemnities were received during 2017 or 2016.

The contracts of the executives contain a clause that stipulates a indemnity between two and three and a half remuneration pay in certain cases of termination of laboral 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 26. Contingent liabilities and commitments

Guarantees

As at 31 December 2017 and 2016 guarantees provided by Gas Natural SDG, S.A. were as follows:

- Guarantees provided to third parties basically related to investment commitments of group companies amounting to Euros 138 million (Euros 251 million at 31 December 2016).
- Guarantees related to economic obligations derived from its participation in the Spanish electricity system (MEFF and OMIE) totalling Euros 200 million (Euros 104 million at 31 December 2016).
- Financial guarantees corresponding to the guarantee of compliance with the loan obligations received by investees amounting Euros 100 million (Euros 113 million at 31 December 2016).
- Debt issue guarantees made by the group companies, Gas Natural Capital Markets, S.A., Gas Natural Finance, B.V., Unión Fenosa Preferentes, S.A.U. and Gas Natural Mexico S.A. de C.V. for an amount of Euros 12,879 million (Euros 11,982 million at 31 December 2016).
- Guarantees for gas supply and transport contracts obligations as well as charter contracts for gas tankers of the group companies Gas Natural Aprovevisionamientos, S.A. and Gas Natural Europe, S.A.S.

- Irrevocable guarantee by Gas Natural SDG, S.A. of all the liabilities and commitments of Vayu Ltd and its subsidiaries in Ireland at 31 December 2017 pursuant to Section 357 of the 2014 Companies Act of Ireland in order to file the consolidated financial statements of Gas Natural Fenosa instead of its separate financial statements, on the basis of the exemption allowed under Section 1 (b) of said Act.

Given that the aforementioned guarantees are basically granted in order to guarantee compliance with contractual obligations or investment commitments, the events that would lead to its execution, and therefore the disbursement in cash, would be breaches by Gas Natural Fenosa of its obligations in relation to the ordinary course of its activity, which is considered to have a probability of remote occurrence. Gas Natural Fenosa estimates that the liabilities not foreseen at 31 December 2017, if any, that could arise from guarantees furnished, would not be significant.

Contractual commitments

At 31 December 2017, the Company is party to several gas supply contracts with “take or pay” clauses negotiated for “own use” (Note 3.5), by virtue of which it has gas purchase rights for the period 2017-2040 in the amount of Euros 8,056 million, calculated on the basis of natural gas prices at 31 December 2017 (2016: Euros 8,358 million based on natural gas prices at 31 December 2016).

Operating lease obligations breakdown as follows:

	2017	2016
Up to one year	20	18
Between 1 and 5 years	73	70
Between 5 and 10 years	43	48
	136	136

Includes the rent of the “Torre del Gas” building owned by Torre Marenostrom, S.L., for which the Company has an operating lease without a purchase option until the year 2019, extended at market value for successive periods of three years, on a discretionary basis for the Company and an obligatory basis for Torre Marenostrom S.L.

It also includes operating leases without a purchase option of five properties in Madrid (Avenida San Luis 77, Antonio López 193, Acanto 11-13, Avenida América 38 and Calle Lérida) for a ten-year term which may be extended for five years except in the case of Avenida América 38 (Note 5).

Contingent liabilities

The Company reports no relevant contingent liabilities relating to litigation or arbitration at the date of these Annual Accounts.

Note 27. Auditors' fees

The fees accrued in thousand Euros by the different companies trading under the PwC brand are as follows:

(thousand euros)	2017			2016		
	PwC Auditores, S.L.	PwC other network	Total	PwC Auditores, S.L.	PwC other network	Total
Auditing services	912	–	912	674	–	674
Assurance services and services related to the audit ¹	383	–	383	289	–	289
Other services ¹	146	881	1,027	137	–	137
Total fees	1,441	881	2,322	1,100	–	1,100

¹ In PwC Auditores, S.L., these items include verification reports of non-financial information, comfort letters and advice on sustainability.

Note 28. Environment

Environmental actions

The Environmental Strategy is based on four environmental pillars that are defined according to the key vectors of the company's environmental management system:

- Climate and Air: Reducing emissions through our operations and promoting the use of sustainable energy.
- Water: Promoting the efficient and responsible use of water.
- Natural Capital: Minimising the impacts on ecosystems and promoting natural capital.
- Circular Economy: Optimising resource consumption and enhancing resource recirculation.

This is achieved through environmental management of Gas Natural Fenosa based on the ISO 14001 model, the correct functioning of which is verified periodically, providing the tools required to assure environmental management. In this context, in 2017 the adaptation to the 2015 reference framework was completed and the certification of environmental management was extended to electricity and gas distribution companies in Chile.

With respect to air and the climate, Gas Natural Fenosa bases its strategy on five lines of action: the reduction of emissions in its operations through low-carbon energy and renewable energy sources, the reduction of emissions through energy efficiency, the development of sustainable products and services, the integration of the climate variable into internal management and the calculation of impact and performance. During 2017, there has been an increase in direct CO₂ emissions compared with 2016 as a direct result of a significant reduction in non-emission generation in Spain due to adverse weather conditions, which has led to an increase in heat production and therefore an increase in CO₂ emissions. As a result, specific emission per unit of energy generated has also increased compared with 2016.

With regard to water management, in 2017 actions were carried out focusing on optimising consumption and reducing waste discharges, promoting sustainable use in stakeholders, inclusion in decision-making and determining impact and performance. In spite of this, in 2017 there was an increase in water use, primarily due to the increased demand in the activity of coal-fired and combined cycle power plants.

In 2017, Gas Natural Fenosa has conducted multiple actions in the natural capital and biodiversity area, all of which are aligned with the reduction in and compensation for its impacts, the enhancement of the value of the natural surroundings and the determination of its impact on natural capital.

Within the axis of the circular economy, actions have been carried out associated with the optimisation of raw materials consumption, reduction of waste generation, contribution to the development of regulations and the determination of impact and performance.

The environmental activities undertaken in 2017 amounted to Euros 10 million, Euros 1 million relating to environmental investment and Euros 9 million relating to the costs of environmental management at facilities (Euros 7 million related to environmental management at facilities in 2016).

Possible contingencies, indemnities and other environmental-related risks in which Gas Natural Fenosa could be incur are adequately covered by subscribed liability insurance policies.

Note 29. Events after the balance sheet date

On 16 January 2018 Gas Natural Fenosa Finance, B.V., through its Euro Medium Term Notes (EMTN) programme, in which the Company acts as guarantor, carried out a bond issue amounting to Euros 850 million, maturing in January 2028 with an annual coupon of 1.5%. The resources obtained by this issuance have been allocated to a repurchase of bonds with maturities between 2019 and 2023 that have been completed on 23 January 2018, for an amount of Euros 916 million.

Appendix I. Gas Natural tax group companies

The companies in the Gas Natural tax group are as follows:

Gas Natural SDG, S.A.	La Energía, S.A.
Boreas Eólica 2, S.A.	La Propagadora del Gas Latam, S.L.U.
Compañía Española de Industrias Electroquímicas, S.A.	La Propagadora del Gas, S.A.
Energías Ambientales de Somozas, S.A.	Lignitos de Meirama, S.A.
Energías Especiales Alcohólicas, S.A.	Nedgia, S.A.
Europe Maghreb Pipeline Limited	Nedgia Andalucía, S.A.
Explotaciones Eólicas Sierra de Utrera, S.L.	Nedgia Aragón, S.A.
Fenosa Wind, S.L.U.	Nedgia Balears, S.A.
Fenosa, S.L.U.	Nedgia Castilla-La Mancha, S.A.
Gas Natural Almacenamiento Andalucía, S.A.	Nedgia Castilla y León, S.A.
Gas Natural Aprovisionamientos SDG, S.A.	Nedgia Catalunya, S.A.
Gas Natural Capital Markets, S.A.	Nedgia Cegas, S.A.
Gas Natural Comercializadora, S.A.	Nedgia Madrid, S.A.
Gas Natural Distribución Latinoamérica, S.A.	Nedgia Navarra, S.A.
Gas Natural Exploración, S.L.	Nedgia Redes Distribución de Gas, S.A.
Gas Natural Fenosa Electricidad Colombia, S.L.	Nedgia Rioja, S.A.
Gas Natural Fenosa Engineering, S.L.	Operación y Mantenimiento Energy, S.A.
Gas Natural Fenosa Generación, S.L.U.	Parque Eólico El Hierro, S.L.
Gas Natural Fenosa Ingeniería y Desarrollo de Generación, S.L.U.	Parque Eólico Montamarta, S.L.
Gas Natural Fenosa Internacional, S.A.	Parque Eólico Nerea, S.L.
Gas Natural Fenosa LNG, S.L.	Parque Eólico Peñaroldana, S.L.
Gas Natural Fenosa Renovables, S.L.U.	Petroleum Oil & Gas España, S.A.
Gas Natural Informática, S.A.	Sagane, S.A.
Gas Natural Redes GLP, S.A.	Sociedad de Tratamiento Hornillos, S.L.
Gas Natural S.U.R. SDG, S.A.	Societat Eòlica de L'Enderrocada, S.A.
Gas Natural Servicios SDG, S.A.	Sociedad Parque Eólico Mouriños, S.L.U.
Gas Natural Transporte SDG, S.L.	Tratamiento Almazán, S.L.
Gas Natural Wind 4, S.L.U.	Tratamiento Cinca Medio, S.L.
General de Edificios y Solares, S.L.	Unión Fenosa Distribución, S.A.
Global Power Generation, S.A.	Unión Fenosa Financiación, S.A.
Holding de Negocios de Gas, S.A.U.	Unión Fenosa Minería, S.A.
JGC Cogeneración Daimiel, S.L.	Unión Fenosa Preferentes, S.A.U.





Gas Natural SDG 2017 Annual Report

Director's report

Company situation. Page 84

Business evolution and results. Page 92

Sustainability. Page 96

Main risks and uncertainties. Page 105

Forecast Group performance. Page 111

Sustainable innovation. Page 113

Additional information. Page 115

Annual Corporate Governance Report. Page 116

Company situation

The long-term commitment to value creation and sustainable management is specified in the Corporate Responsibility Policy, which provides the common framework for action that guides the company’s socially responsible conduct; it was approved and updated by the Board of Directors in December 2015, based on international best practices and the recommendations enshrined in the Code of Good Governance of Listed Companies.

This policy undertakes eight commitments to the company’s stakeholders:

1. Commitment to results.
2. Service excellence.
3. Responsible environmental management.
4. Interest in people.
5. Health and safety.
6. Responsible supply chain.
7. Social commitment.
8. Integrity and transparency.

These commitments are horizontal and are present throughout the company’s business process, based on the generation of economic, social and environmental wealth.

Gas Natural Fenosa is an integrated energy group supplying gas and electricity to almost 18 million customers. It focuses on the gas distribution and supply and on generating, distributing and supplying electricity. It also operates other business lines, such as energy services, which enhance the diversification of activities and revenues, staying at the forefront of new market trends, meeting customers’ specific needs and offering them an integrated service not confined to selling energy.

Gas Natural Fenosa’s mission is:

To meet the needs of...	With vision ...	Based on our values
Our shareholders	Offering increasing sustainable profitability.	> Commitment to results.
Our customers	Being leaders in continuous growth and with a multinational presence, offering high-quality products that respect the environment.	> Customer-oriented. > Sustainability.
Our employees	Offering opportunities for professional and personal development.	> Interest in people. > Social responsibility.
Society	Contributing positively through a commitment to global citizenship.	> Integrity.

Gas Natural Fenosa's business model is implemented through a number of companies in Spain, elsewhere in Europe, and in Latin America and Africa, and is underpinned by the following main businesses:

Networks – Gas distribution	41% of EBITDA: Spain and Latin America
Networks – Electricity distribution	26% of EBITDA: Spain and Latin America
Gas	20% of EBITDA: Infrastructure and supply
Electricity	15% of EBITDA: Spain and International

Note: -2% other activities.

Gas Natural Fenosa has a differentiated business model, with 85% of EBITDA from regulated or quasi-regulated activities and 49% from international projects.

Throughout the value chain, Gas Natural Fenosa's business model stands apart as a leader in the gas sector and a key player in the electricity sector, in both cases ensuring a regular supply of gas and electricity, which is essential to providing a quality service and fulfilling the company's social mission; providing a broad range of value-added services and fostering sustainable innovation to drive development.

Corporate governance

Corporate Governance Model

Gas Natural Fenosa is governed in accordance with the principles of efficiency and transparency in line with the main existing recommendations and standards, and it adopts advanced corporate governance practices for this purpose.

The corporate governance terms of reference mainly comprise:

- > Articles of Association (updated in 2017).
- > Regulations of the Board of Directors and its committees (updated in 2016).
- > Regulations of the General Meeting of Shareholders (updated in 2015).
- > Internal Code of Conduct in connection with the Securities Markets.
- > Human Rights Policy.
- > Code of Ethics (updated in 2015).

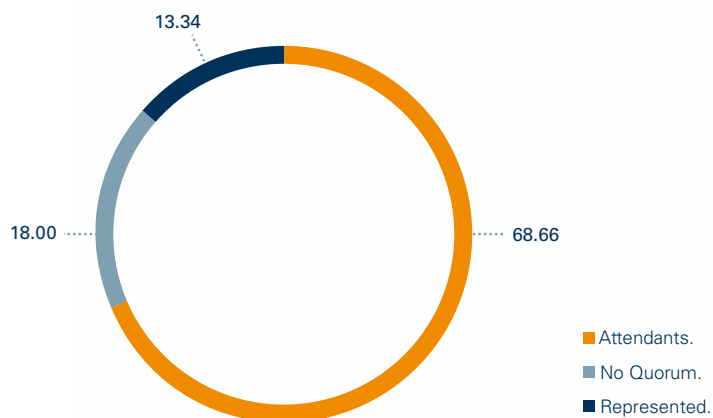
On 21 September 2016, the shareholders of Gas Natural Fenosa, Criteria Caixa, S.A.U. (Criteria) and Repsol, S.A. (Repsol) announced the sale to GIP III Canary 1 S.à.r.l. (GIP) of 20 % (10% each by Criteria and Repsol) of Gas Natural SDG, S.A., as established in the sale agreement signed on 12 September 2016. As a result of that sale in 2016, the composition of Gas Natural Fenosa’s Board of Directors and committees was modified and a condition was introduced into the Regulation of the Board of Directors that a majority of two-thirds of directors would be required to approve certain reserved matters. During 2017 the General Meeting approved by co-optation the following Directors:

- > Mr. Alejandro García-Bragado (Proprietary Criteria)
- > Mr. Marcelino Armenter (Proprietary Criteria)
- > Mr. William Alan Woodburn (Proprietary GIP)
- > Mr. Rajaram Rao (Proprietary GIP)
- > Mr. Mario Armero (Proprietary GIP)
- > Ms. Helena Herrero (independent)

Shareholders’ Meeting

Shareholders who, either individually or collectively with others, hold 100 shares may attend the meeting provided that they are shareholders of record at least five days in advance.

Attendance at the 2017 Shareholders’ Meeting (%): **(82%)**.



Board of Directors

Gas Natural Fenosa structures the functioning of its highest management body, the Board of Directors, through its functioning in Plenary and in Commissions, in response to the requirements of the Capital Companies Law. Therefore, the Board of Directors of Gas Natural Fenosa has an Audit Committee and the Appointments and Remuneration Committee, which exercise the functions entrusted to them by the Law.

Additionally, the Board of Directors has an Executive Committee, which deals with resolving the most operational matters over which the Board has competence.

During 2017, the Board of Directors debated, within the scope of its powers, the main matters considered that are as follows:

- > Monthly, half-year and annual monitoring and supervision of business development.
- > Approval of accounts and other actions required by accounting regulations and/or stock market.

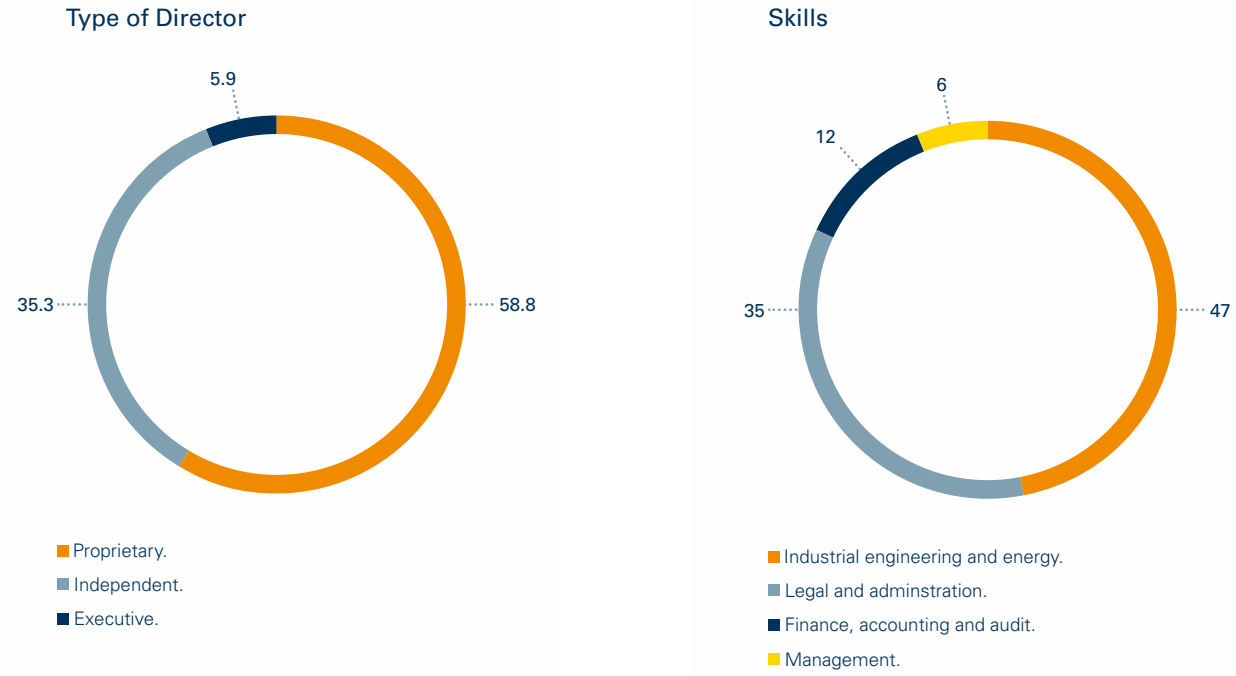
- Strategic discussion aimed at preparing the new Strategic Plan 2018-2020.
- Budget, financing plan, investment plan and other actions in terms of activity programming and financial discipline.
- Efficiency plan.
- Company's registered offices transfer.
- Examination of the main risks of the Company and its control systems.
- Corporate operations, among which are the divestments made in Italy, Colombia and in the gas distribution business in Spain.
- Actions in matters of corporate governance: in addition to the usual (Annual Corporate Governance Report, Annual Remuneration Report,...), this year there has been external advice in the process of evaluating the functioning of the Board of Directors and its Committees, in accordance with the best corporate governance practices.
- General Meeting, including proposal for appointment of new directors and proposal for dividend distribution.
- Social Corporate Responsibility.

Composition of the Board of Directors and its committees (at 31 December 2017)

Board of Directors		Executive Committee	Audit Committee	Appointments and Remuneration Committee	Category of director	Seniority on Board
Chairman	Mr. Isidro Fainé Casas	Chairman			Proprietary	18/05/2015
First Deputy Chairman	Mr. Josu Jon Imaz San Miguel	Board member			Proprietary	21/09/2016
Second Deputy Chairman	Mr. William Alan Woodburn	Board member		Board member	Proprietary	30/09/2016
Managing Director	Mr. Rafael Villaseca Marco	Board member			Executive Director	28/01/2005
Director	Mr. Ramón Adell Ramón	Board member	Chairman		Independent	18/06/2010
Director	Mr. Enrique Alcántara-García Irazoqui		Board member		Proprietary	27/06/1991
Director	Mr. Xabier Añoveros Trías de Bes		Board member		Independent	20/04/2012
Director	Mr. Marcelino Armenter Vidal	Board member			Proprietary	21/09/2016
Director	Mr. Mario Armero Montes				Proprietary	21/09/2016
Director	Mr. Francisco Belil Creixell	Board member		Chairman	Independent	14/05/2015
Director	Ms. Benita María Ferrero-Waldner	Board member			Independent	14/05/2015
Director	Mr. Alejandro García-Bragado Dalmau			Board member	Proprietary	21/09/2016
Director	Ms. Cristina Garmendia Mendizábal		Board member	Board member	Independent	14/05/2015
Director	Ms. Helena Herrero Starkie		Board member		Independent	04/05/2016
Director	Mr. Miguel Martínez San Martín	Board member		Board member	Proprietary	14/05/2015
Director	Mr. Rajaram Rao	Board member	Board member		Proprietary	21/09/2016
Director	Mr. Luis Suárez de Lezo Mantilla		Board member		Proprietary	26/02/2010
Non-director Secretary	Mr. Manuel García Cobaleda	Non-director Secretary	Non-director Secretary	Non-director Secretary	N/A	29/10/2010

There were no director removals or appointments in 2017.

Board of Directors profile (%)



Board of Directors activities and performance

Number of meetings of the Board of Directors and its committees

	Board of Directors	Executive Committee	Audit Committee	Appointments and Remuneration Committee
2017	15	3	10	5
2016	15	6	7	8

Management Committee

In terms of management structure dependent on the Managing Director there is a Management Committee composed of:

Mr. Rafael Villaseca Marco: Managing Director

Mr. Carlos J. Álvarez Fernández: Chief Financial Officer

Mr. Sergio Aranda Moreno: General Manager – Latin America

Mr. Antonio Basolas Tena: General Manager - Strategy and Development

Mr. José M^a Egea Krauel: General Manager - Energy Planning

Mr. Manuel Fernández Álvarez: General Manager - Wholesale Energy Business

Mr. Antonio Gallart Gabás: Chairman of Compañía General de Electricidad, S.A.

Mr. Manuel García Coboleda: General Counsel and Secretary of the Board of Directors

Mr. Jordi García Tabernero: General Manager - Communication and Institutional Relations

Mr. Daniel López Jordà: General Manager - Retail Energy Business

Mr. Antoni Peris Mingot: General Manager - Regulated Business

Ms. Rosa María Sanz García: General Manager - People and Resources

Remuneration policy

Board of Directors

The annual report on director remuneration was presented as a separate item for a consultative vote at the Shareholders' Meeting in 2017.

Directors' remuneration for their membership of the Board and its committees consists solely of fixed amounts determined on the basis of the positions they hold.

Based on a favourable report from the Appointments and Remuneration Committee, the Board of Directors resolved to maintain in 2017, without any changes, the remuneration for membership of the Board of Directors and Executive Committee (in force since 2007) and for membership of the Appointments and Remuneration Committee and the Audit Committee (in force since 2015).

Remuneration for membership of the Board of Directors and its committees (Euros/year):

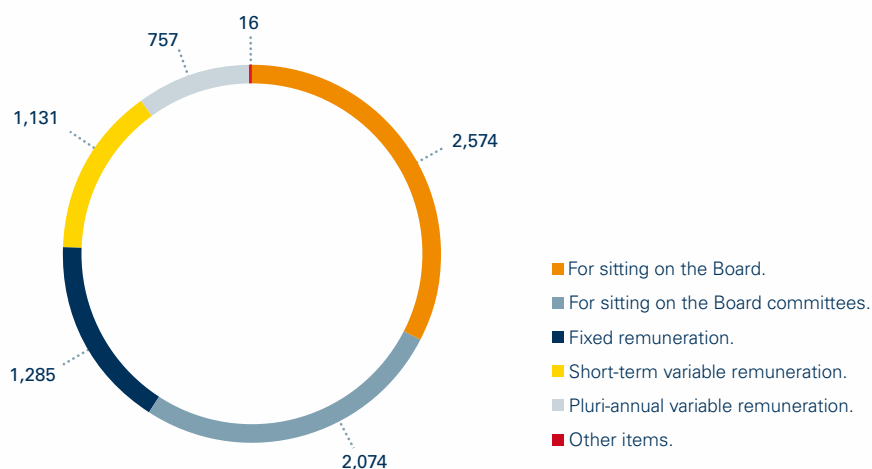
Chairman of the Board of Directors	550,000
Director	126,500
Chairman of the Executive Committee	550,000
Member of the Executive Committee	126,500
Member of the Appointments and Remuneration Committee	25,000
Member of the Audit Committee	40,000

The CEO's remuneration for his executive functions is based on the following:

Item	Objective	Criteria
Fixed remuneration	Remunerate the level of responsibility attached to these functions.	Ensure that the remuneration is competitive vis-à-vis comparable companies.
Annual variable remuneration	Link remuneration with the company's performance in the short term.	Calculated on the basis of attainment of the objectives for the year: economic (EBITDA, net profit, working capital/revenues), efficiency (achievement of synergies), business growth (net increase in no. of gas connection points and sales of LNG in other countries) and quality, security and safety (accident rate, environmental ratios and customer satisfaction).
Multi-year variable remuneration	Strengthen the commitment to achieving the goals set out in the strategic plans.	It is calculated by applying the degree of attainment of the economic goals related to optimisation and financial discipline (EBITDA, net debt/EBITDA, market capitalisation and enterprise value/EBITDA), each weighted 25%. The 2015-2017, 2016-2018 and 2017-2019 remuneration programmes are currently in force.
Other items	Safeguard the company's benefits.	Health and life insurance. Energy rebate.

The remuneration is supplemented by pension plans and a group health insurance policy.

Total remuneration earned by the Board of Directors in 2017, by type (Euros thousand)

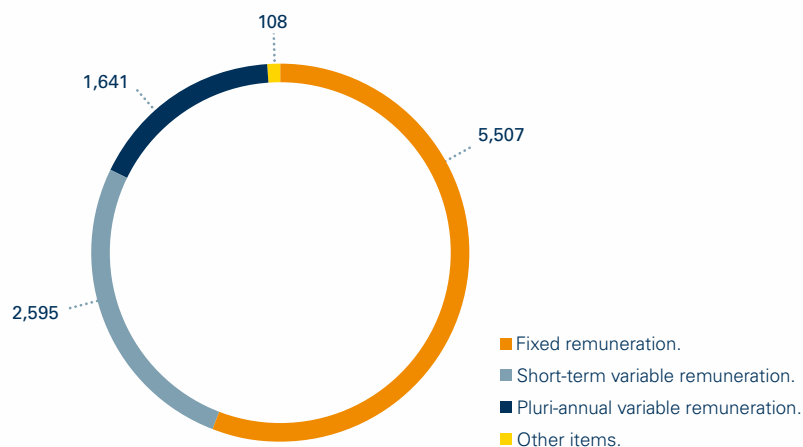


Management Committee

The general remuneration policy for members of the Management Committee is determined by the Board of Directors on the basis of a proposal by the Appointments and Remuneration Committee.

The remuneration model contains the same components as above for the CEO's executive functions, although it has specific individual objectives in addition to the group objectives.

Total remuneration earned by the Management Committee and head of Internal Audit¹ in 2017, by type (Euros thousand)



¹ In accordance with CNMV Circular 5/2013, for the purposes of remuneration, senior management includes executives who report directly to the company's chief executive and also the head of internal audit.

Business evolution and results

The main financial aggregates of Gas Natural SDG and their performance are as follows:

	2017	2016	%
Net turnover	5,053	5,062	(0.2)
Operating profit	1,496	1,617	(7.5)
Profit for the year	1,023	1,067	(4.1)
Shareholders' equity	13,473	13,431	0.3
Net equity	13,466	13,444	0.2
Current liabilities	4,240	3,597	17.9

Gas Natural SDG, S.A., is a company that develops its activity basically through the tendency of other group and associated companies shares, so information bellow refers to de Consolidated group of Gas Natural Fenosa.

Highlights and main aggregates

2017 Highlights

January to March

- > Gas Natural Fenosa issues Euros 1,000 million in notes with a 1.375% annual coupon, maturing in 10 years.
- > Continues to be a member of the *FTSE4Good* sustainability index, for the fifteenth consecutive year.
- > The company is ranked *Gold Class* in the 2017 *RobecoSam* sustainability index.
- > Gas Natural Fenosa earmarks Euros 4.5 million to tackle vulnerability in vulnerable clients.
- > Once again, the company is certified as one of Spain's Top Employers based on its employees' work conditions.
- > Gas Natural Fenosa issues Euros 1,000 million in notes with a 1.125% annual coupon, maturing in 7 years.

April to June

- > Gas Natural Fenosa Renovables will invest Euros 700 million after being awarded 667 MW of wind capacity in an auction held by the Spanish government.
- > Gas Natural Fenosa takes part in the European Make Power Clean initiative to foster a cleaner electricity market in Europe.
- > The Integrated Control Centre (ICC) for the company's hydroelectric plants is opened in Ourense.

July to September

- > Gas Natural Fenosa is granted a Euros 450 million loan from the European Investment Bank (EIB) to finance wind farms and electricity distribution in Spain. It also signs a Euros 200 million loan agreement with Instituto de Crédito Oficial (ICO) to help fund its investment plan through 2020.

- Gas Natural Fenosa signs its first “sustainable loan”, for Euros 330 million, with ING.
- The company is awarded 250 MW of photovoltaic capacity in the new renewables auction which will result in Euros 165 million investments.
- Gas Natural Fenosa signs an agreement to sell a non-controlling 20% stake in its gas distribution business in Spain for Euros 1,500 million.
- Gas Natural Fenosa is one of the winners in DuPont's International Safety and Sustainability Awards.
- Gas Natural Fenosa is leader in the gas utilities sector of the Dow Jones Sustainability Index.
- *Actualidad Económica* ranks Gas Natural Fenosa among top five best companies to work for.
- Gas Natural Fenosa, through its subsidiary GPG, launches commercial operations at its first photovoltaic power plant in Brazil (68MW).

October to December

- Gas Natural Fenosa agrees to sell its companies and assets in Italy to 2i Rete Gas and Edison.
- Gas Natural Distribución to become Nedgia in compliance with the principle of unbundling under European Directive 2009/73/EC (gas).
- Gas Natural Fenosa launches its first green bonds in a Euros 800 million issue to finance renewable projects with a 0.875% annual coupon.
- Gas Natural Fenosa agrees to sell its stake in gas distribution in Colombia to Canadian fund Brookfield.
- The company teams up with Norwegian tech firm Connect LNG to develop DirectLink LNG, the world's first floating LNG ship-to-shore transfer system.
- The company is again included in the Euronext Vigeo Europe 120 and Euronext Vigeo Eurozone 120 indices.

Financial performance (Euros million)

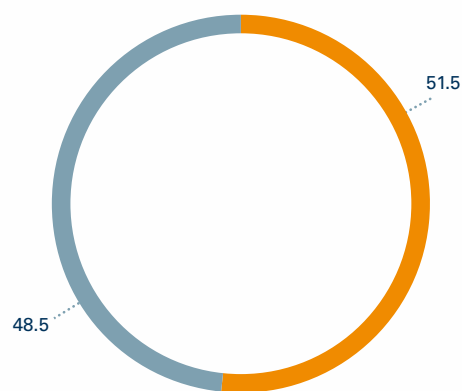
Notes to financial information

- The consolidated income statement and operating figures for 2016 have been re-stated due to the discontinuation of the following operations: gas distribution in Italy and Colombia, electricity distribution in Moldova, gas supply in Italy and electricity generation in Kenya in application of IFRS 5.

Main financial aggregates

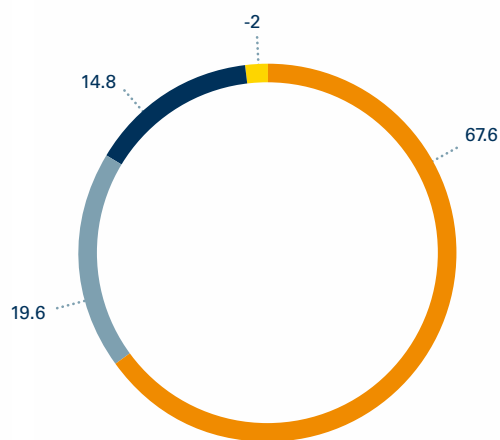
	2017	2016	%
Revenue	23,306	21,908	6.4
EBITDA	3,915	4,664	(16.1)
Income attributable to equity holders of the parent	1,360	1,347	1.0
Net capital expenditure	1,597	2,225	(28.2)
Net borrowings (at 31/12)	15,154	15,423	(1.7)

EBITDA by geography in 2017 (%)



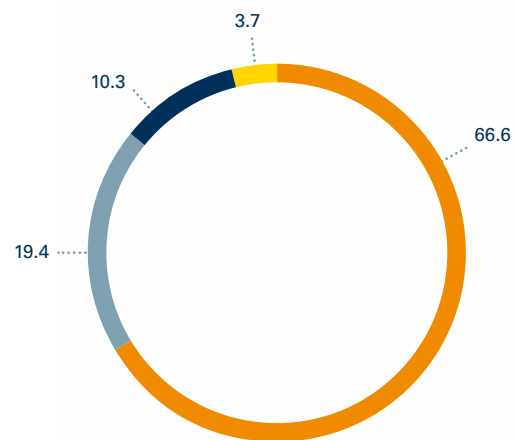
■ Spain.
■ International.

EBITDA by business in 2017 (%)



■ Networks.
■ Gas.
■ Electricity.
■ Others.

Capital expenditure by business in 2017 (%)



■ Networks.
■ Electricity.
■ Others.
■ Gas.

Main financial ratios

	2017	2016
Leverage (%)	45.3	44.8
EBITDA/Cost of net financial debt	6.4x	6.3x
Net financial debt/EBITDA	3.9x	3.3x
ROA (return on assets) (%)	2.9	2.9

Main stock market ratios and shareholder remuneration

	2017	2016
Average no. of shares ('000) ¹	1,000,478	1,000,468
Share price at 31/12 (Euros)	19.25	17.91
Market capitalisation at 31/12 (Euros million)	19,263	17,922
Earnings per share (Euros) ¹	1.36	1.35
Payout (%)	73.6	74.3
Total dividend ²	1,001	1,001
Dividend per share	1.00	1.00
Price-earnings ratio (P/E)	14.2	13.3
EV/EBITDA	8.8	7.1

¹ Calculated considering the weighted average number of shares during the year.

² Based on the total equivalent amount used to pay dividends. In 2017, this included a supplementary dividend amounting to Euros 671 million, pending approval by shareholders at the General Meeting.

Operational performance

Distribution	2017	2016
Gas distribution (GWh)	460,014	426,510
Electricity distribution (GWh)	53,670	65,586
Gas distribution connections ('000)	10,491	10,224
Electricity connection points ('000)	7,415	7,324
Gas distribution network (km)	116,181	113,083
Length of electricity transmission and distribution network (km)	214,399	215,894

Gas	2017	2016
Gas supply in Spain (GWh)	176,053	178,916
Gas supply in rest of world (GWh)	183,978	146,541
Total gas supply (GWh)	360,031	325,457

Electricity	2017	2016
Installed capacity in Spain (MW)	12,716	12,716
Installed capacity in rest of world (MW)	2,732	2,590
Total installed capacity (MW)	15,448	15,306
Net production in Spain (GWh)	27,953	28,504
Net production in rest of world (GWh)	18,436	17,857
Total net production (GWh)	46,389	46,361

Sustainability

Environmental and social performance

Main aggregates

	Unit	2017	2016
Direct greenhouse gas emissions	MtCO ₂ e	20.5	19.6
Emission factor for electricity generation ¹	tCO ₂ /GWh	431	411
Installed capacity free of emissions ²	%	22.3	22.1
Net production free of emissions ²	%	9.7	16.4
Activity with ISO 14001 environmental certification ³	%	87.7	86.3

¹ Factor for power generation facilities operated by Gas Natural Fenosa and in which has a controlling interest (Corporate Responsibility Report perimeter).

² By historic traceability, including nuclear power generation.

³ Taking into account only the EBITDA of companies with environmental impact. The EBITDA of the certificated activity with ISO 14001 represents the 78.8% of total EBITDA.

Integrated environmental management

In 2017, Gas Natural Fenosa activities that have a significant environmental impact was covered by the environmental management model set out in the ISO 14001 standard. It should be pointed out that the system was successfully switched over to the 2016 version of the standard over the course of the year. Variations are due to the increase in certified businesses and disinvestments made by the group which had been certified according to this standard. In 2017, environmental certification was extended to electricity and gas distribution companies in Chile.

Environmental planning is included in the Quality, Environment, Security and Health Plan. This plan consists of strategies and lines of action which define the working guidelines for each period. There were 257 environmental management-related objectives defined in 2017 with satisfactory fulfilment of the plan.

Environmental training is a basic tool for preventing and reducing environmental impacts and improving environmental operational control in our activities. In this sense, a total of 3,826 hours of training were received by 1,572 participants in 2017, with plan objectives being met by 140% and 133%, respectively.

Environmental Strategy to 2020

The Environmental Strategy is based on four environmental and two transversal pillars. The environmental pillars are defined according to the key vectors of the company's environmental management system:

- > **Climate and Air Quality:** Reducing emissions through our operations and promoting the use of sustainable energy.
- > **Water:** Promoting the efficient and responsible use of water.
- > **Natural Capital:** Minimising the impacts on ecosystems and promoting natural capital.
- > **Circular Economy:** Optimising resource consumption and enhancing resource recirculation.

The transversal pillars are necessary for integrating environmental sustainability into the decision-making process within the group's businesses.

In turn, these pillars have been transposed into 22 lines of action (16 environmental and 6 transversal). Each line of action is divided into a series of actions that sets out the guidelines to enable each business to define objectives (specific actions).

The Strategy is instrumented through the Gas Natural Fenosa's environmental management model, based on the international ISO 14001 standard, and forms a basic part of the company's integrated management system (IMS) for quality, the environment, and health and safety.

Climate and air quality

The climate and air quality pillar aims to reduce emissions through our operations and to promote the use of sustainable energy. The lines of action associated with this pillar are:

- > Reducing emissions through the operations.
- > Reducing emissions by means of energy efficiency.
- > Developing sustainable services and products.
- > Integrating internal climate change management.
- > Determining impact and performance.

Thermal power stations operation increased significantly in 2017 compared to 2016 as a consequence of the lower availability of renewable resources in Spain. The lack of rains and wind hindered normal operations of zero-emissions installations, making it necessary to bring in manageable and CO₂-emitting energies to satisfy demand. As a result, emission values were recorded that were significantly higher than those of 2016, a year with more favourable weather conditions, although not as high as those recorded in 2015.

Gas Natural Fenosa is firmly committed to sustained growth in its renewable energy generation installations. Given the circumstances described, power generated from renewable energy sources was lower than the previous year's figure. Despite 2017 being a dry year with less wind, lower environmental impact was appreciated when compared to years with similar weather patterns, such as 2012. Mention should be made of the new developments in renewable technologies taking place in Brazil and those earmarked for 2018 in the Canary Islands.

Gas Natural Fenosa takes an active role in the global business initiatives and climate action and in the most relevant international forums, such as the United Nations Conference of the Parties.

In 2017, there was an increase in absolute emissions of SO₂, NO_x and total suspended particles (TSP) into the atmosphere, due to increased operations of the thermal power stations, caused by the decrease in renewables production (hydroelectricity and wind power) in Spain.

Likewise, there was significant progress made in relation to the development of renewable gas and the promotion of sustainable, low-emission mobility.

Water

For the purpose of promoting the efficient and responsible use of water, the lines of action associated with this pillar are:

- > Optimising water consumption and reducing water discharge.
- > Fostering the sustainable use of water among our stakeholders.
- > Including water in the decision-making process.
- > Determining impact and performance.

In general terms, there was a significant increase in the volume of water consumed in 2017, mainly owing to increased demand created by activity at coal-fired and combined-cycle power stations.

Natural capital

The aim of this pillar is to minimise the impacts on ecosystems and to promote natural capital. In this sense, the associated lines of action are:

- > Reducing and compensating for our impacts and enhancing the value of natural environments.
- > Determining our impact on natural capital.
- > Determining impact and performance.

The company continues to extend the focus of its environmental management towards valuing natural capital, in other words, the reserves of renewable and non-renewable natural assets found in nature, in order to identify and assess the dependency and impact (both positive and negative) of its activities.

The company conducted a large number of actions to preserve biodiversity, some of these in response to the requirements set out by the environmental authorities and others of a voluntary nature.

Circular economy

Gas Natural Fenosa focuses its efforts in the field of circular economy on optimising resource consumption and enhancing resource recirculation. For this purpose, the following lines of action have been developed:

- > Optimising the consumption of raw materials.
- > Reducing the production of waste and encouraging its transformation into by-products.
- > Contributing to the development of circular economy regulation.
- > Determining impact and performance.

In 2017, generation of the most significant non-hazardous waste increased compared to 2016. Owing to reasons previously explained, mention must be made of increased ash and slag production.

Interest in People

Main aggregates

Social performance	2017	2016	% Var.
Number of employees at the end of 2017	15,375	15,502	(0.8)
Voluntary rotation index (%)	2.9	2.5	16.0
Integration index (persons with disability) ¹ (%)	2.57	2.42	6.2
Training time per employees (%)	38.4	51.0	(24.6)

¹ Spain.

People management strategy

During 2017, the strategy of managing people at Gas Natural Fenosa focused on levers of cultural transformation, employee experience, strategic planning of people and new models of organisational performance.

Areas and levers of the people management strategy

Organizational performance

Smart simplicity

- > New organizational models.
- > Evolution of people management processes.

Extended workforce

- > Subcontracting borders.
- > Model of relationship Gas Natural Fenosa-Suppliers.
- > Occupational risk management.

Human resources operating model

- > HR analytics.
- > CSC productivity.

Cultural development

Cultural transformation

- > Target culture.
- > Evolution of people management processes.
- > Role-modelling.

Employee experience

- > Employee journey.
- > Employer branding.

Leadership and talent

Strategic planning of people

- > We take care of the experience.
- > Diversity.
- > Internationalization of the group profile.
- > Strategic workforce planning.

Leadership

- > Employee journey.
- > Employer branding.
- > Meritocracy.

Gas Natural Fenosa pretends to offer its employees stable, quality employment together with a solid, structured and attractive professional career, where 96% of the positions have open-ended contracts.

In this regard, we can highlight the fact that 84% of employees declare they have a high level of commitment to the company (Workplace Climate Survey 2017).

In 2017, the talent management cycle has been applied to all professionals that hold executive positions, and it has been integrated into the new talent management digital platform "Evolution", based on SAP technology. In-class training sessions have taken place in all countries directed to guarantee experience in using the new platform and the understanding of the annual talent cycle.

Through the global talent management model, the company assesses professional skills, individual development plans, talent segmentation and internal mobility and promotion.

The model is implemented in all countries, with the aim of offering development opportunities for all professionals through customized learning actions, mobility, project assignment or by joining coaching and mentoring programs.

Internal mobility is a fundamental pillar of commitment to people and to that end employees have the possibility of internal mobility through the digital communication platforms.

For Gas Natural Fenosa it is essential to promote diversity and equal opportunities in an environment of respect, understanding and ongoing dialogue, with a special focus on the inclusion of individuals with various disabilities and extending this commitment to suppliers and collaborating companies.

In 2017, the company's commitment to diversity remained strong, consolidating the Integrated Diversity Plan (IDP) which brings together specific initiatives for people management, classified into three areas: gender, disabilities and age.

Gas Natural Fenosa continued to promote an appropriate work-life balance through a significant number of flexible employment measures, services and benefits adapted to employee's needs.

Compensation and remuneration

Gas Natural Fenosa's remuneration policy seeks to respond to equity on an internal scale and competitiveness from the market point of view. There are two models:

- > The remuneration level of employees included in the collective bargaining agreement depends on the professional group and subgroup to which they belong.
- > For those not included in the agreement, it is established on an individual basis according to the remuneration policy approved by the Board of Directors' Appointments and Remuneration Committee.

The remuneration package of Gas Natural Fenosa employees is supplemented with a social benefits system, which includes a joint promotion pension plan, the main vehicle of funding post-employment commitments.

Internal communication with employees

The purpose of internal communication has the aim to contribute towards compliance with the company's strategic objectives based on growth, safety, leadership, innovation and the client as the focal point, supported through the different business areas and with the aim of contributing to increase the pride and the sense of belonging.

Gas Natural Fenosa has a range of channels to disseminate these messages, such as the corporate Intranet and the magazine Natural, which is distributed internationally. During 2017 we have been working on creating a new corporate channel for the informative contents which hitherto were disclosed on the Intranet, which will be called Naturalnews and the launch of which is scheduled for the beginning of 2018. This is a move towards communication that is more digital, with a friendly design, accessible through mobile devices, multi-language, interactive with new informative content to increase employees' satisfaction and encourage their participation and collaboration.

More than 950 news items were published in 2017 on Naturalnet along with some 40 videos with major participation by employees. The magazine Natural has also been redesigned to make it more attractive and supportive.

Yammer, the company's corporate social network, is growing more consolidated and already has almost 9,000 registered users at international level.

Tax policies

Tax strategy and Policy for controlling and managing tax risks

At a meeting on 9 January 2018, the Board of Directors adopted the Tax strategy and Policy for controlling and managing tax risks, which sets out the basic principles guiding Gas Natural Fenosa's tax function and the main lines of action to mitigate tax risks and guide proper oversight of same.

The basic principles underlying the tax strategy of Gas Natural Fenosa are as follows:

- > Responsibility in fulfilling tax obligations.
- > Low tax risk profile.
- > Adoption of tax treatments for economic reasons.
- > Transparency in tax information.
- > Cooperation with the tax authorities.

The main lines of the Policy for controlling and managing tax risks are as follows:

- > Clearly defined tax-related governance.

- Tax risk oversight procedures derived from Compliance.
- Procedures for assessing and exercising oversight over grey areas.
- Supervision of the Tax Control Framework.
- Regular reports to the Board of Directors on the tax situation.

All of Gas Natural Fenosa's tax policies are aligned with:

- Gas Natural Fenosa's Corporate Responsibility Policy, which establishes that one of the commitments and principles of action is to "adopt responsible business management practices and comply with all tax obligations in all jurisdictions in which the company operates, accepting the commitment to accountability and collaboration with the corresponding tax agencies."
- Gas Natural Fenosa's Code of Ethics, which establishes that "all employees of the group must comply with the laws in force in the countries where they conduct their activities, thereby heeding the spirit and objectives of the laws and behaving ethically in all their actions."
- the Code of Best Tax Practices, adopted on 20 July 2010 in plenary session by the Foro de Grandes Empresas, a body established by the Spanish Internal Revenue Service with the country's largest companies, including Gas Natural SDG, S.A. That Code contains recommendations from the tax authorities, which have been adopted voluntarily by Gas Natural Fenosa, with the aim of improving the application of the tax system by enhancing legal certainty, reducing litigation, fostering reciprocal cooperation based on good faith and legitimate trust, and the application of responsible tax policies.

To align that Gas Natural Fenosa's tax practices with those principles, the group has a General Standard governing the Tax Control Framework that has been designed in accordance with the guidelines of the Organization for Economic Cooperation and Development (OECD) for multinational companies, as well as for the design and implementation of a Tax Control Framework.

Gas Natural Fenosa also has a Risk Map that specifically identifies tax risks and disputes about the interpretation or application of tax law. The main issues of significance for tax purposes are detailed in Note 16 ("Tax situation") to the Annual Accounts of Gas Natural SDG, S.A.

Tax havens

The creation or acquisition of interests in entities domiciled in countries or territories that are designated as tax havens must be reported to the Board of Directors through the Audit Committee.

In accordance with the Spanish regulations that determine which countries are considered to be tax havens (Royal Decree 1080/1991, of 5 July, and Royal Decree 116/2003, of 31 January), Gas Natural Fenosa had only two holdings in companies incorporated in such territories, which were in process of redomiciliation or liquidation:

- A 95% stake in Buenergía Gas & Power, Ltd., domiciled in the Cayman Islands. This is a company that indirectly owns a stake in just one industrial holding: Ecoeléctrica, S.A., the company that generates electricity using a combined cycle plant in Puerto Rico; the latter is taxed in Puerto Rico and Gas Natural Fenosa does not obtain any tax advantage from this arrangement. On 2 February 2018 a change of registered office to Puerto Rico has been completed, which is in public registry process.
- The 52.2% stake in Gasoducto del Pacífico (Cayman), Ltd., domiciled in the Cayman Islands. This is a dormant company that was acquired by the group as a result of the acquisition of the CGE group and does not provide any tax advantage to Gas Natural Fenosa. The company was fully liquidated on 12 January 2018, and it will be dissolved once it is struck off the public record within three months from that date.

The only intercompany transactions with those companies in the year 2017 are dividends received, as follows:

Recipient	Distributor	Amount (Euros thousand)
Global Power Generation, S.A.	Buenergía Gas & Power, Ltd.	49,504

Tax contribution

Gas Natural Fenosa gives priority to fulfilling its obligation to pay the taxes that are due in each territory in accordance with the applicable regulations.

Gas Natural Fenosa's total tax contribution amounted to Euros 3,272 million in 2017 (Euros 3,419 million in 2016). The following table shows the breakdown of the taxes actually paid by Gas Natural Fenosa in each country, segmented into those that represent an actual expense for the group ("own taxes") and those that the company withholds from or charges to other taxpayers (third-party taxes):

Country	Own taxes						Third-party taxes								Total	
	Income tax ¹		Others ²		Total		VAT		Tax on hydrocarbons		Others ³		Total			
	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016
Spain	112	199	537	512	649	711	845	1,007	342	352	228	229	1,415	1,588	2,064	2,299
Argentina	15	10	67	42	82	52	19	13	–	–	34	22	53	35	135	87
Brazil	51	38	67	49	118	87	74	58	–	–	7	9	81	67	199	154
Colombia	60	75	57	78	117	153	–	7	–	–	11	14	11	21	128	174
Chile	101	42	11	11	112	53	81	117	–	–	22	18	103	135	215	188
Mexico	66	31	4	3	70	34	57	39	–	–	19	11	76	50	146	84
Panama	10	89	9	7	19	96	–	–	–	–	4	3	4	3	23	99
Rest of LatAm	8	12	1	1	9	13	4	2	–	–	4	3	8	5	17	18
Total LatAm	311	297	216	191	527	488	235	236	–	–	101	80	336	316	863	804
Italy	4	19	7	7	11	26	27	27	35	42	5	5	67	74	78	100
Remainder	11	10	28	23	39	33	143	128	76	49	9	6	228	183	267	216
Total	438	525	788	733	1,226	1,258	1,250	1,398	453	443	343	320	2,046	2,161	3,272	3,419

¹ Income tax actually paid in the year that figures in the Cash Flow Statement in the Consolidated Annual Accounts. Does not include accrued amounts. The reconciliation between reported "income tax" and that which would result from applying the nominal tax rate in force in the parent company's home country (Spain) to "Profit before taxes" is detailed in Note 21 ("Tax situation") to the consolidated financial statements.

² Includes energy taxes in Spain amounting to Euros 260 million in 2017 (Euros 244 million in 2016), local taxes, employer social security contributions and other specific taxes in each country.

³ Includes basically employee withholdings and employee social security contributions.

Integrity and transparency

The Code of Ethics of Gas Natural approved by the Board of Directors, is the document that establishes guidelines that must govern the ethical behaviour of managers and employees of Gas Natural Fenosa, in their daily work, with regard to relationships and interactions with all its stakeholders. The principles for the company's employees are related to corruption and bribery, respect for people, professional development, equal opportunities, relation with collaborating companies, occupational health and safety, and caring for the environment, among others.

In addition, Gas Natural Fenosa has an Anticorruption Policy, which establishes the principles which must be used to guide the conduct of all employees and administrators of the companies of the group with regard to the prevention, detection, investigation and correction of any corrupt practice within the organisation.

In 2017, 2% of the notifications received were related to alleged fraud, none of which had any significant impact.

29% of the notifications were related to "Respect for people" chapter of the Code of Ethics, and they were all solved appropriately. None of them were related to discrimination.

Gas Natural Fenosa expects a high level of commitment in fulfilling its Code of Ethics and Anticorruption Policy of all its employees. Therefore, emphasis is placed on transmitting a culture of integrity of the company. Its breach is analysed according to internal procedures, legal regulations and existing agreements.

During 2017, we managed various disciplinary situations from complaints made to the Code of Ethics Committee, or from situations covered in the Code of Ethics or the Anticorruption Policy. In total, 3 misdemeanours, 4 serious offences and 17 very serious offences, of which 13 have resulted in dismissals through breach of the Code of Ethics, were handled.

The Code of Ethics Committee also has a multi-year work plan, which includes actions in the short- and medium-term, with the ultimate goal of extending the code to the highest possible number of activities and people at the company.

The company set up local committees in Argentina, Brazil, Colombia, Chile, Italy, Mexico, Moldova, Panama and South Africa.

Protocol of Investigation and Response to irregular conduct and fraud

The protocol defines the action procedure and system to ensure that any notification from any employee, supplier or external partner of Gas Natural Fenosa concerning allegedly irregular or fraudulent conduct can be formulated and reported in a safe and confidential way in compliance with prevailing legislation, as well as the system for establishing all of the procedures required to enable an efficient investigation into irregular conduct and fraud reported.

The Gas Natural Fenosa reporting channel, through which all the employees and suppliers can send the Code of Ethics Committee queries or notify breaches of the code, in good faith, in a confidential manner and without fear of reprisal.

Crime Prevention Model

The company has a Crime Prevention Model that is updated every year, and which incorporates the control structure that already exists at Gas Natural Fenosa to efficiently prevent the occurrence of criminal offences set out in Organic Law 5/2010 on reform of the Penal Code.

From an organisational standpoint, the Board of Directors has assigned the functions of Autonomous Body, described in Organic Law 1/2015, to the Compliance Assessment Committee, which is responsible for taking significant decisions in relation to the regular monitoring and oversight of the working and compliance with the Crime Prevention Model.

The model contains 21 crimes that have been identified, together with definitions of their impact and probability of occurrence, mechanisms for their control and minimisation, and responsibilities with regard to their fulfilment.

Each year, the model is assessed by an independent third party. In 2017, it issued a satisfactory report on its design and effectiveness.

Although fraud and corruption are covered in the crime prevention system, the company worked to improve and update its internal regulations and define specific protocols and mechanisms in this area.

The Gas Natural Fenosa Anticorruption Policy complies with national and international legislation on corruption and bribery, and mainly that dictated by the Spanish Penal Code.

This policy has the object of establishing the principles which must be used to guide the conduct of all employees and administrators of the companies of Gas Natural Fenosa with regard to the prevention, detection, investigation and correction of any corrupt practice within the organisation.

The policy establishes fourteen principles of action, including aspects such as promoting integrity and transparency in the processing of information, money laundering, conflicts of interest and relationships with third parties.

The focus of the Gas Natural Fenosa Anticorruption programme covers three key areas:

- Establishment of an antifraud and anticorruption culture through training and awareness.
- Implementation of proactive measures to assess the risk of fraud and corruption, monitoring and controls.
- Development of measures and response plans in the event of situations that constitute fraud and corruption. These plans and measures include the investigation of the episodes, the definition of solutions and the establishment of disciplinary measures.

In all operations involving risk, the company conducts due diligence processes systematically, both for high-risk suppliers, and company relationships with third parties (partners, joint ventures, etc.). The counterpart due diligence procedure aims to ensure that, across the board, reputational risk and corruption are analysed and assessed efficiently and in a standard way when third parties intervene in business relationships of the companies forming the group.

In the security area, in 2017 there were 7,010 investigation and antifraud cases of action that took place in Argentina, Brazil, Colombia, Spain, Mexico, Moldova and Panama.

Human Rights Policy

Since 2011, Gas Natural Fenosa has a Human Rights Policy approved by the Management Committee. The policy has been developed and approved in response to society’s growing demands. It is particularly applicable in locations in which local legislation does not provide a sufficient level of protection for human rights.

The policy establishes ten commitments, which were determined on the basis of the main risks that affect human rights in the company, and accepts the UN Guiding Principles on Business and Human Rights.

Human Rights Policy Principles

- | | |
|---|---|
| <p>1 Avoiding any practices which are discriminatory or which might compromise people’s dignity.</p> | <p>6 Commitment towards people linked to suppliers, contractors and collaborating companies.</p> |
| <p>2 Eradicating the use of child labour.</p> | <p>7 Supporting and publicly promoting respect for human rights.</p> |
| <p>3 Helping to ensure freedom of association and collective negotiation.</p> | <p>8 Respecting for indigenous communities and traditional ways of life.</p> |
| <p>4 Protecting people’s health.</p> | <p>9 Protecting facilities and people on the basis of respect for human rights.</p> |
| <p>5 Offering dignified employment.</p> | <p>10 Helping to fight corruption.</p> |

The company encourages the policy to be known and to be complied with using a communication and training plan, which includes a compulsory online course for all employees, seminars based around explaining principles of the policy and conflicts which could arise, and guidance sessions about the policy and its role in business activity. Towards the end of 2017, the course had been completed by 10,132 people.

Main risks and uncertainties

Risk management model

Gas Natural Fenosa's risk management model seeks to ensure that the company's performance is predictable in all aspects that are of relevance to its stakeholders. This requires establishing the risk tolerance by setting limits for the main risk categories. In this way, the company can anticipate the consequences of certain risks and be perceived in the market as a sound, stable company, with all the benefits that entails.

Gas Natural Fenosa has a framework integrating the vision of governance, risks and compliance so as to provide a 360° view of the group's processes, existing controls and the associated risks.



Corporate governance

Preventive risk management, which includes issues beyond the mere economic sphere of the company's activities, is a core feature of Gas Natural Fenosa's corporate governance. Within the framework of its risk management and control policy, the company analyses and approves its risk profile each year and establishes the necessary measures to mitigate risks. Additionally, Audit Committee monitors the operation of risk management and control systems.

Risk management

Gas Natural Fenosa constantly analyses its overall risk profile by identifying, characterising and measuring the risks with the greatest potential impact on the company's financial statements. In this way, it determines the maximum accepted level of risk exposure and the admissible limits. These limits are assigned to each risk category as well as in overall terms; the result is the target overall risk profile.

Internal audit and Compliance

The Internal Audit units are responsible for performing the assurance and control function. To this end, the Internal Audit function has a risk-based approach, which provides independent assurance not linked to management about the effectiveness of the internal control system and of risk measurement and management in all areas of the group.

Risk management bodies

Guaranteeing the predictability and sustainability of the company's operational and financial performance is a key aspects of risk management at Gas Natural Fenosa, and is supported by a number of bodies with clearly identified areas of responsibility.



Audit Committee

Supervises the company's internal control and risk management systems.

Risk Committee

Entrusted with determining and reviewing the company's target risk profile. It also exercises oversight to ensure that the entire organisation understands and accepts its responsibility for identifying, assessing and managing the main risks.

Risk Units

In charge of monitoring and reporting risks and ensuring that they fall within the limits defined in the target risk profile by the Risks Committee.

Businesses

In charge of managing risk in all their areas of action. They identify trends and positions that may entail risk and report them to the Risk Units. They also apply the guidelines and criteria established by the Risk Units.

Other corporate areas

In charge of tracking and managing certain risks which are specific in nature or need to be managed in a specific way. Notable examples are the Environment and Quality Assurance Unit, which handles environmental and climate change risk, and the Reputation and Sustainability Unit, which manages reputational risk. Both operate in coordination with the Risk Units.

Risk categories

Each business unit has specific information on the main types of risk that may affect it. The goal is to facilitate decision-making, which is positive for the company since it enhances profitability, predictability and efficiency.

The system addresses basically three categories of risk:

- Market risk, understood as the uncertainty related to commodity prices, exchange rates and interest rates, which may impact the company's balance sheet, procurement costs or ability to raise funding in the capital markets. It is measured using two yardsticks: in the short term, focused on the income statement, and in the long term, focused on enterprise value, including the capacity to generate cash flow and its stability, variations in the funding structure, and volatility in the applicable discount rates.
- Credit risk, i.e. the risk to the financial solvency of the company's receivables. It also incorporates the short-term measurement of returns on placing cash surpluses with financial institutions, the aim being to select the most efficient portfolios.
- Operating risk, i.e. the possibility of financial losses as a result of failures in processes, internal systems or other factors. It enables risk to be measured objectively, which is decisive for raising awareness in the company and in improving management of exposure, all of which have an essential impact on the reinsurance market's perception of Gas Natural Fenosa's operational excellence.

Risk type	Description	Management	Metric	Trend	
Market risks					
Commodity prices	Gas	Volatility in the international markets that determine gas prices.	Physical and financial hedges. Portfolio management	Stochastic. ↑	Decoupling of long-term contracts from hub prices.
	Electricity	Volatility in the Spanish and Portuguese electricity markets	Physical and financial hedges. Optimisation of the power generating fleet.	Stochastic. ↑	Penetration by renewables with zero marginal cost and intermittent production.
Exchange rate	Volatility in international currency markets.	Geographic diversification. Hedging via local-currency funding and derivatives. Monitoring the net position.	Stochastic.	↔	Uncertainty about growth prospects in Latin America.
Interest rates	Volatility in funding rates.	Financial hedges. Diversification of funding sources.	Stochastic.	↓	Increase financial strength in a context of agile deleveraging.
Credit risk					
Credit	Uncertainty about performance of bad debt ratios as a result of the economic cycle.	Analysis of customer solvency to define specific contractual conditions. Debt collection process.	Stochastic.	↔	Spain is expected to recover slowly, in line with the process of macroeconomic normalisation.
Operational risks					
Regulatory	Exposure to regulatory review of the criteria and returns recognised for regulated activities.	Step up communications with regulators. Adjust efficiency and capital expenditure to recognised rates.	Scenarios.	↔	Different business units at different stages of maturity.

Risk type	Description	Management	Metric	Trend		
Operational risks						
Volume	of gas	Mismatch between gas supply and demand.	Optimisation of contracts and assets worldwide.	Stochastic.	↔	Temporarily slack demand in Spain.
	of electricity	Reduction of the available thermal gap. Uncertainty about volume of hydroelectric output.	Optimisation of the balance between supply and generation.	Stochastic.	↑	Slack demand in Spain, impacting the thermal gap due to renewables' growing share.
Operational: insurable risks	Accidents, damage and non-availability of Gas Natural Fenosa assets.	Continuous improvement plans. Optimisation of total cost of risk and of hedges.	Stochastic.	↓	Development of specific oversight units.	
Operational: image and reputation	Impaired perception of Gas Natural Fenosa by stakeholders.	Identification and tracking of potential reputational events. Transparency.	Scenarios.	↔	Stabilisation of RepTrak index score.	
Operational: environment	Harm to the natural and/or social environment. Development of environmental regulations.	Emergency plans at facilities with risk of environmental accident. Specific insurance policies. End-to-end environmental management.	Scenarios.	↓	Implementation of an Integrated Management System that is audited and certified each year by Aenor.	
Operational: climate change	Changes in environmental factors as a result of climate change. Regulation aimed at combating it.	Corporate positioning vis-à-vis climate change.	Scenarios/ Stochastic.	↑	Uncertainty about policy developments to encourage energy efficiency.	
Operational: geopolitical exposure	Company-owned assets or supply contracts in geographical areas whose political equilibrium is delicate.	Diversification by country and region. Specific insurance policies.	Scenarios/ Stochastic.	↔	Stagnation of the situation in the Middle East/North Africa.	

Metrics used:

- > **Stochastic:** production of trend lines for the main magnitudes, taking the maximum deviation from the benchmark scenario to be the risk, within a pre-set confidence interval. Those magnitudes are generally EBITDA, earnings after taxes, cash flow and value.
- > **Scenarios:** analysis of the impact with respect to the benchmark scenario of a limited number of possible incidents.

Financial risks (interest rate, exchange rate, commodity price, credit and liquidity risk) are detailed in Note 13 to the Annual Accounts of Gas Natural SDG, S.A.

Opportunities

Gas Natural Fenosa's main opportunities are as follows:

- > **Generation mix:** Gas Natural Fenosa's generating fleet, which is dominated by CCGTs, has the necessary flexibility to adapt to different market situations and is a valuable asset for seizing opportunities related to volatility in prices and demand volume in the gas and electricity markets.
- > **Portfolio of natural gas and LNG procurements:** Management of gas pipelines, stakes in plants and the fleet of LNG carriers make it possible to meet the needs of the Group's various businesses in a flexible, diversified way by optimising for different energy scenarios. Specifically, because of its LNG carrier fleet, Gas Natural Fenosa is one of the world's leading LNG operators and a key player in the Atlantic and Mediterranean.
- > **Balanced structural position** in businesses and regions, many of them with stable flows that are independent of commodity prices, making it possible to optimise the capture of energy demand growth and maximise new business opportunities in new markets.
- > **International generation:** Increase the renewable energy generating capacity at an international level given the cost-competitiveness of renewable energies and Gas Natural Fenosa's presence in growth markets.
- > **Technological development and innovation:** Gas Natural Fenosa focuses on research, development and innovation as a means of generating a reliable, sustainable energy supply.

Forecast Group performance

Foundations of strategy

In order to achieve its goals, Gas Natural Fenosa defines medium-term strategies that are updated regularly to adapt to the current and future situation, taking account of the specific features of the company's various lines of business.

The strategic planning cycle is defined as a recurring process that starts from a reflection on strategy, is materialised in each business and corporate unit's business plans and is integrated into the group's integrated business plan.

Energy planning cycle

> Reflection on strategy

Formal adoption of the group's medium-term vision.

Top-down approach.

> Business plans

Formal statement of goals for the business and corporate units.

Bottom-up approach. Integrated business plan.

Formal statement of goals for the group, integrating the business plans.



> Tracking and reporting

Single source of management information for the group and the business and corporate units.

Strategic information management to support decision-making.

> Budget

Operations budget.

Capex budget.

Coordination of the strategic planning, annual budgeting and continuous tracking processes facilitates agile and effective decision-making.

Gas Natural Fenosa strategy framework

The company's strategic vision for 2016-2020 adopted a number of commitments for 2018 and aspirations for 2020 and defined the outlook for the business areas and financial goals for the group in that period. Gas Natural Fenosa plans to present is 2018-2020 Strategic Plan, with updated targets for the group.

The key components of Gas Natural Fenosa's Strategic Plan are:



Framed by tracking of the business environment, the strategic plan establishes:

- > Business management model and objectives.
- > Execution of a new efficiency plan.
- > Continuous management of the business portfolio and its strategic fit.

The strategic plan is materialised in the form of business plans.

Group outlook

The Strategic Vision 2016-2018 was grounded in three growth areas (networks, power generation and gas supply), the goal being to enable Gas Natural Fenosa to continue expanding in the future:

- > **Networks:** in the area of gas, investment in gas networks in Chile and Mexico, entry into the gas distribution business in the Arequipa (Peru) region, new licences and additional growth as a result of conversion of the new liquefied petroleum gas (LPG) connection points in Spain; in the area of electricity, investment in *smart grids* in Spain, investments to meet additional demand in Chile and Panama, electricity subtransmission in Chile driven by new renewable energy projects.
- > **Electricity generation:** improve generating fleet efficiency and performance by adding 3,500 MW overall; 2,500 MW in renewables (Spain and other countries) and 500-1,000 MW in CCGTs that will contribute to developing the downstream LNG business. Growth and development of the international power generation business via GPG.
- > **Gas supply:** new gas procurement contracts totalling about 11 bcm in the two Cheniere projects (Sabine Pass and Corpus Christi) and the Yamal LNG project in Russia; additionally, existing gas supply contracts will be adapted and renegotiated to reflect benchmark market conditions. The LNG carrier fleet will be expanded by four vessels (two of which were added in 2016) and a mobile regasification unit. Because of their larger size, they represent almost 1 million cubic metres of additional capacity. EBITDA is expected to increase by around 10%.

The Strategic Plan 2018-2020 will update the strategies to be implemented to ensure that Gas Natural Fenosa maintains the trend of organic growth in 2018 and subsequent years.

Sustainable innovation

Gas Natural Fenosa, in order to address the new challenges and opportunities posed by the business environment, has promoted the implementation of a model of innovation that seeks to respond to the technological changes that the sector is facing and a strong innovative culture at the company.

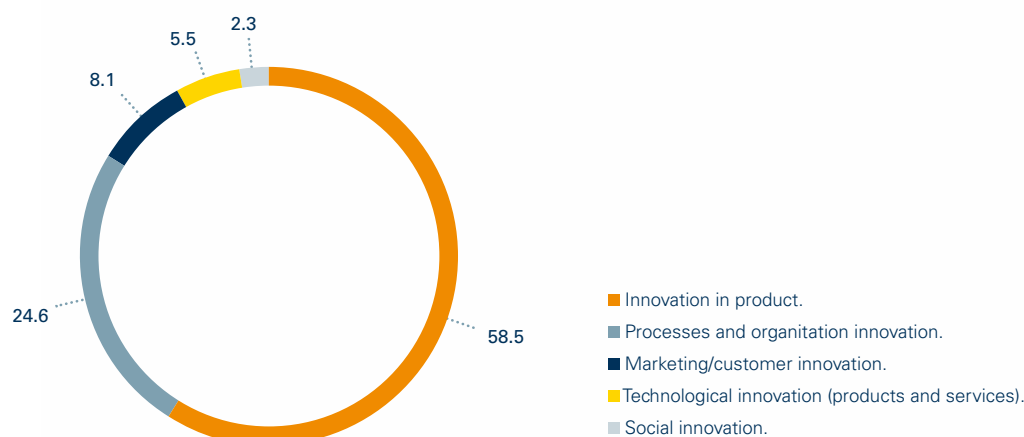
Innovation overview

Below we detail the 5 major blocks into which the company has structured its innovation activities:

- **Social Innovation.** The company has been working to mitigate situations of energy vulnerability since 2014 with prevention actions, through agreements with local and regional governments, and activities to raise awareness with participation on forums and chat groups about poverty. These actions intensified during 2017 through the Vulnerability Plan.
- **Marketing Innovation.** This particular line encompasses all of the company's efforts to find out the actual and specific needs of each one of its customers, and to make sure that they have at their disposal cutting-edge products that help them in their day-to-day life. One of the major initiatives within this kind of innovation is the CEX (Customer Experience) project through which the company introduces a new methodology in which the customer is the starting point and the centre of activity.
- **Organisational Innovation.** In this framework we consider those actions targeted at covering the needs that arise with regard to new business models, those that have entailed a new organisation in the work and those that have been for the purpose of minimising risks and increasing quality and safety in the organisation's practices.
- **Innovation in Product.** Here, we can highlight the PIDIM (Smart Platform for the Sizing and Design of Multigeneration Facilities) project for the purpose of designing, developing and introducing facilities for the distributed generation of heating and cooling electricity that operates in the cloud by receiving data such as the customer's consumption. With this initiative we aim to promote the energy rehabilitation of buildings and to characterise the energy demand of these buildings to calculate the baseline of consumption of the building and to forecast savings. In this sphere we should also highlight development of the Sustainable Logistics Train (SLT) in the quest for a feasible and economic solution for the sustainable management of the so-called "last mile" logistic, where the dissemination of services for customers is often in places where there is restricted traffic access.
- **Process Innovation.** We can point to the Integrated Control Centre (ICC) of hydraulic facilities, headquartered in A Batundeira (Velle - Ourense), which allows centralised and remote control management of the exploitation, operation and maintenance of all the company's power plants and dams in Spain.

The overall figure in 2017 for investment in innovation totalled 99 million euros, as follows:

Investment in innovation (millions of euros)



Innovation Plan

The Innovation Plan is structured by five multidisciplinary working networks and eight technological innovation areas.

Liquefied Natural Gas (LNG)

Gas Natural Fenosa develops innovation projects in three areas of action: optimisation of the LNG logistics chain (Small Scale), development of LNG as a cleaner and more efficient transport fuel (Bunkering) and development of the LNG Measure.

One key project is the DirectLink LNG – Floating Universal Transfer System (UTS), developed during 2016 and 2017. This is an integral patented solution for the transfer and bunkering of LNG from ship to shore, an alternative to the costly traditional infrastructures (port and jetties) and with minimum environmental impact.

Generation

Renewables and storage

Gas Natural Fenosa develops innovation projects in four areas of action:

- Renewable energy: a commitment to a balanced energy mix, so that the emission-free generation technologies and the low-emission technologies represent a significant volume of the total installed capacity.
- Wind energy: with initiatives to monitor the condition of the assets, through measurement systems, smart models and data maintaining and optimizing the performance of the facilities through the implementation of improvements or tests.
- Hydraulic energy: a commitment to the introduction of new technologies both in areas of environmental control as well as in the establishment of mobility systems and remote monitoring, without overlooking improved performance of its hydraulic facilities.
- Storage: focusing on an even greater increase in quality and reliability of supply, on developing joint solutions with customers and also on allowing a greater and easier integration of renewable-source electricity into the grid.

Highlights the project Windex, developed in 2017, which involves application of sensor systems and development of information-processing tools to increase the useful and structural life of wind farms in a safe way.

Reduction of emissions and energy efficiency

The company is carrying out a range of technological developments at its facilities. In addition, the company continues to work to improve the efficiency of its coal and combined-cycle plants.

Highlights the project Optimisation of fuel through lasers developed during 2017, which helps to significantly reduce NOx at the Meirama Thermal Power Plant.

Grids

The company's commitment is two-fold of acting.

- Revitalisation of gas networks: where challenges focus on achieving greater automation of the grid (remote action, reduction of cut-offs and interruptions, improved operational efficiency and maintenance and increased energy performance) and greater interaction with the customer (energy efficiency and active management of demand).
- Electricity grids 4.0: focusing on digitalisation of the electricity distribution grids, moving forward in the management of operation and maintenance of the grid, and integrating the customer into the information flows, whilst simultaneously improving the levels of safety at work and the quality of supply.

Customer

Gas Natural Fenosa has two action lines open in the field of innovation associated to the customer.

- Smart Client: focusing on providing products and services with high value-added for different types of end customers. This Innovation area promotes initiatives based mainly on three core actions: GEDIS and Self-consumption, Integration of new solutions and Data Analytics.
- Energy efficiency and mobility.

One of the most important projects is the Remote Building Analytics Platform, based on the development of an energy management tool (virtual audit) for customers of the SMEs market. Data from smart meters are fed into the tool and these data allow us to define specific segmentation of customers for the purpose of proposing energy efficiency measures and actions in masse.

Automation and management of information

It is a cross-sectional area that aims to bring together projects already being developed in the company to gain synergies and enhance results.

Highlights the project Energy Harvesting UP4, which consists in testing the concept at laboratory level of a device based on a sheet of piezoelectric material to generate small amounts of electricity. The device is put into a gas tube and energy is produced through the flow interaction structure. The aim is to capture energy to feed sensors that will be installed in the gas network.

Additional information

Treasury shares

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%.

Movements during 2017 and 2016 involving the treasury shares of Gas Natural SDG, S.A. are as follows:

	Number of shares	Amounts in million euro	% Share capital
At 1 January 2016	–	–	–
Acquisitions	3,049,189	53	0.3
Disposals	(2,298,644)	(40)	(0.2)
At 31 December 2016	750,545	13	0.1
Acquisitions	7,623,586	147	0.8
Share Acquisition Plan	(336,625)	(7)	–
Disposals	(8,037,506)	(153)	(0.8)
At 31 December 2017	–	–	–

In 2017, the profit on transactions involving treasury shares of Gas Natural Fenosa amounted to Euros 0.5 million, recognised under “Other reserves” (Euros 0.4 million profit in 2016).

Note 10 of the Notes to the Annual accounts of Gas Natural SDG, S.A. contains all the information on treasury shares.

Average supplier payment period

Disclosure of deferrals of payment to suppliers Additional Provision 3 “Duty of disclosure” of Law 15/2010/5 July

The total amount of payments made during the year, with details of payment periods, in accordance with the maximum legal limit under Law 15/2010 of July 5, which laid down measures against late payment, is as follows:

	2017	2016
	Amount	Amount
Total payments (euro)	4,452,183,472	3,993,685,684
Total payments outstanding (euro)	79,531,676	88,041,054
Average supplier payment period (days) ¹	20	22
Transactions paid ratio (days) ²	20	22
Transactions pending payment ratio (days) ³	23	24

¹ Calculated on the basis of amounts paid and pending payment.

² Average payment period in transactions paid during the year.

³ Average age, suppliers pending payment balance.

Events after the reporting date

Events after the reporting date are described in Note 29 to the Annual Accounts of Gas Natural SDG, S.A.

Annual Corporate Governance Report

Attached as an annex and forming an integral part of this Directors’ Report is the Annual Report on Corporate Governance 2017, as required by article 526 of the Capital Companies Act.

A. Ownership Structure

A.1 Complete the following table on the Company's share capital:

Date of last change	Share capital (€)	Number of shares	Number of voting rights
22/06/2012	1,000,689,341	1,000,689,341	1,000,689,341

Report if there are different classes of shares with different rights associated:

No

Class	Number of shares	Nominal value per share	Number of voting rights per unit	Different rights
-------	------------------	-------------------------	----------------------------------	------------------

A.2 Detail the direct or indirect holders of significant shareholdings of the company at the close of the financial year, excluding the Board Members:

Individual or company name of the shareholder	Number of direct voting rights	Indirect voting rights		shares % of total voting rights
		Direct holder of the interest	Number of voting rights	
Global Infrastructure Partners III	0	Gip III Canary 1, S.À R.L.	200,137,868	20.00
Société Nationale pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation	40,092,780		0	4.01
Repsol, S.A.	200,964,920		0	20.08
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa")	0	Criteria Caixa, S.A.U.	244,557,521	24.44

State the most significant changes in the shareholding structure that have occurred during the financial year:

Individual or company name of the shareholder	Date of transaction	Description of transaction
---	---------------------	----------------------------

A.3 Complete the following tables about members of the board of directors of the company who have voting rights attaching to shares of the company:

Individual or company name of director	Number of direct voting rights	Indirect voting rights		shares % of total voting rights
		Direct holder of the interest	Number of voting rights	
Mr. Mario Armero Montes	0			0.00
Mrs. Helena Herrero Starkie	0			0.00
Mr. Miguel Martinez San Martin	0			0.00
Mrs. Cristina Garmendia Mendizabal	0			0.00
Mr. Josu Jon Imaz San Miguel	4,100			0.00
Mr. Luís Suárez De Lezo Mantilla	18,156			0.00
Mr. Marcelino Armenter Vidal	12,600			0.00
Mr. Isidro Fainé Casas	17,426			0.00
Mr. Ramón Adell Ramón	5,000			0.00
Mr. Enrique Alcántara-García Irazoqui	8,339			0.00
Mr. Rafael Villaseca Marco	13,055	Ravifa 2013, S.L. B66079922	8,917	0.00
Mr. Francisco Belil Creixell	7,128			0.00
Mr. Xabier Añoveros Trias De Bes	350			0.00
Mr. Alejandro García-Bragado Dalmau	0			0.00
Mrs. Benita Ferrero-Waldner	0			0.00
Mr. Rajaram Rao	0			0.00
Mr. William Alan Woodburn	0			0.00
% total voting rights held by the board of directors				0.01

Complete the following tables about members of the company's board of directors who hold rights to shares of the company:

Individual or company name of director	Number of direct voting rights	Indirect voting rights			shares % of total voting rights
		Direct holder of the interest	Number of voting rights	Number of equivalent	

A.4 State, if applicable, the family, commercial, contractual, or corporate relationships between significant shareholders, to the extent known to the company, unless they are immaterial or result from the ordinary course of business:

Related individual or company name	Type of relationship	Brief description
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa")	Corporate and Commercial	Commercial or corporate relationships between Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona (La Caixa) and Repsol, S.A. are expressed in the reports of these companies. Previous shareholders agreement was finished on September 21, 2016. See par. A.6.
Repsol, S.A.	Corporate and Commercial	Commercial or corporate relationships between Fundació Bancaria Caixa d'Estalvis i Pensions de Barcelona (La Caixa) and Repsol, S.A. are expressed in the reports of these companies. Previous shareholders agreement was finished on September 21, 2016. See par. A.6.

A.5 State, if applicable, the commercial, contractual, or corporate relationships between significant shareholders and the company and/or its group, unless they are immaterial or result from the ordinary course of business:

Related individual or company name	Type of relationship	Brief description
Fundación Bancaria Caixa d'Estalvis i Pensions de Barcelona ("la Caixa")	Commercial	Existing relationships derive from ordinary commercial traffic and are referred to in par. D.2 and in annual accounts.
Repsol, S.A.	Commercial	Existing relationships derive from ordinary commercial traffic and are referred to in par. D.2 and in annual accounts.
Société Nationale pour la Recherche, la Production, le Transport, la Transformation et la Commercialisation des Hydrocarbures	Commercial	Existing relationships derive from ordinary commercial traffic.

A.6 State whether any private (paracorporate) shareholders' agreements affecting the company pursuant to the provisions of sections 530 and 531 of the Companies Act (Ley de Sociedades de Capital) have been reported to the company. If so, briefly describe them and list the shareholders bound by the agreement:

Yes

Participants in the private shareholders' agreement	% of share capital affected	Brief description of the agreement
Criteria Caixa, S.A.U Repsol, S.A. Gip III Canary 1, S.À R.L.	64.52	On 12 September 2016, the attendees assumed certain commitments related to the Company's Corporate Governance that are intended to: 1. Establish qualified majorities to adopt resolutions on certain matters (arts. 10 and 5 of the Board Regulations); and 2. Increase the number of members of the Executive Committee from 7 to 10 (art. 30 of the Board Regulations) and of the Audit Committee from 3 to 7 (art. 32 of the Board Regulations) and appoint 5 members of the Appointments and Remuneration Committee (art. 31 of the Board Regulations).

State whether the company is aware of the existence of concerted actions among its shareholders. If so, briefly describe them:

No

Participants in concerted action	% of share capital affected	Brief description of the agreement
----------------------------------	-----------------------------	------------------------------------

Expressly state whether any of such agreements, arrangements, or concerted actions have been modified or terminated during the financial year:

A.7 State whether there is any individual or legal entity that exercises or may exercise control over the company pursuant to section 5 of the Securities Market Act (Ley del Mercado de Valores). If so, identify it:

No

Individual or company name

Comments

A.8 Complete the following tables about the company's treasury shares:

As of year-end:

Number of direct shares	Number of indirect shares*	% of total share capital
0	0	0

* Through:

Individual or company name of direct holder of the interest	Number of direct shares
Total	

Explain any significant changes, pursuant to the provisions of Royal Decree 1362/2007, that have occurred during the financial year:

Explain any significant changes

A.9 Describe the terms and conditions and the duration of the powers currently in force given by the shareholders to the board of directors in order to issue, repurchase, or transfer own shares of the company.

The General Shareholders' Meeting of May 14, 2015, in its fourteenth item on the Agenda, authorized the Board of Directors to agree on a period of not more than 5 years to acquire the shares of the Company, subject to the following conditions:

Fourteenth.- Authorization to the Board of Directors for the derivative acquisition of own shares, directly or through companies of the Gas Natural SDG, SA Group, in the terms agreed by the General Meeting and with the legally established limits, without giving effect to the authorization Agreed by the Ordinary General Meeting of April 20, 2010.

Fourteenth 1.- Leave the authorization granted to the Board of Directors by the General Shareholders' Meeting held on April 20, 2010, in order to acquire shares of the Company for pecuniary interest, in the unused portion.

Fourteenth 2.- To authorize the Board of Directors so that, within a period not exceeding five years, it may acquire, for one or more times, for a consideration, up to a maximum of 10% of the capital stock or the maximum amount resulting from application in accordance with current legislation at the time of acquisition, shares of the Company that are fully paid up, without the nominal value of shares acquired directly or indirectly, in addition to those already held by the Company and its subsidiaries exceeding 10% of the subscribed capital, or any other legally established. The minimum and maximum purchase price will be the quotation on the Spanish stock exchanges' Continuous Market with an oscillation of more or less than 5%.

In the event that the shares are not listed, the maximum and minimum acquisition price will be indicated between one-half and two times the book value of the shares, in accordance with the latest audited consolidated balance sheet. The Board of Directors is empowered to delegate this authorization to the Executive Committee or to the person or persons it deems convenient. This authorization is understood to extend to the acquisition of shares of the Company by controlled companies.

Furthermore, the General Shareholders' Meeting of 20 April 2017, in its fourteenth item on the Agenda, authorised the Board of Directors to agree on a period of no more than 5 years to increase the share capital, subject to the following conditions:

Fourteen. Authorisation to the Board of Directors, with power of substitution in the Executive Committee, in accordance with the provisions of article 297.1 b) of the Capital Companies Act, so that, within a maximum period of five (5) years, if it deems it advisable, it can increase the share capital up to the maximum amount corresponding to half of the share capital at the time of authorisation, with an incomplete subscription forecast, issuing ordinary, preference or redeemable shares, voting or not voting, with premium or without premium, in one or more times and in the opportunity and amount it considers appropriate, including the power to eliminate, as the case may be, preferential subscription rights up to the limit of 20% of the share capital at the time of this authorisation, rewriting the corresponding articles of the Articles of Association and leaving without effect the authorisation agreed by the General Meeting of 20 April 2012.

Fourteen.

- 1) Taking into account the current figure of the share capital, to authorise the Board of Directors, with power of substitution in the Executive Committee, to increase the share capital by FIVE HUNDRED MILLION, THREE HUNDRED AND FORTY FOUR THOUSAND, SIX HUNDRED AND SEVENTY EUROS (€500,344,670) within five (5) years, as from this date (20.04.2017), by means of cash disbursement, in one or more times in the opportunity and amount that it decides, issuing ordinary, preference or redeemable shares, with voting or non-voting, with a premium or without a premium, without the need for a new authorisation from the General Meeting, as well as to modify the Articles of Association that may be necessary for the increase or increases of capital made pursuant to said authorisation, with an incomplete subscription forecast, all in accordance with that established in article 297.1 b) of the Capital Companies Act, leaving without effect the authorisation agreed by the General Meeting of 20 April 2012.
- 2) The Board of Directors, with power of substitution in the Executive Committee, is expressly empowered to exclude, in whole or in part, the pre-emptive subscription right in relation to any or all of the issues that it may agree upon based on this authorization. This power is limited to the exclusions of the pre-emptive subscription right not exceeding, as a whole, 20% of the Company's current share capital.
- 3) As a result of the previous agreement, to amend the Transitory Article of the Articles of Association, which will be drafted as follows:

"Temporary article. Delegation to the board of directors.

The Company's Board of Directors is empowered, within a maximum period of five (5) years as from this date (20.04.2017), to increase capital by FIVE HUNDRED MILLION, THREE HUNDRED AND FORTY FOUR THOUSAND, SIX HUNDRED AND SEVENTY EUROS (€500,344,670) on one or more occasions, when and in the amount it so determines, by issuing voting or non-voting ordinary, preference or redeemable shares, at a premium or otherwise, to be paid in cash, without the need for further shareholder approval, including where appropriate the power to totally or partially override pre-emptive subscription rights up to the limit of 20% of the share capital at the time of this authorization, and to amend the Articles of Association as required as a result of any capital increase(s) undertaken by virtue of the aforementioned authorisation, allowing for incomplete subscription, in conformity with the provisions of Article 297.1.b) of the Spanish Capital Companies Act.

A.9 bis Estimated free-float:

	%
Estimated free-float	31.46

A.10 State whether there are any restrictions on the transfer of securities and/or any restrictions on voting rights. In particular, disclose the existence of any restrictions that might hinder a takeover of the company through the acquisition of its shares in the market.

Yes

Description of restrictions

As a company that includes certain regulated and quasi-regulated assets and activities in the Group, the acquisition of shares of Gas Natural SDG, S.A. may be subject to the provisions of Additional Provision Nine of Law 3/2013, of June 4, creating the Comisión Nacional de los Mercados y Competencia (National Commission on Markets and Competition).

Due to its nature as main operator in the gas and electricity markets, the holding of its shares is subject to the restrictions established in article 34 of Decree-Law 6/2000 of Urgent Measures to intensify competition in the markets of goods and services.

A.11 State whether the shareholders acting at a general shareholders' meeting have approved the adoption of breakthrough measures in the event of a takeover bid pursuant to the provisions of Law 6/2007.

No

If applicable, explain the approved measures and the terms on which the restrictions will become ineffective:

A.12 State whether the company has issued securities that are not traded on a regulated market within the European Community.

No

If applicable, specify the different classes of shares, if any, and the rights and obligations attaching to each class of shares.

B. General shareholders' meeting

B.1 State and, if applicable, describe whether there are differences with the minimum requirements set out in the Companies Act in connection with the quorum needed to hold a valid general shareholders' meeting.

No

	Quorum % different from that established in section 193 of the Companies Act general	Quorum % different from that established in section 194 of the Companies Act for the special circumstances described in section 194
Required quorum upon 1st call		
Required quorum upon 2nd call		

Description of differences

B.2 State and, if applicable, describe any differences from the rules set out in the Companies Act for the adoption of corporate resolutions:

No

Describe how they differ from the rules provided by the Companies Act.

	Qualified majority other than that established in section 201.2 of the Companies Act for the cases set forth in section 194.1 of the Companies Act	Other instances in which a qualified majority is required
% established by the entity for the adoption of resolutions		

Description of difference

B.3 State the rules applicable to the amendment of the by-laws of the company. In particular, disclose the majorities provided for amending the by-laws, and any rules provided for the protection of the rights of the shareholders in the amendment of the by-laws.

The amendment to the Articles of Association is regulated by Articles 24, 32 and 68 of the Articles of Association and Article 2 of the Regulations of the General Meeting.

The shareholders, assembled at a duly convened Shareholders' Meeting, shall resolve upon the matters within its competence by simple majority vote in general. Accordingly, a motion will be deemed to have been adopted if the votes in favour of the capital present or represented exceed the votes against.

All shareholders, including dissidents and those that have not taken part in the Meeting, are subject to the resolutions of the Shareholders' Meeting.

For the valid ratification at ordinary or extraordinary Shareholders' Meetings of bond issues, an increase or decrease in capital, the suppression or curtailment of pre-emptive subscription rights in issues of new shares or convertible bonds and the transformation, merger, demerger, transfer en bloc of assets and liabilities, the transfer of registered office abroad and in general any amendment to the Company's Articles of Association, the attendance of shareholders, in person or by proxy, holding at least fifty per cent (50%) of the subscribed voting share capital will be necessary at first call. When the Meeting is convened for a second time, the shareholders present or represented owning twenty-five per cent (25%) of the aforesaid capital shall suffice.

In these cases, if the present or represented capital exceeds 50%, the agreement will be adopted by an absolute majority. However, a favorable vote of two thirds of the capital present or represented at the Meeting will be required when, on second call, there are shareholders representing 25% or more of the subscribed capital with voting rights without reaching 50%.

Amendments to the Articles of Association require the approval of the Shareholders' Meeting subject to the following requirements:

- 1) That the Board of Directors or, where appropriate, the shareholders responsible for the proposal, draw up a written report to justify the proposed amendment.
- 2) The notice of the Shareholders' Meeting must clearly set out the proposed amendment and state that all shareholders are entitled to examine the full text of the proposed amendment and the report in connection with same at the registered offices and on the corporate web site, and to obtain a copy or have it delivered to them free of charge.
- 3) The decision must be adopted by the Shareholders' Meeting as provided in these Articles of Association.
- 4) The decision must be expressed in a public instrument, registered with the Mercantile Registry and published in the Official Bulletin of the Mercantile Registry.

B.4 State the data on attendance at the general shareholders' meetings held during the financial year referred to in this report and those of the prior financial year:

Date of General Shareholders' Meeting	% of shareholders present in person	% of shareholders represented by proxy	Attendance data		% Total
			% absentee voting		
			Electronic vote	Other	
04/05/16	68.67	8.77	0	0	77.44
20/04/17	68.66	13.34	0	0	82

B.5 State whether there are any by-law restrictions requiring a minimum number of shares to attend the general shareholders' meeting.

Yes

Number of shares required to attend the general shareholders' meeting	100
---	-----

B.6 Section deleted.

B.7 State the address and method for accessing the company's website to access information regarding corporate governance and other information regarding general shareholders' meetings that must be made available to the shareholders through the company's website.

Information regarding Corporate Governance can be accessed at this address:
www.gasnaturalfenosa.com – Shareholders and Investor – Corporate Governance.

Information regarding the general shareholders' meeting of the Company can be accessed at this address:
www.gasnaturalfenosa.com – Shareholders and Investors – General Shareholders' Meeting.

C. Structure of the Company's Management

C.1 Board of directors.

C.1.1 Maximum and minimum number of directors set forth in the by-laws:

Maximum number of directors	20
Minimum number of directors	10

C.1.2 Complete the following table identifying the members of the board:

Individual or company name of director	Representative	Type of director	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. Mario Armero Montes		Proprietary	Director	21/09/2016	20/04/2017	General Shareholders' Meeting
Mrs. Helena Herrero Starkie		Independent	Director	04/05/2016	04/05/2016	General Shareholders' Meeting
Mr. Miguel Martinez San Martin		Proprietary	Director	14/05/2015	14/05/2015	General Shareholders' Meeting
Mrs. Cristina Garmendia Mendizabal		Independent	Director	14/05/2015	14/05/2015	General Shareholders' Meeting
Mr. Josu Jon Imaz San Miguel		Proprietary	Vicepresident 1°	21/09/2016	20/04/2017	General Shareholders' Meeting
Mr. Luís Suárez De Lezo Mantilla		Proprietary	Director	26/02/2010	20/04/2017	General Shareholders' Meeting
Mr. Marcelino Armenter Vidal		Proprietary	Director	21/09/2016	20/04/2017	General Shareholders' Meeting
Mr. Isidro Faine Casas		Proprietary	Chairman	18/05/2015	18/05/2015	General Shareholders' Meeting
Mr. Ramón Adell Ramón		Independent	Director	18/06/2010	14/05/2015	General Shareholders' Meeting
Mr. Enrique Alcántara-García Irazoqui		Proprietary	Director	27/06/1991	20/04/2017	General Shareholders' Meeting
Mr. Rafael Villaseca Marco		Executive	Chairman & CEO	28/01/2005	14/05/2015	General Shareholders' Meeting
Mr. Francisco Belil Creixell		Independent	Director	14/05/2015	14/05/2015	General Shareholders' Meeting
Mr. Xabier Añoveros Trias De Bes		Independent	Director	20/04/2012	14/05/2015	General Shareholders' Meeting
Mr. Alejandro García-Bragado Dalmau		Proprietary	Director	21/09/2016	20/04/2017	General Shareholders' Meeting
Mrs. Benita María Ferrero-Waldner		Independent	Director	14/05/2015	14/05/2015	General Shareholders' Meeting
Mr. Rajaram Rao		Proprietary	Director	21/09/2016	20/04/2017	General Shareholders' Meeting
Mr. William Alan Woodburn		Proprietary	Vicepresident 2°	30/09/2016	20/04/2017	General Shareholders' Meeting
Total number of directors						17

State the vacancies on the board of directors during the reporting period:

Individual or company name of director	Class of director at time of vacancy	Date of vacancy
--	--------------------------------------	-----------------

C.1.3 Complete the following tables about the members of the board and each member's status:

Executive Directors

Individual or company name of director	Position within the company's structure
Mr. Rafael Villaseca Marco	Chairman & CEO
Total number of executive directors	1
% total directors	5.88

External proprietary director

Individual or company name of director	Individual or company name of the significant shareholder represented by the director or that has proposed the director's appointment
Mr. Mario Armero Montes	Gip III Canary 1 S. À R.L
Mr. Miguel Martinez San Martin	Repsol, S.A.
Mr. Josu Jon Imaz San Miguel	Repsol, S.A.
Mr. Luís Suárez De Lezo Mantilla	Repsol, S.A.
Mr. Marcelino Armenter Vidal	Criteria Caixa, S.A.U.
Mr. Isidro Faine Casas	Criteria Caixa, S.A.U.
Mr. Enrique Alcántara-García Irazoqui	Criteria Caixa, S.A.U.
Mr. Alejandro García-Bragado Dalmau	Criteria Caixa, S.A.U.
Mr. Rajaram Rao	Gip III Canary 1 S. À R.L
Mr. William Alan Woodburn	Gip III Canary 1 S. À R.L
Total number of proprietary directors	10
% total directors	58.82

External independent directors

Individual or company name of director	Profile
Mrs. Helena Herrero Starkie	Degree in Chemical Sciences. She is President and CEO of Hewlett Packard (HP) for Spain and Portugal.
Mrs. Cristina Garmendia Mendizabal	Doctorate in Biology. She was Minister of Science and Innovation for the Spanish Government from 2008 to 2011. She forms part of the International Advisory Committee for the Productive Transformation Programme of the Colombian Government.
Mr. Ramón Adell Ramón	Doctor in Economic and Business Sciences. Graduate in Law. Professor of Financial Economics and Accounting at the University of Barcelona. He is an academic-elect at the Spanish Royal Academy of Economic and Financial Sciences (Real Academia de Ciencias Económicas y Financieras de España) and an Honorary Member of the European Higher Council of Doctors and Doctors Honoris Causa (Consejo Superior Europeo de Doctores y Doctores Honoris Causa).
Mr. Francisco Belil Creixell	Senior Engineer. He has been a CEO of the South-west Europe region for Siemens, Chairman of the German Chamber of Commerce for Spain and of the Spanish Chemical Industry Federation (Federación de la Industria Química Española).
Mr. Xabier Añoveros Trias de Bes	Doctor in Law and Economic Sciences. Professor of the Masters Degrees in Bankruptcy Law and Capital Companies at the Bar Association of Barcelona (Colegio de Abogados de Barcelona) and in Financial Sectors at the Law Faculty at the University of Barcelona. He is an academic of the Royal European Academy of Doctors (Real Academia Europea de Doctores).
Mrs. Benita María Ferrero-Waldner	Doctorate in Law. An Austrian diplomat, she was in charge of several embassies before becoming Secretary of State for External Relations and Minister of External Relations in Austria, as well as Chair of the Organisation for Security and Cooperation in Europe. She was Commissioner for External Relations and European Neighbourhood Policies and a Trade Commissioner for the European Commission.
Total number of independent director	6
Total % of the board	35.29

State whether any director classified as independent receives from the company or its group any amount or benefit for items other than director remuneration, or maintains or has maintained during the last financial year a business relationship with the company or with any company of its group, whether in the director's own name or as a significant shareholder, director, or senior officer of an entity that maintains or has maintained such relationship.

If applicable, include a reasoned statement of the director regarding the reasons for which it is believed that such director can carry out the duties thereof as an independent director.

Individual or company name of director	Description of the relationship	Reasoned statement
Mrs. Cristina Garmendia Mendizabal	She is Director of Science & Innovation Link, Office (SILO), an organisation that has provided services to a company in the Gas Natural Fenosa Group.	The business relationship held with Science & Innovation Link, Office cannot under any circumstances be classified as significant given the immaterial amount involved.

Other external director

Identify the other external directors and describe the reasons why they cannot be considered proprietary or independent directors as well as their ties, whether with the company, its management, or its shareholders:

Individual or company name of director	Reasons	Company, officer, or shareholder with which the director has ties
--	---------	---

Total number of other external director

Total % of the board

State the changes, if any, in the class of each director during the period:

Individual or company name of director	Date of change	Former class	Current class
--	----------------	--------------	---------------

C.1.4 Complete the following table with information regarding the number of female directors for the last 4 financial years, as well as the status of such directors:

	Number of female directors				% of total directors of each class			
	Financial year t	Financial year t-1	Financial year t-2	Financial year t-3	Financial year t	Financial year t-1	Financial year t-2	Financial year t-3
Executive	0	0	0	0	0	0	0	0
Proprietary Member	0	0	0	0	0	0	0	0
Independent	3	3	2	0	17.65%	17.65%	11.76%	0
Other external	0	0	0	0	0	0	0	0
Total:	3	3	2	0	17.65%	17.65%	11.76%	0

C.1.5 Explain the measures, if applicable, that have been adopted to ensure that there is a sufficient number of female directors on the board to guarantee an even balance between men and women.

Explanation of the measures

The Company addresses the principle of diversity in the composition of its Board of Directors and also respects the right of shareholders to make the proposals for the appointment of Directors that they deem appropriate in accordance with the legal mandate of proportional representation. Therefore, while the Board of Directors is respectful of the proposals of proprietary directors received from shareholders, with regard to independent directors, the proposal corresponds to the Appointments and Remuneration. The latter has adopted an active approach to achieving such diversity in recent renewals. As a consequence, in the proposal to the 2015 Shareholders' Meeting, half of the new independent directors were men and the other half were women and at the 2016 Shareholders' Meeting, since there was only one renewal, it was decided that the only counsellor to propose was a woman. At the 2017 meeting, the Directors whose terms had expired were renewed. The result is that in a short period of time equality has been reached among the independent directors.

C.1.6 Explain any measures approved by the appointments committee in order for selection procedures to be free of any implied bias that hinders the selection of female directors, and in order for the company to deliberately search for women who meet the professional profile that is ought and include them among potential candidates:

Explanation of the measures

The Appointments and Remuneration Committee is charged with the task of reviewing the necessary skills in the candidates who must fill each vacancy, meeting the requirements for each category of Directors and the process of incorporating the new members, reports or proposals where appropriate. When new vacancies need to be filled, steps are taken to ensure that the selection is free from any implied bias that may hinder the proposing of female directors. Women who meet the profile sought are included among the potential candidates, under the same conditions.

If there are few or no female directors despite any measures adopted, describe the reasons for such result:

Explanation of the reasons

Female Directors account for 17.65% of the total number of Directors. The Company has been gradually adding female Directors to its Board of Directors and has gone from 0 female Directors in 2014 to 3 in 2016, maintaining that number in 2017, having managed to achieve equality among the Independent Directors in a short space of time. As indicated, this recommendation must coexist with respect for the legal mandate of proportional representation of the significant shareholders.

C.1.6 bis Explain the conclusions of the appointments committee regarding verification of compliance with the director selection policy. In particular, explain how this policy is promoting the aim that by 2020 the number of female directors will represent at least 30% of the total members of the board of directors.

The Appointments and Remuneration Committee has verified the Directors' Selection Policy and has concluded that it is in accordance with a very defined shareholder structure that imposes respect for certain legal requirements of proportional representation of shareholders, which should be made compatible with the Corporate Governance recommendations. The Appointments and Remuneration Committee is satisfied that with the achievements after the 2017 Shareholders' Meeting have been maintained in the restructuring of corporate governance in September 2016.

As already indicated, the result of this policy is the increase from 0 female Directors in 2014 to 3 in 2016, maintaining that number in 2017, having managed to achieve equality among the Independent Directors in a short space of time.

Separately to this, the Appointments and Remuneration Committee considers it appropriate and invites the main shareholders to consider, along with other factors, particularly those aspects that could have a special impact on the Board's performance, the convenience of aiming for equality not only between the independent directors, but also the Board as a whole.

C.1.7 Explain the form of representation on the board of shareholders with significant holdings.

Of the four significant shareholders that the Company currently has, only three of them have proprietary Directors. Criteria Caixa, S.A.U. has four Proprietary Directors, Repsol, S.A. And GIP III Canary, 1 S À R.L. each of them has three Proprietary Directors and Société Nationale pour la Recherche, la Production, le Transport, Transformation et la Commercialization does not have any proprietary Director. This representation is fully consistent with the principle of proportional representation.

C.1.8 Explain, if applicable, the reasons why proprietary directors have been appointed at the proposal of shareholders whose shareholding interest is less than 3% of share capital.

Individual or company name of the shareholder	Reason
---	--------

State whether there has been no answer to formal petitions for presence on the board received from shareholders whose shareholding interest is equal to or greater than that of others at whose proposal proprietary directors have been appointed. If so, describe the reasons why such petitions have not been answered:

No

Individual or company name of the shareholder	Explanation
---	-------------

C.1.9 State whether any director has withdrawn from the position as such before the expiration of the director's term of office, whether the director has given reasons to the board and by what means, and in the event that the director gave reasons in writing, describe at least the reasons given thereby:

Name of director	Reason for withdrawal
------------------	-----------------------

C.1.10 State any powers delegated to the CEO(s):

Individual or company name of director	Brief description
--	-------------------

Mr. Rafael Villaseca Marco	He has delegated broad powers of representation and administration according to the characteristics and needs of the position of CEO.
----------------------------	---

C.1.11 Identify any members of the board who are directors or officers of companies within the listed company's group:

Individual or company name of the director	Name of entity within the group	Position	Do he/she have executive duties?
--	---------------------------------	----------	----------------------------------

C.1.12 Identify the directors of your company, if any, who are members of the board of directors of other companies listed on official stock exchanges other than those of your group, which have been reported to your company:

Individual or company name of the director	Name of listed entity	Position
Mrs. Cristina Garmendia Mendizábal	Corporación Financiera Alba, S.A.	Director
Mrs. Cristina Garmendia Mendizábal	Compañía De Distribución Integral Logista Holdings, S.A.	Director
Mrs. Cristina Garmendia Mendizábal	Sygnis Ag	Chairman
Mr. Josu Jon Imaz San Miguel	Repsol, S.A.	Chairman & CEO
Mr. Luís Suárez De Lezo	Repsol, S.A.	Secretary of the Board/Board Member
Mr. Marcelino Armenter Vidal	Abertis Infraestructuras, S.A.	Director
Mr. Isidro Fainé Casas	The Bank Of East Asia	Director
Mr. Isidro Fainé Casas	Suez Environnement Company, S.A.	Director
Mr. Isidro Fainé Casas	Telefónica, S.A.	Vicepresident
Mr. Ramón Adell Ramón	Oryzon Genomics, S.A.	Director
Mrs. Benita Ferrero-Waldner	Munich Reinsurance CO	Director
Mr. Alejandro García-Bragado Dalmau	Caixabank, S.A.	Director
Mrs. Cristina Garmendia Mendizábal	Mediaset	Director
Mr. William Alan Woodburn	Hess Midstream Partners	Director
Mr. Marcelino Armenter Vidal	Grupo Financiero Inbursa	Director

C.1.13 State and, if applicable, explain whether the regulations of the board have established rules regarding the maximum number of boards of which its directors may be members:

No

Explanation of rules

C.1.14 Section deleted.

C.1.15 State the overall remuneration of the board of directors:

Remuneration of the board of directors (thousands of euros)	7,857
Amount of pension rights accumulated by the directors (thousands of euro)	3,648
Amount of pension rights accumulated by former directors (thousands of euro)	0

C.1.16 Identify the members of the company's senior management who are not executive directors and state the total remuneration accruing to them during the financial year:

Individual or company name	Position
Mrs. Rosa M ^a Sanz García	Managing Director of People and Resources
Mr. Manuel Fernández Álvarez	Managing Director of Wholesale Energy Business
Mr. José María Egea Krauel	Managing Director of Energy Planning
Mr. Antoni Peris Mingot	Managing Director of Regulated Business
Mr. Daniel López Jordà	Managing Director of Retail Energy Business
Mr. Sergio Aranda Moreno	Managing Director for Latin America
Mr. Antonio Basolas Tena	Managing Director of Strategy and Development
Mr. Carlos Ayuso Salinas	Director of Internal Audit, Compliance and Control
Mr. Jordi García Taberner	Managing Director of Communication and Institutional Relations
Mr. Carlos Javier Álvarez Fernández	Chief Financial Office
Mr. Manuel García Cobaleda	Legal Services General Manager and Boards of Directors' Secretary
Total senior management remuneration (in thousands of euros)	9,851

C.1.17 State the identity of the members of the board, if any, who are also members of the board of directors of significant shareholders and/or in entities of their group:

Individual or company name of director	Company name of the significant shareholder	Position
Mr. Josu Jon Imaz San Miguel	Repsol, S.A.	Chairman & CEO
Mr. Luís Suárez De Lezo Mantilla	Repsol, S.A.	Secretary of the board/board member
Mr. Marcelino Armenter Vidal	Caixa Capital Risc S.G.E.I.C., S.A.	Executive Chairman
Mr. Isidro Fainé Casas	Criteria Caixa, S.A.U.	Chairman
Mr. Alejandro Garcia-Bragado Dalmau	Criteria Caixa, S.A.U.	First Vice President
Mr. Marcelino Armenter Vidal	Inmo Criteria Caixa, S.A.	Director
Mr. Marcelino Armenter Vidal	Mediterránea Beach & Golf Community, S.A.U.	Chairman

Describe any significant relationships, other than the ones contemplated in the prior item, of the members of the board of directors linking them to significant shareholders and/or companies within their group:

Individual or company name of related director	Individual or company name of related significant shareholder	Description of relationship
Mr. Miguel Martinez San Martin	Repsol, S.A.	Cfo and Corporate Development
Mr. Luis Suárez De Lezo Mantilla	Repsol, S.A.	Secretary of the Board
Mr. Marcelino Armenter Vidal	Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Managing Director Criteria Caixa, S.A.U.
Mr. Isidro Fainé Casas	Fundación Bancaria Caixa D'estalvis I Pensions De Barcelona (la Caixa)	Chairman of the Board of Trusteesmr
Mr. Rajaram Rao	Global Infrastructure Partners III	Shareholder
Mr. William Alan Woodburn	Global Infrastructure Partners III	Chairman of the Portfolio Management Committee

C.1.18 State whether the regulations of the board have been amended during the financial year:

No

Description of changes

C.1.9 State the procedures for the selection, appointment, re-election, evaluation, and removal of directors. Describe the competent bodies, the procedures to be followed, and the criteria applied in each of such procedures.

The procedures for the selection, appointment, re-election, evaluation, and removal of directors are established in Articles 41 and 42 of Articles of Association and in articles 4, 11 to 15 and 31 of Regulations of the Board of Directors.

1.- Appointment of Board Members:

The Board Members shall be designated by the General Shareholders Meeting or by the Board of Directors, in accordance with the provisions of the Corporate Enterprises Act and in the Article 41 of Association of the Company.

If vacancies occur during the term for which the Directors were appointed, the Board may appoint, through the co-opting system, the people who must occupy them until the first General Shareholders' Meeting is held.

These people are not required to be shareholders in order to be appointed as Directors.

People who are in any of the circumstances that, in accordance with the current legislation, impede them from being Independent Directors cannot be proposed, appointed or classified as such.

The Board Members that are designated must be persons that, in addition to their compliance with all legal requirements and all terms provided for under the Articles of Association in respect of the appointment thereof, are prestigious and well-known persons that have adequate knowledge and professional expertise in respect of the exercise of their functions.

The appointment and re-election of Directors is subject to a formal and transparent procedure, with a prior report/proposal from the Appointments and Remuneration Committee.

The proposals for the appointment of Board Members that the Board of Directors submits to the General Shareholders Meeting for consideration and the decisions for the appointment thereof that are adopted by the General Shareholders Meeting by virtue of the co-option powers that are legally available thereto, must be preceded by a proposal from the Appointments and Remuneration Committee in the case of Independent Board Members or by a report for the rest of the Board Members. When the Board diverges from recommendations of said Committee, the reasons for said divergence must be justified and formally recorded in the Minutes of the meeting.

2.- Re-election of Board Members:

The Board Members shall exercise their position during the maximum term of three years, and may be re-elected. The Board Members designated pursuant to the co-option system shall exercise their positions subject to the terms provided for under applicable legislation.

The Appointments and Remuneration Committee, which is responsible for the evaluation of the quality of the work and the commitment to their positions of the Board Members that have been proposed during the preceding mandate, must, necessarily, propose, in the case of Independent Board Members and must inform in respect of the rest of the Board Members, regarding the proposal for the re-election of Board Members that the Board of Directors decides to present to the General Shareholders Meeting.

Independent directors will not be in the charge for a period of more than 12 years.

3.- Evaluation:

According to Article 4.5. of Regulations of the Board of Directors, the Board will evaluate periodically its performance, as well as the performance of the different Committees.

4.- Removal of Board Members:

The Directors shall cease to hold office for the term for which they were appointed, unless re-elected and when the General Meeting decides to use the powers it holds. Likewise, they shall cease in all other cases in which they may do so in accordance with the Law, the Articles of Association and the Regulations of the Board of Directors.

The Board Members must present their resignation from the Board of Directors and must formalize, if the Board deems necessary, their corresponding formal resignation from office in the following situations:

- a) When the Executive Board Members cease to exercise their executive functions.
- b) When the Board Members are subject to any of the situations of disqualification or prohibition as provided for under applicable law, under the Articles of Association or under these Regulations.
- c) When the Board Members seriously breach their obligations as Board Members, thereby placing the interests of the Company at risk.
- d) When the reason for which the Board Members were appointed as Independent Board Members, Executive Board Members or Proprietary Board Members no longer exists.

In accordance with the terms of Article 15.4 of the Regulations of the Board of Directors, when an Independent Board Member is removed from office prior to the conclusion of the mandate for which he or she was appointed, the reasons for said removal from office must be explained in a letter addressed to the rest of the Board Members. The removal of the Board Members shall be notified as relevant information.

In any case, it should be noted that the Board of Directors pays special attention to diversity issues, and not just gender issues, within the framework of fully respecting the rights of shareholders recognised by the Law of Proportional Representation. This has translated into the current members of the Board of Directors having different professional profiles and careers, which complement each other. The Board of Directors is made up of Directors who have clearly domestic and international financial profiles, business profiles, experience in the institutional field and in the international relations, legal and corporate governance areas, are involved in the world of innovation and new technologies, etc. The Board of Directors considers this circumstance to be especially relevant because it contributes to promoting a more complete and inclusive view when analysing the different issues submitted to it.

C.1.20 Explain the extent to which the self-evaluation of the board has given rise to significant changes in its internal organization and regarding the procedures applicable to its activities:

Description of changes

The Board of Directors' self-assessment has not led to major changes in the internal organization and procedures applicable to its activities. The Board concludes in its report that during the 2017 financial year it has functioned with expected normality, fully exercising its powers with respect to the legislation and the regulations governing the organisation and functioning of the Board Regulations.

Irrespective of the fact that the Chairman of the Board and the Managing Director have intervened in all matters submitted to the Board, the diversity of profiles of the members of the Board of Directors has resulted in their interventions standing out in matters such as:

Mr. Josu Jon Imam San Miguel: energy efficiency and gas distribution investment in Mexico. Evolution of international markets.

Mr. William Alan Woodbury: Electricaribe. Environment, health and safety.

Mr. Rampant Dell Rampant: energy policy in Spain. Financial aspects.

Mr. Enricher Alimentary-Garcia Iroquoian: gas networks in Europe. Situation of Electrical.

Mr. Xabier Añoveros Trias de Bes: energy poverty. International legal security.

Mr. Marcelino Armenter Vidal: Economic issues. Investment criteria.

Mr. Mario Armero Montes: high cost of technological development. Aspects of the Group's personnel.

Mr. Francisco Belil Creixell: disinvestment and renewables. International strategy.

Mrs. Benita María Ferrero-Waldner: coal in Europe and other regulatory matters.

Mr. Alejandro Garcia-Bragado Dalmau: technological development. Regulatory risk of disinvestment. Corporate governance.

Mrs. Cristina Garmendia Mendizábal: investments in automotive technology: electric vehicles. Innovation. Strategy.

Mrs. Helena Herrero Starkie: energy poverty and new technologies.

Mr. Miguel Martínez San Martín: marketing. Disinvestment and renewables.

Mr. Rajaram Rao: Budget and Financing Plan.

Mr. Luis Suárez de Lezo Mantilla: situation of gas distribution in Colombia. Corporate governance.

C.1.20 bis Describe the process of self-evaluation and the areas evaluated by the board of directors, as it may be assisted by an external consultant, regarding diversity in its composition and powers, the operation and composition of its committees, the performance of the chairman of the board and chief executive officer, and the performance and contribution of each director.

The evaluation process carried out has been adapted to the corporate governance model and the needs of GAS NATURAL FENOSA, having been developed in the following stages:

Stage 1: 1. Establishment of a work schedule and preparation of surveys to be completed by the Directors. 2. Sending of surveys to each Director for completion; and 3. Receipt of surveys and preparation for personal interviews.

Stage 2: 4. Personal interviews with the Directors. 5. Analysis of the results obtained and preparation of an evaluation report of the Board of Directors and of each of the Committees for their submission to the Appointments and Remuneration Committee.

The evaluation process has examined: (i) the quality and efficiency of the operations of the Board of Directors, (ii) the operation and composition of the Committees of the Board of Directors, (iii) the diversity in the composition and powers of the Board of Directors, (iv) the performance of the Chairman of the Board of Directors and the Company's chief executive and (v) the performance and contribution of those responsible for the different Board Committees.

C.1.20 ter. List any business relationships of the consultant or any company of its group with the company or any company of its group.

Neither

C.1.21 State the circumstances under which the resignation of directors is mandatory.

The Directors shall cease to hold office for the term for which they were appointed, unless re-elected and when the General Meeting decides to use the powers it holds. Likewise, they shall cease in all other cases in which they may do so in accordance with the Law, the Articles of Association and the Regulations of the Board of Directors.

The Board Members must present their resignation from the Board of Directors and must formalize, if the Board deems necessary, their corresponding formal resignation from office in the following situations:

- a) When the Executive Board Members cease to exercise their executive functions.
- b) When the Board Members are subject to any of the situations of disqualification or prohibition as provided for under applicable law, under the Articles of Association or under these Regulations.
- c) When the Board Members seriously breach their obligations as Board Members, thereby placing the interests of the Company at risk.
- d) When the reason for which the Board Members were appointed as Independent Board Members, Executive Board Members or Proprietary Board Members no longer exists.

C.1.22 Section deleted.

C.1.23 Are qualified majorities, different from the statutory majorities, required to adopt any type of decision?

Yes

If so, describe the differences.

Description of differences

Article 10.4 of Regulations of the Board of Directors provides as follows:

"4. The resolutions and decisions must be adopted with the favourable vote of the absolute majority of the Board Members that are either present or represented thereat, unless the Corporate Enterprises Act, the Articles of Association or these Regulations provide for the need for a qualified majority. The written voting procedures, without a meeting session, shall only be possible when none of the Board Members are opposed to this voting procedure and provided that the requirements provided for under the Companies Register Regulations are satisfied.

In particular, the favourable vote of at least two thirds of the Board Members, present or represented, shall be necessary for the valid adoption of the resolutions and decisions regarding the following aspects, that are reserved for the plenary session of the Board and, accordingly, are not able to be delegated.

- a) The acquisition or disposal of assets that belong to the Company (irrespective of the legal nature of said operations and, in particular, although said operations are carried out by means of merger or split-off operations or any other subsidiary company operations) for a sum that exceeds 500,000,000 Euros, unless the approval thereof corresponds to the General Shareholders Meeting or are carried out in execution of the budget or the strategic or business plan of the Company.
- b) The approval of the budget and the strategic or business plan of the Company.
- c) The modification of the dividends distribution policy and the approval of a new dividends distribution policy.
- d) The formalization, modification, renewal, non-renewal or termination by the Company of financing or refinancing contracts for a sum that exceeds 500,000,000 Euros.
- e) The formalization, modification, renewal, non-renewal or termination by the Company of any material contract, other than the contracts provided for under paragraph d) hereinabove, the amount of which exceeds 500,000,000 Euros in the case of gas procurement contracts and which exceeds 200,000,000 Euros in the case of other contracts.
- f) Any material modifications to the accounting or tax criteria and policies of the Company, unless they are the result of modifications to applicable legislation or of the application of directives or criteria established by competent public authorities.
- g) The redrafting of the annual accounts of the Company, unless said redrafting is the result of any legislative modification or of the application of directives or criteria established by competent public authorities.
- h) Capital investments (CAPEX) not provided for in the annual budget of the Company that exceed 200,000,000 Euros.
- i) The modification of this paragraph i), the modification of the aspects and terms of paragraphs a) to h) hereinabove or the modification of the qualified majority voting requirements provided for in respect thereof.

C.1.24 Explain whether there are specific requirements, other than the requirements relating to directors, to be appointed chairman of the board of directors.

No

Description of requirements

C.1.25 State whether the chair has a tie-breaking vote:

No

Matters on which a tie-breaking vote may be cast

C.1.26 State whether the by-laws or the regulations of the board set forth any age limit for directors:

No

Age limit for the chair

Age limit for the CEO

Age limit for directors

C.1.27 State whether the by-laws or the regulations of the Board establish any limit on the term of office for independent directors that is different than the term provided by regulatory provisions:

No

Maximum number of terms

C.1.28 State whether there are formal rules for proxy-voting at meetings of the board of directors, the manner of doing so, and especially the maximum number of proxies that a director may hold, as well as whether any restriction has been established regarding the categories of directors to whom proxies may be granted beyond the restrictions imposed by law. If so, briefly describe such rules.

According to Article 47, paragraph two, of the Articles of Association: "Directors unable to attend may appoint another Director to act on their behalf, with no limit applying to the number of Directors that may be represented by another. Proxies must be granted in writing. Non-executive directors may grant proxy only to another non-executive director."

On the other hand, Article 10.3 of Regulations of the Board of Directors provides: "Each Board Member may confer his or her proxy representation upon another Board Member, without any limitation as to the number of proxy representations that may be held by the Board Members. The proxy representation of the absent Board Members may be formalised by any documented procedure whatsoever, including that of telegrams, e-mail, telex or facsimile addressed to the Chairman or the Secretary of the Board, a sufficient period of time beforehand."

C.1.29 State the number of meetings that the board of directors has held during the financial year. In addition, specify the number of times the board has met, if any, at which the chair was not in attendance. Proxies granted with specific instructions shall be counted as attendance.

Number of meetings of the board	15
Number of meetings of the board at which the chair was not in attendance	0

If the chair is an executive director, state the number of meetings held without the presence in person or by proxy of any executive director and chaired by the lead independent director.

Number of meetings	0
---------------------------	---

State the number of meetings held by the different committees of the board of directors during the financial year:

Number of meetings of the Executive Committee	3
Number of meetings of the Audit Committee	10
Number of meetings of the Appointments and Remuneration Committee	5
Number of meetings of the appointments Committee	
Number of meetings of the Remuneration Committee	
Number of meetings of Committee _____	

C.1.30 State the number of meetings that the board of directors has held during the financial year with the attendance of all of its members. Proxies granted with specific instructions shall be counted as attendance:

Number of meetings with the attendance of the directors	8
% in attendance of total votes during the financial year	97.25

C.1.31 State whether the annual individual accounts and the annual consolidated accounts that are submitted to the board for approval are previously certified:

Yes

Identify, if applicable, the person/persons that has/have certified the annual individual and consolidated accounts of the company for preparation by the board:

Name	Position
Mr. Carlos Javier Álvarez Fernández	Chief Financial Officer

C.1.32 Explain the mechanisms, if any, adopted by the board of directors to avoid any qualifications in the audit report on the annual individual and consolidated accounts prepared by the board of directors and submitted to the shareholders at the general shareholders' meeting.

Article 7 of the Regulation of the Board of Directors provides as follows: "1.- After the Board has received the reports issued by the Economic and Financial Department and by the Audit Committee, and after the pertinent clarifications in respect thereof, the Board of Directors shall draft, in clear and precise terms, that facilitate the adequate understanding of the content thereof, both the individual and consolidated Annual Accounts and Management Report. The Board of Directors shall ensure that the foregoing represent the true and fair image of the equity, the financial situation and the results of the Company, in accordance with the provisions of the Corporate Enterprises Act. 2.- Except in the case of any express declaration to the contrary, which must be formalized by way of formal Certificate, it shall be understood that, prior to the formalization of the Annual Accounts, as required pursuant to the Corporate Enterprises Act, the Board of Directors and each one of the members thereof, has been provided with all of the information necessary for the formalization thereof, and any necessary qualifications shall be included therein, as the case may be. 3.- The Board of Directors shall use their best endeavours to draft the accounts in such a way so that the accounts auditor of the Company is not required to include any qualifications whatsoever to the accounts. Notwithstanding the foregoing, when the Board of Directors considers that it must maintain its own criteria, the Board shall publicly explain the terms and scope of the discrepancy"

Prior to its submission to the Audit Committee and subsequently to the Board of Directors, the Company's Accounts are certified by the Economics and Finance Director General.

Pursuant to those established in article 51 bis of the Articles of Association and in the Capital Companies Act, the Audit Committee is responsible for, inter alia, the functions of informing the General Meeting of shareholders on matters arising in relation to matters within the competence of the Committee and, in particular, on the outcome of the audit, explaining how it has contributed to the integrity of the financial information and the role that the Committee has played in that process, process of preparation and presentation of the mandatory financial information and to present recommendations or proposals to the Board of Directors, aimed at safeguarding its integrity.

In addition, the Board of Directors of the Company has entrusted the Audit Committee with other powers to ensure that the Board of Directors seeks to present the accounts to the General Shareholders' Meeting without limitations or qualifications in the Audit Report and, in exceptional cases where there are exceptions, both the Chairman of the Committee and the Auditors explain to the shareholders the content and scope of such limitations.

C.1.33 Is the secretary of the board a director?

No

If the secretary is not a director, complete the following table:

Individual or Company name of the Secretary	Representative
Mr. Manuel García Cobaleda	

C.1.34 Section deleted.**C.1.35 State the mechanisms, if any, used by the company to preserve the independence of auditors, financial analysts, investment banks, and rating agencies.**

Among the legal duties of the Audit Committee are to establish the appropriate relations with the external auditor to receive information on issues that may threaten its independence, for its consideration by the committee, and any others related to the process, and where appropriate the authorization of services other than those prohibited under the conditions set out in Articles 5 (4) and 6.2 (b) of Regulation (EU) No 537 / 2014, of April 16, and as provided for in section 3 of Chapter IV of Title I of Law 22/2015, of July 20, Audit of Accounts, on the regime of independence, as well as those other communications provided for in the statutory audit and auditing standards. In any case, they must receive annually from the external auditors the declaration of their independence in relation to the entity or entities related to it directly or indirectly, as well as the detailed and individualized information of the additional services of any kind provided and the corresponding fees received of these entities by the external auditor or by the persons or entities related to it in accordance with the provisions of the regulations governing the audit activity.

It is also the function of the Audit Committee to issue annually, prior to the issuance of the audit report, a report that will express an opinion on whether the independence of auditors or audit firms is compromised. This report must contain, in any case, the reasoned assessment of the provision of each and every one of the additional services referred to in the previous letter, individually considered and as a whole, other than statutory audit and in relation to the regime of independence or with the regulations regulating the audit activity.

The Board of Directors has also entrusted the following functions to the Audit Committee: ensuring that the remuneration of the external auditor for their work does not compromise their quality or independence and ensure that the company and the external auditor respect the rules in force on the provision of services other than audit services, limits on the concentration of the auditor's business and, in general, on the other rules on the independence of auditors.

Additionally, Article 6.4 of the Council Regulation provides that "The Board of Directors shall ensure that a direct relationship is maintained with the members of the senior management bodies of the Company and with the Auditors thereof. The objective, professional and permanent nature of said relationship shall strictly respect the independence of the Auditors."

The principles underlying the Company's relationship with financial analysts and investment banks are based on transparency, simultaneity and non-discrimination, as well as the existence of specific and distinct partners for each group.

In addition, the Company pays particular attention not to compromise or interfere in the independence of financial analysts with respect to the services provided by investment banks, in accordance with the internal codes of conduct established by them and aimed at the separation of their Analytical and advisory services.

C.1.36 State whether the Company has changed the external auditor during the financial year. If so, identify the incoming and the outgoing auditor:

No

Outgoing auditor

Incoming auditor

If there has been any disagreement with the outgoing auditor, provide an explanation thereof:

No

Description of the disagreement

C.1.37 State whether the audit firm performs other non-audit work for the company and/or its group. If so, state the amount of the fees paid for such work and the percentage they represent of the aggregate fees charged to the company and/or its group:

Yes

	Company	Group	Total
Amount of other non-audit work (thousands of euros)	1,027	178	1,205
Amount of non-audit work / Aggregate amount billed by the audit firm (%)	44.2	5.9	22.6

C.1.38 State whether the audit report on the annual accounts for the prior financial year has observations or qualifications. If so, state the reasons given by the chair of the audit committee to explain the content and scope of such observations or qualifications.

No

Explanation of reasons

C.1.39 State the consecutive number of years for which the current audit firm has been auditing the annual accounts of the company and/or its group. In addition, state the percentage represented by such number of financial years audited by the current audit firm with respect to the total number of financial years in which the annual accounts have been audited:

	Company	Group
Number of continuous financial years	27	27
Number of years audited by the current audit firm / Number of years in which the company has been audited (%)	100	100

C.1.40 State whether there is any procedure for directors to hire external advisory services, and if so, describe it:

Yes

Describe the procedure

Article 21 of Regulations of the Board of Directors provides as follows: "1.- The Board Members shall have access, through the Chairman, and, as the case may be, through the Secretary, to all of the services of the Company and may compile and receive, with the broadest possible powers, the information and advisory services that may be required in relation to any aspect of the Company whatsoever. The right to information shall be extended to the subsidiary companies and shall be channelled through the Chairman or the Secretary of the Board of Directors or of the corresponding Committees of the Board, where the information shall be directly provided thereto, and the Board Members shall be provided with the appropriate liaisons or any measures necessary for the analysis thereof. 2.- Furthermore, the Board Members shall have the right to propose to the Board of Directors that the Company contract, at the cost and expense thereof, the legal advisors, accountants, technical professionals, financial advisors, commercial professionals or any other professional whatsoever that they consider necessary for the interests of the Company in order to assist the Board Members in the exercise of their functions, when related to specific problems of certain relevance and complexity that are associated with the exercise of their positions. 3.- Both the request for access as well as the proposal that are referred to under paragraphs 1 and 2 of this Article, must be notified to the Chairman of the Company through the Secretary of the Board. The Board of Directors may veto the approval of the proposal that is referred to under paragraph 2 of this Article if the Board considers that said proposal is unnecessary for the performance of the functions of the Board Member, or that the sum thereof is disproportionate in relation to the importance of the problem and the assets and revenue of the Company, or, finally, that said technical support or advisory services could be adequately provided by experts and technical staff of the Company."

C.1.41 State whether there is any procedure for directors to obtain sufficiently in advance the information required to prepare for meetings of management-level decision-making bodies and, if so, describe it:

Yes

Describe the procedure

Article 9, points 2 and 3, of the Regulations of the Board of Directors: "2.- The notification of the ordinary meeting sessions of the Board shall be carried out by the Chairman, or by the Secretary or Deputy Secretary, under the instructions of the Chairman, and shall be carried out by any of the notification channels that are provided for under the Articles of Association, and said documentation shall be forwarded by way of e-mail, provided that the recipient Board Member has provided an e-mail address for said purposes. The meeting notification shall include the place at which the meeting is to be held and the agenda thereto and shall be issued, except in exceptional cases, at least 48 hours prior to the meeting. Prior to each meeting, the Board Members shall be provided with the information and documentation considered to be pertinent or relevant in relation to the matters to be discussed at the meeting of the Board. Furthermore, the Board Members shall be provided with the Minutes of the previous meeting, whether or not approved. The Chairman shall be responsible for establishing the agenda for the meetings, except in the case of the compulsory meeting pursuant to paragraph 1 hereinabove, in which case the agenda for the meeting shall include the aspects set out by the Board Members that have requested the meeting of the Board. The constitution of the Board shall be valid, without the prior notification thereof, if all of the Board Members are either present or duly represented and provided that they unanimously accept the holding of the meeting of the Board. The meetings of the Board of Directors will normally take place at the registered office but they may also be held in any other place determined by the Chairman and indicated in the call. 3. The Board may also hold its meeting in various rooms simultaneously, provided that the real time interactivity and intercommunication between them, and therefore the unity of the act, is ensured through audio-visual or telephonic means. In said situations, the meeting notification shall set out the connection system to be used and, if applicable, the places in which the necessary technical resources shall be available in order to attend and participate at the meeting. The resolutions shall be deemed to be adopted at the place where the Chairman is physically present."

The procedure followed is to refer, usually one week in advance, to the date of the meeting, the agenda and any information that is available and may be useful for a more accurate knowledge of the matters to be discussed at the Board meeting.

Likewise, during the meeting, officers whose affairs are treated are available to be called - and, often, made use of - so that the Directors can request clarifications, data or opinions in relation to the points dealt with in the session.

Finally, Directors may request additional information that they deem necessary for the exercise of their functions through the Board Secretariat.

C.1.42 State whether the company has established any rules requiring directors to inform the company — and, if applicable, resign from their position— in cases in which the credit and reputation of the company may be damaged, and if so provide a detailed description:

Yes

Explain the rules

Pursuant to Article 16.3 (e) of the Board Regulations, the Director is subject to the duty of loyalty under the terms established in current legislation and, in particular, the Director shall inform the Company of any kind of judicial, administrative or Any nature in which it is implied that, because of its importance, could seriously affect the reputation of the Company. The Board shall examine the matter and take such measures as may be desirable in the interest of the Company with the required urgency.

The Board Members must present their resignation from the Board of Directors and must formalize, if the Board deems necessary, their corresponding formal resignation from office in the following situations:

- a) When the Executive Board Members cease to exercise their executive functions.
- b) When the Board Members are subject to any of the situations of disqualification or prohibition as provided for under applicable law, under the Articles of Association or under these Regulations.
- c) When the Board Members seriously breach their obligations as Board Members, thereby placing the interests of the Company at risk.
- d) When the reason for which the Board Members were appointed as Independent Board Members, Executive Board Members or Proprietary Board Members no longer exists.

C.1.43 State whether any member of the board of directors has informed the company that such member has become subject to an order for further criminal prosecution upon indictment or that an order for the commencement of an oral trial has been issued against such member for the commission of any of the crimes contemplated in section 213 of the Companies Act:

No

State whether the board of directors has analysed the case. If so, provide a duly substantiated explanation of the decision adopted regarding whether or not the director should remain in office or, if applicable, describe the actions taken by the board of directors through the date of this report or that it plans to take.

No

C.1.44 Describe the significant agreements entered into by the company that go into effect, are amended, or terminate in the event of a change in control at the company as a result of a takeover bid, and effects thereof.

An important part of the investments with partners outside the group contain clauses of change of control that allow the other partner to choose to acquire the shares in case of change of control of the holding company of the group Gas Natural Fenosa.

On the other hand, most of the debt that includes a change of control clause, either by acquiring more than 50% of the voting shares or by obtaining the right to appoint the majority of the members of the Board of Directors of Gas Natural, are subject to additional conditions such as a significant reduction in the credit rating or rating caused by the change of control; material damage to the creditor; entails a material adverse change in the solvency or ability to perform the contract. These clauses represent the repayment of the debt, although they usually have a longer period than the one granted in cases of early ruling; in some cases the granting of guarantees is contemplated as an alternative to reimbursement.

Specifically, the bonds issued, in an approximate volume of 11,200 Million Euros, as is usual in the euromarket, would be subject to early maturity, provided that this change of control caused a three-step or three full notches fall in at least two of the three qualifications it had and all ratings fell below "investment grade" and whenever the Rating Agency expressed that the reduction of the credit rating is motivated by the change of control.

There are also loans for an amount of approx. 2,800 million Euros which could be subject to early repayment in the event of a change of control, most of this amount linked to infrastructure financing with funds from the European Investment Bank. Financing that was taken for the acquisition of Unión Fenosa. They also require a reduction in the rating and have special repayment terms that are longer than those of early termination cases.

Most of the change control clauses are linked to the occurrence of damage to creditors or significant reductions in rating. Most of the change in control is excluded if any of the current shareholders hold relevant interests in the company jointly with a third party. Some contract provides for the granting of guarantees as an alternative to reimbursement of the amount arranged and generally have special debt repayment terms that are longer than those of early termination cases.

C.1.45 Identify on an aggregate basis and provide a detailed description of the agreements between the company and its management level and decision-making positions or employees that provide for indemnities, guarantee or "golden parachute" clauses upon resignation or termination without cause, or if the contractual relationship is terminated as a result of a takeover bid or other type of transaction.

Number of beneficiaries 25

Type of beneficiary Description of agreement

Management Committee and other officers

The Chief Executive's contract was amended in October 2016 regarding the causes and termination regime, with the said clause of the contract being amended and extending its duration to its entire mandate as a Director of the Company.

The CEO's contract establishes an indemnity in the amount of three annuities of the total remuneration at the date of the contractual modification for certain cases of extinction of the contractual relationship: by decision of the company, unless very serious breach and culpable of his professional obligations which causes serious prejudice to the interests of Gas Natural SDG SA, by decision of the Chief Executive Officer or by termination of the contract. In addition, and as a post-contractual non-competition agreement for one year, an indemnity equivalent to one year of full compensation is established.

The contracts signed with the members of the Management Committee and the Director of Internal Audit contain a clause that establishes an indemnity between two and three and half years of remuneration in certain cases of termination of the relationship, which include certain cases of change of control, unfair dismissal or the circumstances contemplated in articles 40, 41 or 50 of the Workers' Statute. These contracts also contain a clause establishing compensation equivalent to one year of fixed remuneration for post-contractual non-competition for a period of two years.

Number of beneficiaries 25

Type of beneficiary	Description of agreement
Management Committee and other officers	<p>Also, compensation agreements exist with sixteen other executives, equivalent to one year of fixed remuneration for post-contractual non-competition for a period of two years.</p> <p>In addition, twelve executives, who partially coincide with the previous ones, have compensation agreements whose amounts entitle them to receive a minimum compensation of one year of fixed remuneration in one case and two years of remuneration in others in certain cases of termination of the relationship, which include unfair dismissal and the circumstances contemplated in arts. 40, 41 or 50 of the Workers' Statute.</p>

State whether such agreements must be reported to and/or approved by the decision-making bodies of the company or its group:

	Board of directors	General Shareholders' Meeting
Decision-making body approving the provisions	Yes	No
Is information about these provisions provided to the shareholders at the general shareholders' meeting?	Yes	

C.2 Committees of the board of directors.

C.2.1 Describe all of the committees of the board of directors, the members thereof, and the proportion of executive, proprietary, independent, and other external directors of which they are comprised:

Executive Committee

Name	Position	Class
Mr. Isidro Fainé Casas	Chairman	Proprietary
Mr. Ramón Adell Ramón	Member	Independent
Mr. Marcelino Armenter Vidal	Member	Proprietary
Mr. Francisco Belil Creixell	Member	Independent
Mrs. Benita María Ferrero-Waldner	Member	Independent
Mr. Josu Jon Imaz San Miguel	Member	Proprietary
Mr. Miguel Martínez San Martín	Member	Proprietary
Mr. Rajaram Rao	Member	Proprietary
Mr. Rafael Villaseca Marco	Member	Executive
Mr. William Alan Woodburn	Member	Proprietary
% executive directors		10
% proprietary directors		60
% independent directors		30
% other external directors		-

Explain the duties assigned to this committee, describe the procedures and rules of organization and operation thereof, and summarize the most significant activities thereof during the year.

a) Functions of the executive committee:

Aspects that are ordinarily not able to be delegated, however that may be adopted by the Executive Committee or by the Managing Director(s), by reasons of urgency, that have been duly justified, and that must be ratified at the first meeting of the Board of Directors that is held after the adoption of the decision.

- a) The approval of the management objectives, the annual financing plan, the investments and financing policy, the corporate social responsibility policy.
- b) The determination of the policy for the control and management of risks, including tax risks, and the supervision of the internal information and control systems.
- c) The determination of the corporate governance policy of the Company and of the Group of which the Company is the parent company; the organization and functioning thereof and, in particular, the approval and modification of the Regulations thereof.
- d) The approval of the financial information that, by reason that the Company is a listed company, must be periodically published by the Company.
- e) The definition of the structure of the group of companies of which the Company is the parent company.
- f) The approval of all types of investments and operations that, by reason of the significant sum or the special characteristics thereof, constitute strategic operations or are the subject of special tax risks, unless the approval thereof corresponds to the General Shareholders Meeting.
- g) The approval of the creation or acquisition of shareholdings in other special purpose entities or companies registered in countries or territories that are considered to be tax havens, as well as any other analogous transactions or operations that, by reason of their complexity, may undermine the transparency of the Company and its Group.
- h) The approval, subject to the prior report of the Audit Committee, of the operations that the Company or any of its Group companies carry out with Board Members, in the terms established in applicable legislation, or with shareholders that hold, either individually or jointly with other shareholders, a significant shareholding in the share capital of the Company, including shareholders that are represented on the Board of Directors of the Company or of other companies that form part of the corporate Group thereof or with any related-parties thereof.
- i) The determination of the tax strategy of the Company.

Aspects for which the resolutions or decisions thereof may be adopted, indistinctly, by the Board of Directors or by the Executive Committee.

- a) The definition of the general structure of delegations and empowerments.
- b) The incorporation of new companies or entities or the variation of the shareholdings in already existing companies.
- c) The approval of merger, take-over, split-off, integration or winding-up operations, with or without liquidation, for which any of the companies of the Group have any interests whatsoever.
- d) The disposal of shareholdings in the share capital of companies or of other fixed assets by any Group company.
- e) The approval of the investment projects to be implemented by any Group company.
- f) The approval of the programs for the issue and renewal of series of promissory notes, of debentures or of other similar securities by any Group company.
- g) The approval of financial operations, to be carried out by any Group company, that are not included in the Annual Financing Plan.
- h) The provision of guarantees and bonds by Group companies in order to guarantee the obligations of entities that do not belong to the Group, or that have, if they do belong to the Group, external partners.
- i) The assignment of rights regarding the commercial name and trademarks, as well as in respect of patents, technology and any other modality of industrial property that belongs to any Group company.
- j) The approval of the appointment and removal of the Trustees and other positions of the Gas Natural Fenosa Foundation and of the natural persons legal representatives of Gas Natural SDG, S.A. in the situations in which Gas Natural SDG, S.A. is designated as the corporate director of any other company. Approval of contributions to sponsorship or patronage activities.
- k) The formalization of commercial, industrial or financial agreements that are of a relevant importance for the Group and that represent any modification, change or review of the current Strategic Plan or Annual Budget.

In relation to the aspects set out under paragraphs b), c), d), e), g), h) and i), the approval of the Board of Directors or the Executive Committee shall be required in relation to the resolutions or decisions that, by reason of the nature or amount thereof, are of special relevance for the Group. An operation shall be deemed to be of special relevance when the economic importance of the operation exceeds 15 million Euros, except in relation to paragraphs h) and i), in which case said limit shall be that of 5 million Euros and in respect of paragraph j), for which said limit shall be that of 200,000 Euros.

Unless any other regime is approved upon the adoption of the corresponding resolution or decision, it shall be considered that an investment or operation does not require any additional approval in the case of any deviation of the operation, when said deviation does not exceed 10% or a further 15 million Euros above of the amount authorised by the Board or, as the case may be, by the Executive Committee.

When necessary, the resolutions of the Board of Directors and of the Executive Committee must be adopted subject to the prior report of the pertinent Committee.

b) Procedures and rules of organization and operation:

The Executive Committee shall be comprised by the Chairman of the Board of Directors and by a maximum of another nine Board Members, that shall belong to the categories provided for under Article 3 of these Regulations, and shall be of a similar proportion to that of the existing Board of Directors. The designation of the members of the Executive Committee shall require the favourable vote of at least two thirds of the members of the Board.

The Chairman of the Board of Directors shall act as the Chairman of the Executive Committee and the Secretary of the Board shall act as the Secretary thereof, that may be substituted by the Deputy Secretary.

The Executive Committee shall be deemed to be validly constituted when half plus one of the members thereof are either present or represented.

The members of the Executive Committee shall be removed from office when they cease to be Board Members or when the Board removes them from the Executive Committee. The vacancies on the Executive Committee shall be newly designated as soon as practicable by the Board of Directors.

The permanent delegation of powers by the Board of Directors in favour of the Executive Committee shall include all of the powers of the Board, with the exception of the powers that are not able to be delegated, whether pursuant to legal provisions or the Articles of Association or pursuant to these Regulations.

The Executive Committee, which shall be called by the Chairman thereof, shall meet, whenever deemed necessary by the Chairman thereof or at the prior request of at least 1/3 of the members thereof. The Secretary shall draft the Minutes of the resolutions and decisions adopted at the meeting session thereof, which shall be detailed at the next plenary session of the Board of Directors.

In the cases in which, in the judgement of the Chairman or of the majority of the members of the Executive Committee, the importance of the matter so requires, the resolutions and decisions adopted by the Committee shall be submitted for the ratification of the plenary session of the Board.

The foregoing shall also be applicable to the matters that the Board had forwarded to the Executive Committee for the study and analysis thereof, whereby the Board reserves the right to adopt the final decision in relation thereto.

In all other cases, the resolutions and decisions adopted by the Executive Committee shall be valid and binding, without the need for any subsequent ratification thereof by the plenary session of the Board, without prejudice to the provisions of Article 5 of these Regulations.

The provisions of these Regulations in relation to the functioning of the Board of Directors shall, to the extent possible, also be applicable to the Executive Committee.

c) Most important activities during 2017.

In the exercise of its powers, during the 2017 financial year it has analysed, informed and/or adopted agreements on, among other things:

- > Quality and efficiency of its operation
- > Various investment proposals.
- > Budget.
- > Status reports on different issues.

State whether the composition of the executive committee reflects the participation of the different directors within the board based on their class:

Yes

If no, explain the composition of your executive committee.

Audit Committee

Name	Position	Class
Mr. Ramón Adell Ramón	Chairman	Independent
Mr. Enrique Alcántara-García Irazoqui	Member	Proprietary
Mr. Xabier Añoveros Trias de Bes	Member	Independent
Mrs. Cristina Garmendia Mendizabal	Member	Independent
Mrs. Helena Herrero Starkie	Member	Independent
Mr. Rajaram Rao	Member	Proprietary
Mr. Luís Suárez de Lezo Mantilla	Member	Proprietary
% proprietary directors		42.86
% independent directors		57.14
% other external directors		–

Explain the duties assigned to this committee, describe the procedures and rules of organisation and operation thereof, and summarise the most significant activities thereof during the year.

a) Functions of Audit Committee:

The Committee has the powers established by the Law and those entrusted to it by the Board of Directors in general or in particular.

On November 27, 2015, the Board of Directors has entrusted the following functions:

- Prepare the report on the independence of the Auditor.
- Prepare the Report on the functioning of the Audit Committee.
- Prepare the Report on related-party transactions.
- Prepare the Report on corporate social responsibility policy.
- Ensure that the Board of Directors seeks to present the accounts to the General Meeting of Shareholders without limitations or qualifications in the Audit Report and that, in the exceptional cases in which there are qualifications, both the Chairman of the Committee and the Auditors, clarify to shareholders the content and scope of such limitations.
- In relation to information and control systems:
 - a) To supervise the preparation process and the integrity of the financial information relating to the company and, as the case may be, to the group, reviewing compliance with regulatory requirements, adequate delimitation of the consolidation perimeter and correct application of the accountant criteria.
 - (b) Ensure the independence of the unit that assumes the internal audit function; Approve the orientation and its work plans, ensuring that its activity is focused mainly on the relevant risks of society; Receive periodic information on their activities; And verify that senior management takes into account the conclusions and recommendations of its reports. To propose to the Chairman of the Board of Directors the selection, appointment, re-election and dismissal of the person in charge of the internal audit service, as well as to propose the budget for that service, with the last decision corresponding to the Chairman of the Board of Directors.
 - (c) Establish and supervise a mechanism that allows employees to communicate, on a confidential basis and, if it is possible and considered appropriate, anonymous, irregularities of potential significance, especially financial and accounting, that they notice within the company.

- a) In case of resignation of the external auditor, examine the circumstances that motivated it.
 - (b) Ensure that the remuneration of the external auditor for their work does not compromise their quality or independence.
 - (c) Supervise that the company reports as a relevant fact to the National Securities Market Commission the change of auditor and accompany it with a statement on the possible existence of disagreements with the outgoing auditor and, if they existed, on their content.
 - (d) Ensure that the external auditor holds a meeting with the board of directors annually to inform him of the work performed and of the evolution of the accounting and risk situation of the company.
 - (e) Ensure that the company and the external auditor comply with the current rules on the provision of non-audit services, the limits on the concentration of the auditor's business and, in general, the other rules on the independence of auditors.
- a) Call any employee or manager of the Company, and even arrange for them to appear without the presence of any other manager.
- a) Analyse and inform the Board of Directors about the economic conditions and the accounting impact and, in particular, where applicable, on the exchange ratio, in relation to the operations of structural and corporate modifications that, by their nature or quantity, have special relevance. Those transactions whose net value exceeds the value of 25% of the assets included in the last approved balance sheet of the Company shall be deemed to be relevant.
- a) In relation to the supervision of compliance with the corporate governance rules, the Codes of Conduct and the corporate social responsibility policy.
 - a) The supervision of compliance with the internal codes of conduct and the corporate governance rules of the company.
 - (b) Supervision of the communication strategy and relationship with shareholders and investors, including small and medium shareholders.
 - (c) The periodic evaluation of the adequacy of the corporate governance system of the company, in order to fulfil its mission of promoting social interest and taking into account, as appropriate, the legitimate interests of the remaining interest groups.
 - (d) Monitoring and evaluation of the processes of relationship with the different stakeholders.
 - (e) The evaluation of all matters related to non-financial risks of the company - including operational, technological, legal, social, environmental, political and reputational.
 - (f) Coordination of the non-financial information and diversity reporting process, in accordance with applicable regulations and international reference standards.

b) Procedures and rules of organization and operation

The Audit Committee shall be comprised by a minimum of three and a maximum of seven Board Members, that shall be designated by the Board of Directors from among the Non-Executive Board Members, and at least one of the Non-Executive Board Members thereof shall be designated taking into account his or her knowledge and expertise in accounting or audit fields, or in both fields. The members thereof shall be removed from office when they cease to be Board Members or when the Board removes them from the Audit Committee or by reason of the expiry of the period of three years after their appointment, however the members thereof may be re-elected.

The majority of the members of the Committee shall be Independent Board Members, from among which, the Board of Directors shall designate the Chairman of the Audit Committee, who shall not have a casting vote. The Secretary of the Board of Directors shall act as the Secretary of the Committee.

The Committee, which shall be called by the Chairman thereof, shall meet as often as necessary in order to issue reports or proposals in relation to its functions or when deemed necessary by the Chairman thereof, or at the prior request of at least two of the members thereof and, shall meet at least four times a year. The meeting notification must be issued at least two days prior to the date set down for the meeting thereof, except in the case of any justified and reasoned urgency. The meetings shall ordinarily take place at the registered office of the Company. The Committee may invite any manager or employee that it deems necessary to attend the meetings.

c) Most important activities during 2017

In the exercise of its powers, during the financial year it has informed and / or adopted proposals on, among other things:

- > Quality and efficiency of its operation.
- > External audit of individual and consolidated annual accounts.
- > Economic information.
- > Appointment of Auditors.
- > Tax status report.
- > Independence of Auditor.
- > Related-party transactions.
- > Verification of the criminal prevention system.

Identify the director who is a member of the audit committee and who has been appointed taking into account the director's knowledge and experience in the areas of accounting, audit, or both, and report the number of years that the chair of this committee has held office.

Name of director with experience	Mr. Ramón Adell Ramón
Number of years during which chair has held the position	3

Appointments and Remuneration Committee

Name	Position	Class
Mr. Francisco Belil Creixell	Chairman	Independent
Mr. Alejandro García-Bragado Dalmau	Member	Proprietary
Mrs. Cristina Garmendia Mendizabal	Member	Independent
Mr. Miguel Martínez San Martín	Member	Proprietary
Mr. William Alan Woodburn	Member	Proprietary

% proprietary directors	60
% independent directors	40
% other external directors	-

Explain the duties assigned to this committee, describe the procedures and rules of organisation and operation thereof, and summarise the most significant activities thereof during the year.

a) Functions of the Appointments and Remuneration Committee:

The Committee has the powers established by the Law and those entrusted to it by the Board of Directors in general or in particular.

The Board of Directors has entrusted the following duties:

- Prepare the report on the functioning of the Appointments and Remuneration Committee.
- Verify the policy for the selection of Directors and report it in the Annual Corporate Governance Report.
- By delegation to be given by the Chairman of the Board, organize and coordinate the periodic evaluation of the Board and the first executive manager of the Company.
- Prepare the report on the functioning of the Board of Directors.
- To propose to the Board of Directors the basic conditions of the contracts of the senior managers.
- Verify compliance with the remuneration policy established by the Company.
- Periodically review the remuneration policy applied to directors and senior managers, including remuneration systems with actions and their application, as well as to ensure that their individual remuneration is proportionate to the remuneration of other directors and senior executives of the company.
- Ensure that any conflicts of interest do not undermine the independence of the external advice provided to the commission.
- Verify information on the remuneration of directors and senior executives contained in the various corporate documents, including the annual report on directors' compensation.
- By agreement of the Board of Directors of January 29, 2016, it was entrusted to exercise all the powers in matters of corporate social responsibility that until that date were exercised by the Audit Committee.

b) Procedures and rules of organization and operation

The Appointments and Remuneration Committee shall be comprised by a minimum of three and a maximum of five Board Members that shall be designated by the Board of Directors from among the Non-Executive Board Members, taking into account the knowledge and skills thereof. The members thereof shall be removed from office when they cease to be Board Members or when the Board of Directors removes them from the Appointments and Remuneration Committee or by reason of the expiry of the period of three years after their appointment, however the members thereof may be re-elected.

At least two members of the Appointments and Remuneration Committee shall be Independent Board Members and, from among the Independent Board Members thereof, the Board of Directors shall designate the Chairman of the Appointments and Remuneration Committee, who shall not have a casting vote. The Secretary of the Board of Directors shall act as the Secretary of the Committee.

The Committee, which shall be called by the Chairman thereof, shall meet as often as necessary in order to issue reports or proposals in relation to its functions or when deemed necessary by the Chairman thereof, or at the prior request of at least two of the members thereof. The meeting of the Committee shall be called by the Chairman, at least two days prior to the date set down for the meeting thereof, except in the case of any justified and reasoned urgency. The meetings shall ordinarily take place at the registered office of the Company. The Committee may invite any manager or employee that it deems necessary to attend the meetings.

c) Most important activities during 2017:

In the exercise of its powers, during the financial year it has informed and / or adopted proposals on, among other things:

- Annual report on the remuneration of Directors.
- Degree of achievement of the Group's objectives.
- Remuneration of employees.
- Quality and efficiency of its operation
- Re-election, ratification or appointment of Directors.

C.2.2 Complete the following table with information regarding the number of female directors comprising the committees of the board of directors for the last four financial years:

	Number of female directors							
	Financial year t		Financial year t-1		Financial year t-2		Financial year t-3	
	Number	%	Number	%	Number	%	Number	%
Executive Committee	1	10	1	10	0	0	0	0
Audit Committee	2	28.57	2	28.57	0	0	0	0
Appointments and Remuneration Committee	1	20	1	20	1	33	0	0

C.2.3 Section deleted.

C.2.4 Section deleted.

C.2.5 State, if applicable, the existence of regulations of the board committees, where such regulations may be consulted, and the amendments made during the financial year. Also state if any annual report of the activities performed by each committee has been voluntarily prepared.

The Committees are regulated under the Articles of Association and the Regulation regarding the organization and functioning of the Board of Directors and its Committees of Gas Natural SDG, S.A.

Both documents are published in the website of the Company (www.gasnaturalfenosa.com) > Shareholders and Investors > Corporate Governance > Governing Regulations.

Both the Executive Committee and the Audit Committee and the Appointments and Remuneration Committee have produced a report on the quality and effectiveness of their operation during the previous year.

C.2.6 Section deleted.

D. Related-party transactions and intragroup transactions

D.1 Explain any procedures for approving related-party and intragroup transactions.

Procedure for the approval of related-party transactions

According to art. 5.II of the Regulations of the Board of Directors, powers of the Board which may not be delegated but may be adopted by the Executive Committee or by the Chief Executive Officer on duly justified grounds of urgency and which shall be ratified by the first Board of Directors following the adoption of the decision, one of them is the approval, following a report by the Audit Committee, on the operations carried out by the Company or its group companies with directors, under the terms established in current legislation, or with shareholders holding, individually or in concert with others, of a significant shareholding, including shareholders represented in the Board of Directors of the Company or other companies that are part of the same group or with persons related to them.

Moreover, art. 6.5 of the Regulations of the Board indicates that the Board of Directors will include in the Annual Report and in the Annual Corporate Governance Report information on transactions with significant shareholders (total volume of transactions and nature of the most relevant ones) so that other shareholders may know its scope and importance.

- a) On 30 September 2011 the Board of Directors, following a favourable report from the Appointments and Remuneration Committee (then competent), agreed to grant a generic authorisation to the related polyethylene network purchase transactions of Repsol Butano, S.A. which are carried out under normal market conditions. This authorization is executed by the General Director of Regulated Businesses.
- b) The Board of Directors on 25 May 2012, following a favourable report from the Appointments and Remuneration Committee (then competent), granted a generic authorisation for ordinary operations carried out under market conditions with Caixabank, S.A., or with any entity belonging to "la Caixa" Group relating to: opening of current bank accounts, temporary financial investments generated by cash surpluses from current operations, management of receipts at collection, various payments related to usual operations (payroll, Taxes, social security, suppliers and others of a similar nature), issuance of VISA and equivalent cards, purchase and sale of currency in cash or in advance before payment and collection of invoices in foreign currency approved, confirmation of letters of credit, of interest rate derivatives, as well as ISDA and CMOF contracts, as well as any other of a similar nature, which cover all or some of the foregoing transactions). This authorization is executed by the Economics and Finance Director General.
- c) The Board of Directors on 22 July 2016, following a favourable report from the Audit Committee, adopted the agreement on the realisation under the ISDA framework of operations with Repsol, S.A., relating to OTC of electricity, gas and CO₂. This authorization is executed by the General Director of Wholesale Energy Businesses.
- d) The Board of Directors on 7 March 2017, following a favourable report from the Audit Committee, authorised the sale of the electricity and gas supply to the "la Caixa" group under market conditions. The Audit Committee must be informed of the use of this authorisation annually.
- e) The Board of Directors on 7 March 2017, following a favourable report from the Audit Committee, authorised the sale of the electricity supply to the Repsol group under market conditions. The Audit Committee must be informed of the use of this authorisation annually.
- f) The Board of Directors on 4 April 2017, following a favourable report from the Audit Committee, authorised the contracting to the electricity generator Guacolda Energía, S.A. (49% owned by Global Infrastructure Partners), under market conditions, of various supplies to supply customers under a free market system. The Audit Committee must be informed of the use of this authorisation annually.

D.2 Describe those transactions that are significant due to the amount or subject-matter thereof between the company or entities of its group and the company's significant shareholders:

Individual or company name of the significant shareholder	Individual or company name of the company or entity within its group	Nature of the relationship	Type of transaction	Amount (thousands of euros)
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Interest charged	1,509
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Contributions to pension plans and life insurance	35,265
Fundación Bancaria Caixa d'estalvis i Pensions De Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Services received	11,955
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Interest paid	653
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Provision of services	559
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Financing agreements: other	1,323,987
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural Sdg, S.A.	Commercial	Sales of intangible assets	362,465
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Financing agreements: loans	119,541
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Guarantees	160,000
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Management contracts	1,030,014
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Dividends and other distributed benefits	244,558
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Services received	14,045

Individual or company name of the significant shareholder	Individual or company name of the company or entity within its group	Nature of the relationship	Type of transaction	Amount (thousands of euros)
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Purchase of finished or non-finished goods	345,504
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Provision of services	38,629
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Sales of finished or non-finished goods	817,607
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Purchase of fix assets or goods	10,879
Repsol, S.A.	Gas Natural SDG, S.A.	Commercial	Dividends and other distributed benefits	200,859
Gip III Canary 1, S.À R.L.	Gas Natural SDG, S.A.	Commercial	Dividends and other distributed benefits	200,138
Fundación Bancaria Caixa d'estalvis i Pensions de Barcelona (la Caixa)	Gas Natural SDG, S.A.	Commercial	Sales of finished or non-finished goods	22,971

D.3 Describe those transactions that are significant due to the amount or subject-matter thereof between the company or entities of its group and the company's directors or officers:

Name or corporate name of the directors or officers	Individual or company name of related party	Relation	Nature of the relationship	Amount (thousands of euros)
---	---	----------	----------------------------	-----------------------------

D.4 Report the significant transactions made by the company with other entities belonging to the same group, provided they are not eliminated in the preparation of the consolidated accounts and they are not part of the ordinary course of business of the company as to their purpose and conditions.

In any case, report any intragroup transaction with entities established in countries or territories considered to be tax havens:

Corporate name of the entity in the group	Brief description of the transaction	Amount (thousands of euros)
Global Power Generation, S.A.	Dividends received from Buenergía Gas & Power, Ltd.	49,504

D.5 State the amount of transactions with other related parties.

0 (thousands of euros)

D.6 Describe the mechanisms used to detect, determine, and resolve potential conflicts of interest between the company and/or its group, and its directors, officers, or significant shareholders.**1.- Directors:**

According to the Regulations of the Board of Directors:

The Board Members are subject to the duty of loyalty in the terms established under applicable legislation and, in particular:

- The Board Members must abstain from participating in the deliberations and voting procedures in relation to resolutions or decisions in which he or she or any related party is subject to any direct or indirect conflict of interest. The foregoing shall exclude the obligation to abstain from resolutions or decisions that affect the Board Member in his or her capacity of director of the Company, such as the designation or revocation thereof in relation to positions within the governing body or other similar positions.
- Furthermore, the Board Member must adopt the measures necessary in order to avoid situations in which his or her interests, whether directly or indirectly in relation to any third-party, may be subject to any conflict of interest with the Company's interests and with his or her duties to the Company.
- In their capacities of loyal and prudent representatives of the Company, the Board Members must inform the Company of the shares of the Company that they hold, whether directly or indirectly through companies in which they hold a significant shareholding, in accordance with the procedure and the other formalities established for investments in shares of Gas Natural SDG, S.A. and the subsidiary companies thereof.
- The Board Members must notify the Company of any significant changes to their professional situation and any changes that affect the nature or category in which the Board Members are classified.
- The Board Members shall inform the Company of any type of legal or administrative claim whatsoever or of any facts that may relate to the Board Members that, by reason of the importance thereof, may seriously affect the reputation of the Company. The Board shall examine the situation and shall adopt the measures that are required in the interests of the Company, with the required urgency.

The Board of Directors shall, at all times, use its best endeavours to avoid that the Proprietary Board Members exercise their powers or position in order to obtain equity advantages without the adequate consideration or balancing entry, in benefit of the shareholder that has proposed the appointment of the Proprietary Board Members.

The Board Members must abstain from carrying out activities, either on their own behalf or for any third party, that would constitute effective competition, whether real or potential, with the Company or that, in any other way whatsoever, would create any permanent conflict of interest with the Company. In particular, Board Members must not perform, either directly or indirectly, any positions of any nature at competitor companies or entities of Gas Natural SDG S.A. or of any company of its Group, and must not provide, in favour of said companies or entities, any representation or advisory services whatsoever. A company or entity shall be deemed to constitute a competitor of Gas Natural SDG, S.A., when it is engaged, whether directly or indirectly, or through its Group companies, in activities included within the corporate activities of Gas Natural SDG, S.A.

2.- Directors and senior officers:

Furthermore, in accordance with art. 5 of the Internal Code of Conduct in matters relating to the Securities Markets (RIC), Persons with Management Responsibilities (included among which are also Directors, members of the Management Committee and the Internal Audit Director) and Initiated Persons will refrain from directly or indirectly carrying out transactions for certain periods of time, on their own behalf or on behalf of a third party, involving the affected securities (i) The transferable securities issued by the Company and/or companies from the GNF Group, which are traded in a secondary market or other regulated markets, in multilateral trading systems or other organised secondary markets, or in respect of which an admission to trading has been processed in one of these markets or systems, (ii) The financial instruments and contracts of any kind that grant the right to purchase the securities indicated in (i), (iii) The financial

instruments and contracts whose underlying assets are the securities indicated in (i) and (iv) For the sole purposes of the rules of conduct regarding insider information contained in Title III of the Regulation, the securities and financial instruments issued by other companies or entities other than the Company, with respect to which the insider information is available).

Following a written request by the interested party to the Board Secretary, Internal Audit may authorise Persons with Management Responsibilities to carry out personal transactions involving the affected securities during the periods in which there is a general prohibition, when certain circumstances set forth in the RIC itself exist and can be demonstrated. Internal Audit will inform the Audit Committee at least once a year about the authorisations that have been requested.

Moreover, in accordance with section 4.10 of the Code of Ethics, employees must inform the company should they or their close family members participate or intend to participate in the governing bodies of other companies that may clash with the interests of Gas Natural Fenosa. Whilst carrying out their professional responsibilities, employees must act with loyalty and defend the group's interests. They must also avoid situations that may give rise to a conflict between personal interests and those of the company. Therefore, the employees of Gas Natural Fenosa must refrain from representing the company and intervening in or influencing decision-making in any situation where they have a direct or indirect personal interest.

3.- Significant shareholders:

The Board of Directors, following a report by the Audit Committee, approves the operations carried out by the Company or its group companies with Board Members, under the terms established by current legislation, or with individual shareholders, individually or in concert with others, a significant participation, including shareholders represented on the Board of Directors of the Company or other companies that are part of the same group or with persons related to them.

D.7 Is more than one company of the group listed in Spain?

No

Identify the subsidiaries listed in Spain:

Listed subsidiaries

State whether they have publicly and accurately defined their respective areas of activity and any possible business relationships among them, as well as those between the listed dependent company and the other companies within the group:

Describe the possible business relationships between the parent company and the listed subsidiary, and between the subsidiary and the other companies within the group

Identify the mechanisms established to resolve possible conflicts of interest between the listed subsidiary and the other companies within the group:

Mechanisms for the resolution of possible conflicts of interest

E. Control systems and risk management

E.1 Explain the scope of the Risk Management System of the company including all tax aspects thereof.

The Risk Management System is an integral system that is continuously operative, that consolidates the management activities per area or business unit or activity, subsidiaries, geographic zones and support areas (such as, for example, human resources, marketing or management control) at a corporate level, and quantifies the impact of the main risk factors and also guarantees the homogeneity for the criteria used to measure said risk factors.

The purpose thereof is to forecast any potential deviations in relation to the global targets and to guarantee that the decision-making process takes into consideration an adequate balance between risk and returns, from the perspective of both the marginal contribution to the global portfolio as well as in relation to each one of the different businesses.

The purpose of the risk management system at Gas Natural Fenosa is to guarantee the predictability and sustainability of the operational and financial performance of the Company. It aims to ensure that the most significant risks are correctly identified, evaluated and managed by the different General Directorates/Business Units.

E.2 State the bodies of the company that are responsible for the drafting and implementation of the Risk Management System including all tax aspects thereof.

Risk Analysis Committee

The Risk Analysis Committee is responsible for determining and reviewing the target Risk Profile of the Company. The Committee ensures that said risk profile is aligned with the strategic position of the Company and protects the interests of the interest groups thereof. Furthermore, the Committee ensures that all members of the organisation understand and accept their responsibility for the identification, assessment and management of the most relevant risks.

Risk Units

The Risk Units report directly to the Economic and Financial Department, which provides said Department with the corporate vision necessary for the carrying out of its functions, without prejudice to the fact that specific Wholesale Business Risk and Retail Business Risk management units also report to the Economic and Financial Department, in close contact with the business units that have the highest exposure to risk by reason of their profile and turnover.

The purpose of the Risk Units is to externalise exposure to the uncertainties and to internalise the levels of exposure to risk in the decision-making processes of senior management, as an instrument for the effective selection of returns. The Risk Units are responsible for coordinating the different agents involved in risk management. The monitoring and assessment of the exposure to risk pursuant to an integrated approach enables the Company to maximise the efficacy of its decision-making procedures, by optimising the returns/risk binomial.

The Risk Units are responsible for ensuring the maintenance of the global risk profile, as well as for the permanent measurement and control of the risk.

The Businesses

The Businesses are responsible for risk management within their pertinent areas. The Businesses identify the trends and positions that may imply risk and reports said risks to the Risk Units, and they also apply the management directives and criteria issued by the Risk Units.

The risk management is based upon a series of key concepts which include the concept of the Risk Profile, which is considered to mean the level of exposure to the uncertainty as a result of the joint incidence of different categories of risk identified by Gas Natural Fenosa.

Other corporate areas

Other corporate areas are responsible for the monitoring and management of certain risks, by reason of the specific nature and the particularities of the management mechanisms thereof. For example, the Environmental and Quality Control Department, that is responsible for the environmental risk and climate change, and the Reputation and Sustainability Department, that manages reputational risks. The foregoing areas operate in coordination with the Risk Units.

E.3 State the main risks, including all tax risks, that the company is subject to in relation to its business targets.

	Description	Risk Management
Market risk		
Price of gas	Volatility in international markets that determine the price of gas.	Physical and financial hedging. Portfolio Management.
Price of electricity	Volatility of electricity markets in Spain and Portugal.	Physical and financial hedging. Optimisation of the electricity generation assets.
Volume of gas	Deviation between the supply and demand of gas.	Optimisation of contracts and assets. Trading.
Volume of electricity	Reduction of the available thermal generation gap. Uncertainty in the volume of hydraulic production.	Optimisation of the electricity commercialisation/ generation balance.
Regulation	Exposure to the review of the recognised criteria and of profitability levels for regulated activities.	Intensification of the communication with regulatory authorities. Adjustment of efficiencies and investments at recognised rates.
Exchange rate	Volatility in the international currency markets.	Geographical diversification. Hedging by way of financing in local currencies and derivatives. Monitoring of the net position.
Interest rate and credit spread	Volatility in the financing facility rates.	Financial hedging. Diversification of the financing sources.
Tax	Ambiguity or subjectivity in the interpretation of the applicable tax regulations, or by the substantiation modification thereof.	Queries to independent expert bodies. Contracting of first tier consultancy firms. Ratification of the Code of Good Tax Practices. Allocation of provisions with prudent criteria.
Credit risk		
Credit	Uncertainty about the evolution of the default ratios conditioned by the economic cycle.	Analysis of the solvency of customers to define specific contractual terms and conditions. Debt recovery procedures.
Operational risk		
Operational risk: image and reputation	Deterioration of the perception of Gas Natural Fenosa from different interest groups.	Identification and monitoring of potential reputational events. Communication transparency.
Operational risk: insurable	Accidents, damages or unavailability of the assets of Gas Natural Fenosa.	Continuous improvement plans. Optimisation of the total cost of risk and hedges.
Operational risk: the environment	Damages to the natural and/or social environment. Trends of environmental regulation.	Emergency plans in facilities subject to risk of environmental accidents. Specific insurance policies. Integral environmental management.
Operational risk: climate change	Trends of environmental factors as a result of climate change. Regulation to combat climate change.	Corporate positioning in the face of climate change. Active participation in influencing forums.

E.4 State whether the company has a tolerance level in relation to the risk, including tax risks.

The Company has tolerance levels established at a corporate level for the main types of risk.

The risk assessment process begins with the identification of the risks, generally by the businesses that are exposed thereto. Said identification takes place at the time at which the exposure exists. Notwithstanding the foregoing, on an annual basis the Risk Units carry out a detailed review of the risks in order to guarantee the correct identification of all of the exposures, whether current or potential risks.

The Risk Units are responsible for carrying out the assessment of the identified risks, in light of:

- a) Position at risk: Definition and characteristics.
- b) Impact variables.
- c) Qualitative and quantitative severity in the case of the occurrence of the risk.
- d) Probability of the risk taking place.
- e) Risk mitigation controls and mechanisms used and the efficacy thereof.

Finally, a tolerance level shall be proposed for the types of risks identified, that shall be approved by the Risk Analysis Committee.

E.5 State which risks, including tax risks, have taken place during the year.

The risks that materialised during the financial year have been inherent to the activity carried out, such as, for example: exposure to regulatory risks, fuel and pool volatility in Spain, and exchange, interest, credit or counterparty rates. During 2017, it is worth noting the impact that weather conditions, such as drought, have had on the Company's electricity business.

The risk control mechanisms have enabled the Company to keep their impact within the established tolerance range, defined by means of the current risk limits.

On 14 March 2017, the Superintendency of Residential Public Services in Colombia decided that the intervention involving Electricadora del Caribe SA, a company majority owned by GNF that had begun on 14 November 2016, would be for liquidation purposes.

On 22 March 2017, Gas Natural Fenosa delivered the relevant documentation to start the arbitration procedure before the Tribunal of the United Nations Commission on International Trade Law.

Throughout the entire process Gas Natural Fenosa has reiterated its willingness to negotiate.

E.6 Explain the response and supervision plans for the main risks of the entity, including tax risks.

The risks regarding the performance of Gas Natural Fenosa are set out in the Risks Map, containing:

- > Definition and characteristics of the main risk factors.
- > Evolutionary aspects of the Risks Map.
- > Impact variables.
- > Main measurement methodologies used according to risk type.
- > Qualitative, quantitative and probabilistic severity of the risk materialising.
- > Defined controls and the effectiveness of these.

The Risk Units and other specific areas (Regulation, Environment, Electricity Generation) carry out periodic measurements of the trends of the main risks, and set out the pertinent indications in the case that any exposure levels or trends are detected that may exceed the established tolerances.

F. Internal risk control and management systems in relation to the process for the issue of financial reporting (ICSFR)

Describe the mechanisms that comprise the risk control and management systems in relation to the process for the issue of financial reporting (ICSFR) of your company.

F.1 Control of the Company

State, including the main characteristics thereof, at least:

F1.1 Which bodies and/or functions are responsible for: (i) the existence and maintenance of an adequate and effective ICSFR; (ii) the implementation thereof; and (iii) the supervision thereof.

Gas Natural Fenosa has defined its Internal Control System on Financial Reporting (hereinafter, "ICSFR") in the "General Guidelines of the Internal Control System on Financial Reporting (ICSFR) of Gas Natural Fenosa".

As part of the ICSFR, Gas Natural Fenosa has defined, in the aforementioned General Guidelines, the responsibilities model thereof. Said model is defined in relation to the following five ambits of responsibility:

- Board of Directors: Is responsible for the existence of an adequate and effective ICSFR, the supervision of which is delegated upon the Audit Committee.

The Regulations regarding the Organisation and Functioning of the Board of Directors of Gas Natural SDG, S.A. and its Committees, in Article 5, paragraph II thereof, provides that the determination of the policy for the control and management of risks, including tax risks, and the supervision of the internal reporting and control systems is, among other functions, an aspect that is ordinarily no able to be delegated by the Board of Directors.

- Audit Committee: This Committee is, *inter alia*, responsible for the supervision of the ICSFR. Article 32, paragraph 2 of the Regulations of the Board of Directors states that the Committee shall have the powers that are provided for under the Corporate Enterprises Act and the powers that are generally or specifically conferred by the Board of Directors. Thus, the Corporate Enterprises Act, at Section 529 quaterdecies thereof, states, at paragraph 4.b), that the Audit Committee shall have the function of supervising the efficacy of the internal control of the company, the internal auditing and the risk management systems, as well as the function of discussing with the accounts auditor the significant weaknesses of the internal control system detected during the audit. In particular and in relation to the reporting and control systems, the Audit Committee is responsible for, *inter alia*, the supervision of the process for the drafting and for the integrity of the financial reporting of the Company and, as the case may be, the group, and for reviewing the compliance of the required guidelines, the adequate delimitation of the scope of the consolidated accounts and the correct application of the accounting criteria. For the carrying out of part of the foregoing functions the Audit Committee is supported by the Internal Auditing, Compliance and Control Unit.
- Economic and Financial Department: Is responsible for the design, implementation and functioning of the ICSFR. For the carrying out of this function, the Economic and Financial Department is supported by the Internal Control on Financial Reporting Unit.
- Internal Auditing, Compliance and Control Unit. In general, this unit is responsible for supporting the Audit Committee in the supervision and continuous assessment of the efficacy of the Internal Control System in all aspects of Gas Natural Fenosa, by providing a methodical and rigorous approach for the monitoring and improvement of the processes and for the assessment of the operational risks and controls associated thereto, including the risks and controls that correspond to the ICSFR and to the Crime Prevention Model.
- Business units and corporate units involved in the process for the drafting of financial reporting. They are responsible for executing the processes and for maintaining the daily operations and ensuring that the implemented control activities are performed.

F1.2 Whether, especially in relation to the process for the drafting of the financial reporting, the following elements exist:

- **Departments and/or mechanisms responsible for: (i) the design and review of the organisational structure; (ii) clearly defining the lines of responsibility and authority, with an adequate distribution of tasks and functions; and (iii) ensuring that sufficient procedures exist for the correct dissemination thereof within the company.**

The design and review of the organisational structure of the senior management, as well as the definition of the lines of responsibility are carried out by the Board of Directors, by means of the Managing Director and by the Appointments and Remuneration Committee.

In order to guarantee the adequate management of the economic and financial reporting of the group, the Economic and Financial Department has developed, as part of the ICSFR, a technical instruction that consists of a map of interrelationships (reporting flows) regarding the process of the drafting of the financial reporting which sets out the communications between the Economic and Financial Department, the different process managers and the persons responsible for the source or the application of the financial reporting and that is referred to as "Map of interrelationships regarding the financial reporting of Gas Natural Fenosa".

Accordingly, Gas Natural Fenosa has taken into account six different aspects for the drafting of the map of interrelationships regarding the processes for the drafting of the financial reporting:

- (i) the information necessary for the drafting of the financial reporting;
- (ii) the persons responsible for the source or the application of the financial reporting and
- (iii) the distribution of tasks among the different organisational units
- (iv) the scope of said distribution to all of the companies within the group
- (v) the frequency of the reporting of the information.
- (vi) the information systems that are involved in the drafting process and for the issue of the financial reporting;

Accordingly, by means of the map of interrelationships of Gas Natural Fenosa, the processes that relate to the drafting of the financial reporting are clearly defined, including both the operational processes with relevant impacts regarding the financial reporting as well as the processes related to the administration and accounting area, and the persons responsible for said information.

- **Code of conduct, approval body, degree of dissemination and instruction, principles and values included therein (stating whether special mentions exist regarding the registration of operations and the drafting of financial reporting), body responsible for analysing breaches and for proposing corrective actions and sanctions.**

The commitments of the senior management of Gas Natural Fenosa include their undertaking to use their best endeavours to ensure that the operations are carried out within the context of ethical professional practices, and not only through the implementation of mechanisms for the purpose of preventing and detecting fraudulent conduct committed by employees, or inappropriate practices that may imply sanctions, fines or that may damage the image of Gas Natural Fenosa, but rather through by enhancing the importance of the ethical values and principles of integrity among their professional staff.

Accordingly, Gas Natural Fenosa has implemented a Code of Conduct (hereinafter, the "Code of Ethics"), that was approved by the Board of Directors at its meeting held on 31 March 2005, that is binding upon all of the employees of Gas Natural SDG, S.A. and all of the subsidiary companies in which Gas Natural Fenosa controls the management activities thereof. The updates and modifications of the Code of Ethics are carried out by the Board of Directors of Gas Natural SDG, S.A.

Since its ratification, the Code of Ethics has been modified on four occasions, the most recent of which took place on 27 June 2014, in order to update the code and to incorporate new commitments assumed by Gas Natural Fenosa in relation to the entry into force of the reform of the Spanish Criminal Code (Act 5/2010), the implementation of a Crime Prevention Model within the Group, the issue of the Anti-Corruption Policy of Gas Natural Fenosa and in order to adapt the code to the best practices of Corporate Responsibility.

The Code of Ethics sets out the general ethical principles of Gas Natural Fenosa, that define the values to be followed in practice throughout the organisation and that include: (i) Purpose (ii) scope of application (implication of all of the members of Gas Natural Fenosa); (iii) fundamental principles of conduct at Gas Natural Fenosa (declaration of the style of government of the group); (iv) conduct guidelines (declaration of the key values of Gas Natural Fenosa); (v) acceptance and compliance of the Code; (vi) Code of Ethics Committee and (vii) term.

The Code of Ethics considers integrity and responsibility in the exercise of professional activities to constitute a fundamental general criteria for conduct at Gas Natural Fenosa. In particular, the Code of Ethics establishes a series of conduct guidelines that are to a greater or lesser extent related to the reliability of the financial reporting and with the compliance of applicable regulations, and in particular:

- Respect for legality, human rights and ethical values. (Section 4.1)

“Gas Natural Fenosa is committed to acting at all times in accordance with applicable legislation, with the internal Regulatory System established with internationally accepted ethical practices, with complete respect for human rights and public liberties (...)”

- Treatment of information and knowledge (Section 4.11):

“All employees who enter information of any type into the group’s computer systems must ensure its rigour and reliability.

In particular, all financial transactions of the group must be shown clearly and accurately in the corresponding records, through the corresponding Accounting Accounts, and in all operations that are conducted, including all income and incurred expenses.

Employees of Gas Natural Fenosa will abstain from any practices that contravene the commitment to clearly and accurately reflect all the financial transactions in the group’s Accounts”

Furthermore, Gas Natural Fenosa has established an Anti-Corruption Policy, which was approved by the Steering Committee at its meeting held on 3 March 2014, and modified at the meeting held on 24 November 2015, which is binding upon all of the employees of all of the companies that comprise the Gas Natural Fenosa group and in which Gas Natural Fenosa holds majority shareholdings as well as the companies in which Gas Natural Fenosa is responsible for the operations and/or management thereof. The Policy is understood to be an extension of Chapter 4.7. “Corruption and bribery” of the Code of Ethics of the group and the purpose thereof is to establish the principles that must be adhered to by all of the employees and directors of the companies of Gas Natural Fenosa in relation to the prevention, detection, investigation and remedy of any corrupt practice within the organisation.

Furthermore, Gas Natural Fenosa has an Internal Code of Conduct for aspects related to the Securities Market, that has also been approved by the Board of Directors of the Company.

In July 2005 the Code of Ethics Committee of Gas Natural Fenosa was established with the principal mission of promoting the dissemination and application of the Code of Ethics within the entire group and for providing a communication channel for all employees in order to receive queries and notifications regarding breaches of the Code and of the Anti-Corruption Policy.

In order that the Code of Ethics Committee is able to exercise its functions in an objective and independent manner, the Committee is chaired by the Internal Auditing, Compliance and Control Unit and is formed by representatives of different units involved in the monitoring of compliance of the Code of Ethics and the Anti-Corruption Policy.

The Committee reports regularly to senior management and to the Audit Committee. The purpose thereof is to provide reports and recommendations, and to propose corrective actions to the units responsible for the provision of solutions to the problems related to the practical application of the Code of Ethics and of the Anti-Corruption Policy and furthermore to act as a liaison between said units and the employees.

The sanctionary regime, where necessary, is established by the Human Resources Unit.

Furthermore, the Code of Ethics Committee may propose, and in fact has done so on several occasions, updates of the terms of the Code. Said updates are, first of all, approved by the Audit Committee and, thereafter, ratified by the Board of Directors.

Moreover, Local Code of Ethics Committees have been established that are responsible for promoting the dissemination and application of the Code in certain countries in which Gas Natural Fenosa operates, namely, in Argentina, Brazil, Chile, Mexico, Colombia, Panama, Italy and Moldavia.

In order to promote not only the exercise of said responsibility but also the knowledge and dissemination of the Code of Ethics, the Code of Ethics is available in 9 languages:

- Externally: the corporate website of Gas Natural Fenosa.
- Internally, on the Naturalnet group platform.

Furthermore, online training courses have been developed through the Corporate University of Gas Natural Fenosa, that are obligatory for all of the employees of Gas Natural Fenosa.

Gas Natural Fenosa, through the Code of Ethics Committee, periodically carries out Declaration of Compliance of the Code of Ethics and Anti-Corruption Policy campaigns, in order to establish the conduct guidelines that are expected of all employees, as well as to disseminate the mechanisms that exist for carrying our queries and notifications, and to periodically formalise the commitment of all of the employees of the group in accordance with the ethical guidelines and principles of integrity.

Gas Natural Fenosa, in order to promote the knowledge of the Code of Ethics among its suppliers and collaborating companies includes in its General Contracting Terms and Conditions a clause that promotes among its suppliers practices in harmony with the conduct guidelines included in the Code of Ethics of Gas Natural Fenosa, and the suppliers are notified of where they may obtain a copy of the Code of Ethics of the group, and are also provided with information regarding the queries and notifications channels for aspects related to the Code of Ethics. Furthermore, in 2016 the Code of Ethics for Suppliers was approved and published, the purpose of which is to establish the guidelines that must govern the ethical behaviour of suppliers, contractors and external collaborators of Gas Natural Fenosa. This Code sets out the commitments provided for under the United Nations Global Compact as well as under the Code of Ethics, the Human Rights Policy, the Corporate Responsibility Policy and the Anti-Corruption Policy of Gas Natural Fenosa.

➤ **Complaints channel, that provides for the notification to the Audit Committee of financial and accounting irregularities, as well as potential breaches of the Code of Conduct and irregular activities within the organisation, and state whether said channel is confidential.**

At Gas Natural Fenosa the concept of professional ethics is centred upon integrity and professional responsibility, where the concept of integrity is understood to mean ethical, honourable and good faith actions and the concept of professional responsibility is understood to mean proactive and efficient actions for excellence, quality and professional service.

As provided for under Article 32.2 of the Regulations of the Board of Directors and its Committees, "the Audit Committee shall have the powers that are provided for under the Corporate Enterprises Act and the powers that are generally or specifically conferred by the Board of Directors". Accordingly, the powers of the Audit Committee include the power to "establish and supervise a mechanism that enables employees to communicate, confidentially and, if possible and if considered appropriate, anonymously, any potentially significant irregularities, in particular of a financial and accounting nature within the company".

In harmony with the foregoing, the Board of Directors, at its meeting held on 31 March 2006, established that the notifications received through the notification procedure for breaches of the Code of Ethics of Gas Natural Fenosa, related to fraudulent practices, audits or deficiencies in the accounting and internal control thereof, shall be directly notified to the Audit Committee.

As a mechanism for obtaining a higher degree of internal control regarding compliance with the principles included in the Code of Ethics, in July 2005 the Code of Ethics Committee of Gas Natural Fenosa was established, whereby one of the main functions thereof is to provide and supervise a communication channel for all employees in order to receive queries and notifications of breaches of the Code, and accordingly to facilitate the resolution of disputes related to the application of the Code of Ethics and of the Anti-Corruption Policy and to draft reports for the governing bodies of Gas Natural Fenosa in relation to the dissemination and compliance of the Code of Ethics and of the Anti-Corruption Policy, and the activities of the Committee itself.

The aforementioned communication channel constitutes an open channel (e-mail, fax, postal mail and internal mail) between the Code of Ethics Committee and all of the employees of Gas Natural Fenosa in order to notify of aspects related to the Code. This channel enables all of the employees of the group, suppliers and collaborating companies to obtain or provide information regarding any aspects related to the Code of Ethics and Anti-Corruption Policy. Said parties may also contact the Code of Ethics Committee in order to notify the Committee confidentially and in good faith of conduct that breaches the Code. And all of the foregoing outside the normal reporting mechanisms for employees.

All of the communications between the Code of Ethics Committee and the employees of Gas Natural Fenosa are absolutely confidential, and adhere to the limitations established under the Spanish Data Protection Act 15/1999, of 13 December. Accordingly, the Chairman of the Committee (The Internal Auditing, Compliance and Control Director) is the only member thereof, in first instance, that is authorised to access all of the information regarding all of the queries and notifications received from the group through the query and notification procedure. Furthermore, the notifications related to fraudulent practices, audits or deficiencies in accounting or internal control processes are directly notified to the Audit Committee.

The foregoing queries and notifications are considered and resolved by the Code of Ethics Committee.

In the 2017 Gas Natural Fenosa Corporate Responsibility Report, further information is provided regarding the Code of Ethics, the Anti-Corruption Policy, the activities of the Code of Ethics Committee and the use of the communication channel.

➤ **Training programs and periodic updates for the staff involved in the drafting and review of the financial reporting, as well as in the assessment of the ICSFR, that covers, at least, accounting rules, audits, internal control and risk management.**

The need has sufficiently qualified and up to date professionals involved in the preparation and review of the financial reporting, as well as in the assessment of the ICSFR, means that it is necessary to develop an adequate training plan, such that the people responsible for each area have the necessary knowledge in order to be able to carry out the different functions included within the processes for the preparation and review of the financial reporting.

Accordingly, Gas Natural Fenosa has a Corporate University, that is responsible for the knowledge and development management of people throughout the Company. The Corporate University has a quality control management system in accordance with Standard ISO 9001:2015 that was renewed in 2017 and that obtained the CLIP accreditation in 2003 which was last renewed in 2013 for a period of five years. Said certification acknowledges the quality of the training and development processes of people in corporate education organisations.

The objectives of the Corporate University include, among others: ensure knowledge management in a multinational and multicultural organisation; accompany the business in relation to the main plans of the group; position the organisation as a leader in training within the energy sector; guarantee that employees obtain the technical knowledge and the necessary skills in order to fulfil the established strategic objectives and to transmit and share experiences and best practices that exist at the Company. Accordingly, the Corporate University is a place to meet, debate and where people are trained that promotes innovation and excellence in the development of talent so that our professionals can fulfil the objectives of the Company.

The content of the programmes is structured through Training Schedules. These schedules take advantage of training synergies and furthermore cover the development needs in an ordered, complete, stable and sustainable manner. The schedules are comprised of three blocks: context knowledge (general and specific to all schedules), functional knowledge (specific to the position or profile) and skills (based upon the 24 skills of the Leadership Model). With the implementation of Success Factors as a training management tool, since 2017 all employees have had the chance to access any online content from the company's catalogue.

In 2014 the "Programa Savia" [Savia Program] was established, which is a training program the purpose of which is to strengthen the current role of managers, that must be the change agents in relation to the global implementation of the new processes associated with the strategic challenges. In 2015 the second phase of the program was commenced, Savia 2.0, which was focused upon the experience of customers and on change management. This programme continued in 2016, placing the focus, on this occasion, on cooperation and empowerment, completing the delivery of the course in October 2017. Furthermore, the pilot of the 4th edition was launched in 2017 with a focus on cyber security and innovation, and it is expected to be rolled out during 2018.

Another of the most important programmes implemented in 2017, and as a measure against the multiplication of computer attacks, was to implement a global plan with awareness sessions for Directors and Sub-directors, as well as to run a specific online course for all employees, with a focus on technical knowledge and on the duties and obligations in this area. This will be launched at the beginning of 2018.

On the other hand, the specific knowledge for the economic and financial has several objectives, including, to homogenise the economic and financial processes carried out within any ambit of the organisation; the updating of the accounting, tax, financial, risk management and management control criteria as well as the international regulations and technical knowledge of the tax area; as well as to provide sufficient knowledge regarding the valuation of companies, financial derivatives and the analysis of financial statements.

In total, in 2017 around 200 professionals from the Economic and Financial Department carried out over 1,400 hours of training in relation to specific content, including, among other aspects, management control, the "Óptima" project, accounting, treasury and taxation.

Here it is worth mentioning two training programmes:

- Completion of the training schedule aimed at the management control team in Spain that started in 2016. The group's evolution in the area of Scorecards has also required the role of Controller to develop, becoming a strategic adviser to the business, not only competent from a technical point of view but also able to anticipate and adapt to new challenges.

A two-year training programme was developed for them that is based on three areas: technical ability, anticipation and business impact.

- Beginning of training for the Óptima project. Óptima is a management model that transforms the decision-making model of Gas Natural Fenosa, integrating business information with its economic impact, and boosting predictive capacity, continuous review, simulation and analysis. Implementation in the regulated businesses in Spain and in Generación México began during 2017.

F.2 Risk assessment of the financial reporting

State, at least:

F.2.1 What are the main characteristics of the process for the identification of risks, including risks of error or fraudulent practices, in relation to:

> Whether the process exists and is documented.

The approach adopted by Gas Natural Fenosa to carry out the process for the identification and analysis of the risks of the financial reporting is set out in three inter-related matrices:

- The definition matrix of the scope of the financial reporting
- The matrix for the risks associated with the financial reporting
- The control activities matrix of the financial reporting

The purpose of the definition matrix of the scope of the financial reporting is to identify the accounts and the breakdowns that have a significant associated risk, the potential impact of which in the financial reporting of the group is substantial and requires, accordingly, special attention. Accordingly, in the process for the identification of the significant accounts and breakdowns a series of quantitative variables have been taken into account (balance and variation of the account) as well as qualitative variables (complexity of the transactions; changes and complexity of the regulations; need to use estimations or forecasts; application of judgements and qualitative importance of the information). The methodology for the drafting of the scope matrix has been set out in a technical instruction called "Definition matrix of the scope of the financial reporting of Gas Natural Fenosa".

For each one of the significant accounts/breakdowns set out in the definition matrix of the scope, the critical processes and sub-processes have been defined that impact the accounts/breakdowns and the risks have been identified that may generate errors in the financial reporting, and the objectives for control of the existence and occurrence thereof; integrity; valuation; presentation, breakdown and comparability; and rights and obligations, are covered in the "Matrix for the risks associated with the process of the drafting and issue of the financial reporting of Gas Natural Fenosa".

Within the risks identification process defined by Gas Natural Fenosa in the ICSFR, the problem related to fraudulent practices has been considered as a highly relevant element. Accordingly, the fraud risk control policy of Gas Natural Fenosa is based upon three basic aspects:

- Fraud prevention.
- Fraud detection.
- Investigation and management of the fraud situations.

Preventive anti-fraud controls have been defined, from the perspective of financial reporting, that are classified in two categories. The so-called active controls, considered as barriers that restrict or prevent persons that may try to commit fraud from having access to the valuable assets. On the other hand, the passive controls aim to prevent fraud by way of dissuasive measures.

Finally, both the general control activities as well as the process control activities, that consist of the policies and procedures included throughout the stages of the process for the preparation of the financial reporting and that ensure the reliability thereof, are set out in the "Control activities matrix of the financial reporting of Gas Natural Fenosa".

The ICSFR of Gas natural Fenosa is a dynamic system, and accordingly the periodic update thereof constitutes a fundamental process in order to fulfil at all times the purposes thereof, that is to say, in order to ensure that the financial reporting of the group is reliable. In particular, the definition matrix of the scope thereof is updated on an annual basis.

> **Whether the process covers all of the objectives of the financial reporting, (existence and occurrence; integrity; valuation; presentation, breakdown and comparability; and rights and obligations), whether it is updated and of so, how often.**

Gas Natural Fenosa, aware of the need for and the importance of a tool that ensures the adequate control of the management of the ICSFR, implemented in 2013 the SAP GRC Process Control application, for the integral management of the documentation, and the assessment and supervision of the internal control of the processes of Gas Natural Fenosa. Said implementation, carried out within the framework of the efficiency enhancement program of Gas Natural Fenosa, was carried out, initially, in all of the Spanish companies in which Gas Natural Fenosa holds a majority shareholding as well as in the companies in which Gas Natural Fenosa is responsible for the operations and/or management thereof. In 2014 the implementation of the SAP GRC Process Control tool was carried out in Colombia and in the Shared Economic and Financial Services Centre of South America; in 2015 the implementation was extended to other countries of the group, such as Mexico and France; in 2016 the tool was implemented in Holland, in 2017 in Panama and Brazil, and the progressive implementation thereof is scheduled in the countries where Gas Natural Fenosa operates. For the implementation of SAP GRC Process Control, both within Spain as well as at an international level, Gas Natural Fenosa has received the support of the users responsible for the key controls of the ICSFR and of the Internal Auditing, Compliance and Control Unit.

It is noteworthy to mention that, during the year 2015, the scope of the corporate ICSFR model was extended to the countries which have recently been included within the group, such as Chile, as a result of the acquisition in November 2014 of the Chilean group Compañía General de Electricidad, S.A. (CGE). This incorporation strengthens and enhances the Internal Control in Gas Natural Fenosa.

With the exception of the definition matrix of the scope, the ICSFR model of Gas Natural Fenosa is integrated within SAP GRC Process Control. This tool identifies the General Environment Controls and the General Computer Controls, together with the critical processes, their associated risks, as well as the control activities that mitigate said risks, that are set out in the aforementioned risks and controls matrices. Furthermore, the units responsible for the carrying out of the control activities are identified and integrated in the processes structure.

The following benefits are provided through the implementation of SAP GRC Process Control:

- It centralises all of the documentation and management of the ICSFR of Gas Natural Fenosa in a homogeneous manner.
- It integrates the internal control of the financial reporting in the business and corporate processes, thereby enabling each organisational unit to carry out, periodically, the assessment of their controls, with the provision of the necessary documentary evidence, and, annually, to carry out the internal certification process of the ICSFR.
- It uses workflows and forms for the management of the control activities, for the documentation of the evidence of the execution thereof and for the action plans.
- It provides for access to documentation that evidences the controls of the processes and displays the immediate result of the assessment in a user-friendly manner.
- It constitutes a support tool for the supervision process of the ICSFR by the Internal Auditing, Compliance and Control Unit.
- It provides for the provision and support of the information required for both the external and internal reporting of the ICSFR.

After the implementation of SAP GRC Process Control in April 2013, during the subsequent years the requests for assessment of the controls have been carried out in accordance with the established timetable, and the documentary evidence of the execution of the controls has been requested from the units involved in the ICSFR, in accordance with the established frequency. Said assessment makes it possible, if applicable, to identify and inform about weaknesses and the necessary action plans.

- **The existence of a process for the identification of the scope of the consolidated accounts, taking into account, among other aspects, the possible existence of complex corporate structures, instrumental or special purpose (SPV) entities.**

The identified critical processes include the process for the identification of the scope of the consolidated accounts of Gas Natural Fenosa, that has been described in a technical instruction called "Consolidated Accounts Procedures of the Gas Natural Fenosa group". Said document sets out the process for the monthly update of the scope of the consolidated accounts, in accordance with the corporate operations of the period, and the units involved therein are defined. This process of identification and update of the scope of the consolidated accounts is of fundamental importance for the drafting of the consolidated financial reporting of Gas Natural Fenosa.

- **Whether the process takes into account the effects of other types of risks (operational, technological, financial, legal, reputational, environmental risks, etc.) to the extent that they affect the financial statements.**

The risks matrix identifies the risks associated with the fulfilment of the objectives of financial reporting, taking into account in said identification the effects of other types of risks (for example: operational, technological, financial, reputational risks, etc.) that form part of the Corporate Risks Map of Gas Natural Fenosa.

- **Which governing body of the company supervises the process.**

The supervision of the efficacy of the ICSFR is the responsibility of the Audit Committee. For the performance of this function, the Audit Committee receives the support of the Internal Auditing, Compliance and Control Unit and the External Audit (see section F.5).

F.3 Control activities

State, together with the main characteristics thereof, whether at least the following aspects exist:

F.3.1 Procedures for the revision and authorisation of the financial reporting and the description of the ICSFR, to be published in the securities markets, stating the parties responsible for said procedures, as well as the descriptive documentation of the activities and controls flows (including those related to fraud risk) of the different types of transactions that may substantially affect the financial statements, including the procedure for the closing of the accounts and the specific review of the relevant judgements, estimations, valuations and forecasts.

Gas Natural Fenosa carries out periodic reviews of the financial reporting that is drafted, as well as of the description of the ICSFR, in accordance with the different levels of responsibility that guarantee the quality thereof.

By way of initial review, the persons responsible for the closing of the accounts of each company of Gas Natural Fenosa review the financial reporting drafted in order to ensure that it is reliable.

Furthermore, the financial reporting of Gas Natural Fenosa is periodically reviewed by the manager of the Economic and Financial Department, who identifies possible deviations.

Finally, the Chief Financial Officer (CFO) certifies the reasonableness of the individual and consolidated annual accounts that are presented to the Board of Directors for approval.

On the other hand, as is set out in the "General Guidelines for the Internal Control System on Financial Reporting (ICSFR) of Gas Natural Fenosa", the control activities defined by the group in the ICSFR comply with the fundamental objective of ensuring that the financial reporting of Gas Natural Fenosa represents the true and faithful image of the group.

The control activities defined in the ICSFR include both general controls as well as controls of the critical processes.

The general controls are mechanisms that, although they do not provide for a sufficient degree of control over the processes of the group, nonetheless provide for the fulfilment of a series of key objectives for an effective ICSFR, that is to say, they describe the policies and directives designed in order to protect the ICSFR of Gas Natural Fenosa as a whole.

On the other hand, all of the identified critical processes have been documented by means of the control activities matrix as well as by the corresponding technical instructions that describe the processes. In the management tool of the ICSFR, SAP GRC Process Control, the critical processes are identified, as well as their associated risks and the control activities that mitigate said risks, together with the documentation that describes said processes. Accordingly, Gas Natural Fenosa has identified all of the necessary processes for the drafting of the financial reporting, for which relevant judgements, estimations, valuations and forecasts have been used, all of which are considered to be critical. On a periodic basis, the Audit Committee is notified of the main hypotheses applied in order to estimate the financial reporting that depend upon relevant judgements, valuations and forecasts.

The following information has been included within the critical processes and control activities documentation included within SAP GRC Process Control:

- > Description of the process.
- > Diagram of the reporting flows of the process.
- > Map of the systems that are involved in the process.
- > Description of the financial reporting risks associated with the different control processes and objectives
- > Definition of the control activities for the mitigation of the identified risks and the attributes thereof.

› Description of the persons or units responsible for the processes and the control activities.

Moreover, in the definition of the control activities the following control activities classifications have been identified, in light of the following five criteria:

› Scope: Depending upon the scope of the control activities, the activities may be divided into:

- General control activities.
- Process control activities.

› Degree of automation: Depending upon the degree of automation of the control activities, the activities may be divided into automatic and manual activities.

› Nature of the activity: Depending upon the nature of the control activities, the activities may be divided into preventive or detection activities.

› Frequency: Depending upon the recurrence of the activity over time, for example: annual, weekly, monthly, daily, etc.

Finally, in the ICSFR of Gas Natural Fenosa the annual internal certification model has been defined for the controls identified in the critical processes, that must be carried out by the business and corporate units involved in the process of the drafting of the financial reporting. The Financial Reporting Internal Control Unit is responsible for the implementation and monitoring of this certification process. To carry out this internal certification process, the units involved use the functions integrated within the SAP GRC Process Control tool for the management of the ICSFR of Gas Natural Fenosa (see section F.2.1).

In turn, the Internal Auditing, Compliance and Control Unit is responsible for reviewing and assessing the conclusions regarding compliance and efficacy that result from the annual internal certifications process of the units responsible for the controls, of the identification of the weaknesses and of the action plans.

F3.2. Policies and procedures for the internal control of the information systems (including, access security, change control, operational aspects, continuous operability and segregation of the functions) that support the relevant processes of the company in relation to the drafting and publication of the financial reporting.

For the critical processes associated with the drafting and publication of the financial reporting of Gas Natural Fenosa that have been defined in the ICSFR of the group, the control activities have been identified that operate in the information systems, both for the systems that are directly used for the preparation of financial reporting as well as for the systems that are relevant in the control process of transactions that are set out therein.

Generally speaking, within the information systems map of Gas Natural Fenosa, a series of policies have been defined and implemented in order to guarantee the following aspects:

› Access security both for the data as well as for the applications.

› The control regarding changes to the applications.

› The correct procedures for the use of the applications.

› The availability of the data and the continuity of the applications.

› An adequate segregation of the functions.

a) Access security:

A series of measures have been defined at different levels in order to guarantee the confidentiality and to avoid the unauthorised access both to the data as well as to the applications. The management and authentication of the majority of the internal users is centralised in the Directories of OIM (Oracle Identity Manager), that ensures their confidentiality.

The Company has two main DPC (Data Processing Centres) in Madrid, that provide for the availability of the information systems in the case of any contingency. Only authorised personnel are able to access said facilities, and all access is logged and, subsequently, reviewed in order to analyse any anomaly.

The communications with said systems include systems such as Firewall, IPS (Intrusion Prevention System) and antivirus systems in order to enhance the internal control against threats.

Moreover, the Company is currently working on the creation and updating of the BRS (Business Recovery Systems) of the main information systems, for the recovery of interrupted critical functions.

Finally, at an application, operational system and database level, the user-password combination is used as a preventive control. At a data level, profiles have been defined that limit access thereto. Gas Natural Fenosa is developing a project for the definition and implementation of a users/roles/profiles matrix for the enhancement of the segregation of functions that ensures the procedures for access to systems and data.

b) Change control:

A change management methodology has been developed and implemented based upon best practices, which establishes the checks and validations necessary in order to limit the risk in said process.

The main aspects thereof are set out hereinbelow:

- > Approval by the Technical Committee, Changes Committee and Business.
- > Carrying out of tests in different environments, prior to the production phase.
- > Specific environments for the development and test tasks.
- > Rollback procedures.
- > Segregation of functions in the majority of the environments between the development and production equipment.
- > Monitoring and control in any phase of development.
- > User manuals and training courses.
- > Periodic maintenance of the documentation regarding changes.

c) Operability:

In order to guarantee that the operations are correctly carried out, said operations are monitored on four different levels:

- > All of the interfaces between systems are monitored so as to ensure the correct execution thereof.
- > At a perimeter level, different availability indicators exist so as to avoid any communications interruptions.
- > Automatic validations regarding the data entered so that the data is checked against the expected data in light of the nature, type thereof, etc.

› Of the infrastructures that support the applications.

Furthermore, an internal Help Desk service exists that final users may use and they have available a management tool in order to report any types of incident.

d) Availability and continuity:

The majority of the systems have a high degree of local availability, and the servers thereof are situated in the same DPC, and in certain cases, in the support DPC for critical aspects. The high availability of the information systems provides for the availability thereof in the case of incidents.

Furthermore, a backup copy of the data is periodically carried out, that is temporarily kept in a safe place based upon the legal requirements established for each one of the systems. The data is copied and stored in different locations which prevents any information loss. To restore and recover said data, a specific procedure exists, although periodic tests are not carried out.

e) Segregation of functions:

Access to the information systems is defined based upon roles and profiles that define the functionalities that must be available to users. Said profiles are used in order to limit the access of users to the information systems.

f) Regulatory compliance: LOPD (Spanish Data Protection Act)

Gas Natural Fenosa complies with the Spanish Data Protection Act in order to guarantee and protect the personal data of its employees and customers based upon the provisions of the Data Protection Act 15/1999, of 13 December.

The data controller of each file that contains personal data shall ensure legal compliance at Gas Natural Fenosa by:

- › Registering the files at the Spanish Data Protection Agency ("AEPD") of all of the files that include personal data.
- › Ensuring that the data is adequate and accurate and is managed proportionally in relation to the purpose for which it was obtained.
- › Guaranteeing the due compliance of the duties of secrecy and security.
- › Notifying the interested parties of the compilation thereof and obtaining the consent thereof for the processing of the data.
- › Guaranteeing the exercise of the rights of access, correction, cancellation and challenge.
- › Ensuring that all legal provisions are complied with in relation to the relationships with third parties that provide services with access to personal data, establishing by means of contract that the data processor shall process the data in accordance with the instructions of the data controller of the file, shall not apply or use the data for any other purposes other than that which is set out in the contract, shall not disclose said data, not even for the purposes of the storage thereof, to any other persons (the same security measures as applied by the data controller must be applied thereto).
- › Compliance with the sector legislation applicable to Gas Natural Fenosa.

Based upon Section 9 of the LOPD, that conditions the security measures to the state of technology, Gas Natural Fenosa adopts the technical measures that guarantee the security of the personal data and avoids the alteration, loss, or unauthorised processing or access thereto in order to guarantee the confidentiality, integrity and availability of the data.

Pursuant to Section 96 of the LOPD, Gas Natural Fenosa carried out biennial audits of its information systems in order to comply with the provisions of the Data Protection Regulations, as well as the data protection procedures and instructions.

F3.3 Internal control policies and procedures for the supervision of the activities subcontracted to third parties, as well as the assessment, calculation or valuation aspects thereof that are commissioned to independent experts, that may substantially affect the financial statements.

Gas Natural Fenosa has developed a series of policies and procedures in order to supervise the management of the activities subcontracted to third parties, all of which have been approved by the levels established in the group, which include, the existence of “General Guidelines for External Contracting”, “General Guidelines regarding the Quality of Suppliers” and the procedures that are established therein, and the “Counterparty Due Diligence Procedure (corruption and reputational risks)”.

In this context, Gas Natural Fenosa has established in the “General Guidelines for External Contracting” the general principles that must be applied for all awards and contracting of works, goods and services carried out by the group, that guarantees an efficient and quality homogeneous model for the management of the Procurements process at Gas Natural Fenosa.

The foregoing Guidelines also establish, generally speaking, the responsibilities of the different units in the contracting process, which include the Procurements Department as the area responsible for promoting the creation of long-term relationships of trust and confidence with suppliers by establishing objective and impartial mechanisms of assessment and selection and ensuring that the supply chain complies with the principles provided for in the Code of Ethics for Suppliers, that the suppliers, as from 2016, must ratify and the terms of which are sourced from the Code of Ethics of Gas Natural Fenosa, from the Human Rights Policy, from the Health and Safety Policy, from the Anti-Corruption Policy, as well as from internationally recognised principles of good governance. The aforementioned Guidelines creates the obligation for the initial evaluation of all potential suppliers prior to the participation thereof within a procurements process, by which the Company evaluates, inter alia, legal, financial, quality, safety and security, environmental and corporate responsibility aspects, and also carries out the periodic evaluation thereof. In certain critical processes an additional level of control is required, that is referred to as “certification”, which is supported by documentary evidence and/or audits in order to secure the quality of the goods and services that are acquired.

For said purposes, Gas Natural Fenosa has developed, in the “General Guidelines regarding the Quality of Suppliers” and in the relevant procedures thereof, the basic principles that govern the evaluation and certification process of the suppliers of the group, which include the establishment of procedures and controls that guarantee the compliance of requirements set out in the specifications by potential suppliers and awarded contractors and furthermore also requires the certification of the suppliers of certain services or materials identified as of high risk (Operating Risk, Legal Risk, Health and Safety Risk, Quality Risk, and Environmental-Social-Governance Risk). The certification process may reveal anomalies that require a corrective action plan, or that result in the non-certification of a supplier, that shall prevent the supplier from rendering services to Gas Natural Fenosa.

Furthermore, the measurement of performance is carried out by means of satisfaction surveys of the service provided by suppliers that carry out high risk activities, with special attention on the Health and Safety aspects. The necessary corrective measures or action plans are established, as the case may be.

The main areas that affect critical processes of the financial reporting that Gas Natural Fenosa has subcontracted to third parties are:

- › Certain processes of the Systems area.
- › Meter reading and measurement processes.
- › Certain Customer Services processes.
- › Logistics operator.
- › Payslip and staff management process.
- › Site management and maintenance works of the distribution business.
- › Certain services provided to customers of the Retail business.

Furthermore, the Business Units carry out the supervision and the quality control of their suppliers in order to determine whether they fulfil the required levels of quality for the execution of the works. Alternatively, they forward their proposals for the removal of the certifications/accreditation for suppliers/products/persons as a result of any deficiencies in the performance of the services or products.

Gas Natural Fenosa contracts experts for activities that support valuations, judgements or accounting calculations, solely and exclusively when said experts are registered in the corresponding Professional Colleges, or equivalent accreditation, and provided that they declare their independence and are internationally renowned companies.

Furthermore, Gas Natural Fenosa has defined the "Counterparty Due Diligence Procedure" that, in general, aims to provide hedging coverage for the main legal and reputational risks that affect business relationships with third parties and, in particular, the coverage of crimes associated with corruption risks.

The Internal Auditing, Compliance and Control Unit of Gas Natural Fenosa audits the processes and the correct application of the Procurement, Quality of Suppliers and Counterparty Due Diligence Procedures and in the case that breaches are detected the corresponding corrective actions are carried out.

F.4 Information and communication

State, together with the main characteristics thereof, whether at least the following aspects exist:

F.4.1 A specific function for the purpose of defining and keeping up to date the accounting policies (accounting policy area or department) and for resolving doubts or disputes in relation to the interpretation thereof, while maintaining fluid communication with the persons and units responsible for the operations within the organisation, as well as an updated accounting policies manual that is provided to the units pursuant to which the company operates.

The Economic and Financial Department is responsible, through the Accounting Planning and External Audit Unit, among other functions, for keeping up to date the accounting policies applicable to the group. Accordingly, it is responsible for the updating of the "Accounting Plan of Gas Natural Fenosa", that includes the accounting criteria and the accounts plan of the group, as well as for the analysis of the accounting changes that may affect the financial reporting of Gas Natural Fenosa.

The updating of the "Gas Natural Fenosa Accounting Plan" is carried out on an annual basis, and the most recent update was carried out in December 2017. The updates review both the accounting criteria based upon changes to the applicable IFRS-EU regulations as well as the accounting structure of the group, ensuring the traceability between the individual accounts plans of the subsidiaries of the group and the accounts plan of Gas Natural Fenosa, that constitutes the basis for the drafting of the different financial reporting to be provided to external bodies as well as the Management Control information.

After the Accounting Plan has been updated, it is disseminated to all of the staff of the organisation via the intranet of Gas Natural Fenosa. Furthermore, and after the updated accounting plan has been published on the intranet, an online alert is sent to users that access the intranet that notifies all staff of said update.

On the other hand, the Accounting Planning and External Audit Unit is responsible for analysing the IFRS-EU regulatory changes that may significantly affect the financial statements and for notifying the managers of Gas Natural Fenosa that are affected by said regulatory changes. The foregoing Unit is also responsible for resolving the doubts and questions regarding the accounting classification of certain transactions that may be raised by the financial reporting staff of Gas Natural Fenosa.

F.4.2 Mechanisms for the capture and preparation of the financial reporting with homogeneous formats, that are applicable and used by all of the units of the company or group, that support the main financial statements and the notes, as well as the information that is set out regarding the ICSFR.

The integral economic and financial management model of Gas Natural Fenosa ensures the uniformity of the administrative and accounting processes by means of the centralisation of the accounting activities and the economic administration in Shared Economic and Financial Services Centres ("CSCs") and through the use of SAP as a support system in the majority of the companies that form part of the group. The rest of the companies that do not use SAP are required to adhere to the criteria established by the group in order to ensure the uniformity of said processes.

Said model is characterised, fundamentally, by the fact that:

- > it constitutes a single model for all countries and businesses;
- > it incorporates the legal, tax, commercial and regulatory requirements of each one of the countries;
- > it incorporates the internal control requirements;
- > it constitutes the basis for obtaining the information that is provided to Senior Management and to official bodies;
- > it is supported by a specific organisational model as well as specific economic and financial processes and computer systems for all countries and businesses;

The IFRS-EU financial statements of each country are directly obtained through the local account-group account assignment and the registration of the IFRS-EU adjustments in the SAP application.

As part of the ICSFR of the group, the map of interrelationships regarding the drafting of the financial reporting of Gas Natural Fenosa has been defined. Said map sets out, among other things, the computer systems that are involved in the process for the drafting and issue of the financial reporting both from the perspective of the individual accounting close as well as from the consolidated accounting close perspective.

Accordingly, in relation to the drafting process of the financial reporting of Gas Natural Fenosa, the application SAP BPC is used, that is the SAP tool for the management of the consolidated process.

The information is automatically and directly loaded into said system, after the month has been closed.

Both of the foregoing tools provide support for the consolidation process and for Management Control in relation to tasks such as:

- > Standardisation of the information.
- > Validation of the information.

The drafting of the economic information, both of the financial reporting, as well as of the management information is centralised in the Integrated Reporting Centre, that ensures the integration, homogeneity, coherence and rationalisation of the reporting of Gas Natural Fenosa.

Furthermore, Gas Natural Fenosa has local accounts plans in order to comply with the accounting, tax, commercial and regulatory requirements established under the specific legislation of the countries in which the group operates. Said local accounts plans are grouped together to complete the unified and homogeneous group accounts plan for the purposes of the consolidated accounts and financial reporting.

F5 Supervision of the functioning of the system

State, including the main characteristics thereof, at least:

F5.1 The supervision activities of the ICSFR carried out by the Audit Committee as well as whether the company has an internal auditing function that includes activities that provide support to the Committee in relation to its supervision activities for the internal control system, including the ICSFR. Furthermore, state the scope of the assessment of the ICSFR carried out during the year and the procedure by which the person or unit responsible for carrying out the assessment notifies of the results thereof, whether the company has an action plan that details the potential corrective measures, and whether the impact thereof has been taken into consideration in relation to the financial reporting.

The Audit Committee has the powers that are provided for at law as well as the specific or general powers that are delegated upon it by the Board of Directors. The powers thereof include the following:

- Supervise the drafting process, the presentation and the integrity of the financial reporting of the Company and, as the case may be, of the group, and to review the compliance with the regulatory requirements, the adequate delimitation of the scope of the consolidated accounts and the correct application of the accounting criteria.
- Supervise the efficacy of the internal control of the Company, the internal auditing and the risk management systems, including the tax risks, as well as to discuss with the accounts auditor the significant weaknesses of the internal control system detected during the carrying out of the audit.
- Notify the General Shareholders Meeting regarding the questions that are raised thereby in relation to the aspects for which the Committee is responsible.
- To forward to the Board of Directors the proposals for the selection, appointment, re-election and replacement of the external auditor, as well as the terms and conditions for the contracting thereof and to regularly obtain from the external auditor information regarding the audit plan and the execution thereof, and furthermore to preserve the independence thereof in the exercise of its functions.
- Establish the necessary relationships with the external auditor in order to obtain information regarding the questions that may jeopardise the independence thereof, for the examination thereof by the Committee, and any other questions related to the accounts audit process, as well as any other communications provided for under applicable accounts audit legislation and in the audit regulations. In any event, the Committee must receive, annually, from the external auditors the declaration of their independence in relation to any directly or indirectly related parties, as well as the information regarding the additional services of any type whatsoever provided thereby and the corresponding professional fees received from said entities by the external auditor or by the persons or related parties thereof, in accordance with the provisions of accounts audit legislation.
- Annually issue, prior to the release of the accounts audit report, a report that sets out an opinion regarding the independence of the accounts auditor. Said report must contain, in any circumstances, the valuation of the provision of the additional services referred to under the preceding paragraph, both individually and as a whole, other than for the legal audit and in relation to the regime of independence or the audit regulations.
- Ensure the independence of the unit that assumes the internal auditing functions; approve the orientation and the work plans thereof, ensuring that the activities thereof are mainly focused toward the relevant risks of the Company; to receive periodic information regarding the activities thereof; and to verify that senior management take into account the conclusions and recommendations of its reports. To propose to the Chairman of the Board of Directors the selection, appointment, re-election and removal of the internal auditing service manager, as well as to propose the budget for said service, however the final decision shall be adopted by the Chairman of the Board of Directors.

The Audit Committee shall obtain, in order to be able to perform its activities, the information and documentation provided by the Internal Auditing, Compliance and Control Unit and by the Economic and Financial Department.

The functions of the Internal Auditing, Compliance and Control Unit has been established at Gas Natural Fenosa as independent and objective assessment activities, and accordingly the Internal Auditing, Compliance and Control Units, in turn, reports to the Audit Committee and to the Managing Director of Gas Natural SDG, S.A.

Its mission is to ensure the continuous review and the improvement of the internal control system of the group, as well as to ensure compliance with external and internal regulations and with the established control models in order to safeguard the efficacy and efficiency of the operations, and to mitigate the main risks in each of the different areas of the group, in particular the operational, corruption, fraud and legal risks. Furthermore, it is responsible for the management of the Crime Prevention Model and of the Code of Ethics Model of Gas Natural Fenosa and for reporting regarding the internal auditing activities to the Audit Committee.

In the performance of its activities, Internal Auditing carries out the methodical review of the internal control systems of the processes of the group in all of the different aspects thereof, as well as the assessment of the controls and the operational risks associated with said processes (including those established in the ICSFR and in the Crime Prevention Model), through the definition and implementation of the "Annual Internal Audit Plan", in order to improve the efficacy and efficiency thereof. Furthermore, it supports senior management through the fulfilment of its objectives.

The final objective is to safeguard the efficacy and efficiency of the operations and to mitigate the main risks in each one of the ambits of Gas Natural Fenosa, in particular in relation to operational, corruption, fraud and legal risks.

The "Strategic Audit Plan" (with a time frame of five years) and the annual internal audit plans are drafted taking into account, fundamentally, the "Corporate Strategic Plan", the risk areas included in the Corporate Risks Map, the scope matrix of the Internal Control System on Financial Reporting (ICSFR), the operational risks maps, the results of the audits of previous years, and the proposals of the Audit and Control Committee and from top-tier management.

In accordance with the Strategic Audit Plan, the Internal Control System on Financial Reporting (ICSFR) of Gas Natural Fenosa shall be completely supervised by Internal Auditing within the period of five years.

The methodology for the assessment of operational risks is in accordance with best corporate governance practices, based on the conceptual framework of the COSO Report (Committee of Sponsoring Organisations of the Treadway Commission) and on the basis of the types of risks defined in the company's Corporate Risk Map.

The operational risks associated with the processes are prioritised by assessing their incidence, relative importance and degree of control. Depending on the findings, the company designs an action plan with corrective measures that enables mitigation of residual risks identified with a potential impact above the tolerable or accepted risk established.

Internal Auditing is supported by the implementation of a SAP environment corporate application which it uses to manage and document internal audit projects in accordance with the defined methodology.

Specifically, and in relation to the Internal Control System on Financial Reporting (ICSFR), Internal Auditing is responsible for:

- > Validating the correct design of the ICSFR, in accordance with the basic principles of the model approved by the Audit Committee.
- > Supervising the efficacy and suitability of the control policies and procedures implemented (with the complete implementation thereof over five years).
- > Reviewing and assessing the conclusions regarding the compliance and efficacy of the ICSFR from the internal certificates of the business and corporate units responsible for the controls (with the complete implementation thereof over five years).
- > Assessing and communicating the results obtained in the general supervision process of the ICSFR and from the controls over the ICSFR processes.

In relation to the Crime Prevention Model, the Internal Auditing, Compliance and Control Area is responsible for the annual supervision thereof in order to reasonably ensure the efficacy and efficiency of the Model for the prevention, identification or mitigation of crimes provided for under applicable legislation.

The main processes reviewed by Internal Audit during 2017 were as follows:

Business processes

- > Gas Distribution: Meter Reading and Determination of Consumption, Customer Acquisition and Commissioning, Construction of Networks, Maintenance of Gas Infrastructures, Network Operation, Home Visit Operations.
- > Electricity Distribution: Operations, Service Provision, Medium and Low Voltage Development, Meter Reading, Meter Reading Office, Management of Irregularities and Fraud.
- > Electricity Generation: Operation and Maintenance of Generation Assets, Warehouse Management, Monitoring and Managing of Contracts, Development and Launch of New Projects.
- > Retail Market: Customer Acquisition and Contracting of Energy and Products, Customer Acquisition and Contracting of Energy Facilities, Administration of Contracts and Management of Access.

- › Wholesale Market and Global Accounts: Management and Monitoring of Global Accounts, Customer Acquisition and Contracting.
- › Provisioning and Transport: Technical Management of Gas Pipelines.
- › Exploration and Production: Exploration/Production.
- › Energy Management: Electricity Sales: Settlement, billing and collection, Energy Trading.

Strategic and support processes

- › Customer Services: Collection, Billing, Debt Management.
- › Management of Physical Resources: Procurements within and outside the scope of consolidation, Counterparty Due Diligence.
- › Internal Control Management: Monitoring of corrective actions, ICSFR, Data Protection Act.
- › Information Systems Management: Management of IS Projects, Maintenance of Evolutions, Backup, Information Security.
- › Human Resources Management: Human Resources Administration and Services, DPO.
- › Communication Management and Foreign Relations: Foundations, Corporate Responsibility.
- › Management of Economic and Financial Resources: Treasury Stock, Economic and Administrative Management of Operations.
- › Legal Consultancy and Support Services: Powers.
- › Review of the Regulatory System of the Group.
- › Code of Ethics.
- › Update of the operational risks map.
- › Review of the assessment and implementation of the Productivity Plan
- › Crime Prevention Model.

31% of the processes reviewed relate to business activities within Spain and the remaining 69% correspond to the international element.

The controls of the previous processes related to Financial Reporting, were reviewed in accordance with the working methodology that has been set out hereinabove.

F5.2 Whether a discussion procedure exists by means of which the accounts auditor (in accordance with the provisions of the NTA), the internal audit staff and other experts may notify to senior management and the Audit Committee or directors of the company the significant internal control weaknesses identified during the processes of review of the annual accounts or during any other processes carried out thereby. Furthermore, state whether an action plan exists for the correction or mitigation of the detected weaknesses.

As provided for under Article 6.4 of the Regulations regarding the Organisation and Functioning of the Board of Directors and its Committees:

“The Board of Directors shall ensure that a direct relationship is maintained with the members of the senior management bodies of the Company and with the Auditors thereof. The objective, professional and permanent nature of said relationship shall strictly respect the independence of the Auditors.”

Furthermore, Article 9 of the Regulations provide that:

The Board shall meet at least once every two months, and, at the proposal of the Chairman, as often as the Chairman deems necessary for the proper functioning of the Company. The meeting must, necessarily, be called when requested by at least 1/3 of the Board Members, in accordance with the terms of Article 46 of the Articles of Association of the Company. During the ordinary meeting sessions of the Board, there will be discussion of the general aspects related to the businesses of the Group, the economic results, the Balance Sheet, the Cash situation and their comparison with the approved budgets, the aspects and matters set out in Article 5, if applicable, and in any event the points included on the agenda for the meeting, drafted in accordance with the terms of these Regulations. During said periodic meetings, the Board shall also receive information regarding the most significant operational results and problems as well as in relation to the foreseeable situations that may be critical for the interests of the Company and the actions that the Steering Committee proposes in order to manage said situations, as the case may be (...).

Accordingly, the members of the Board of Directors, in order to obtain the information necessary for the exercise of their functions, are supported by the Steering Committee, the specific function of which is to carry out the continuous monitoring of senior management of the group, as well as the Audit Committee, the functions of which include the analysis and supervision of the process for the drafting of the regulated financial reporting, as well as the efficacy of the internal control system.

The permanent delegation of powers by the Board of Directors in favour of the Steering Committee shall include all of the powers of the Board, with the exception of the powers that are not able to be delegated, whether pursuant to legal provisions or the Articles of Association or pursuant to these Regulations.

In accordance with the Articles of Association of the Company and the Regulations of the Board of Directors and its Committees, the Audit Committee shall be comprised by a minimum of three and a maximum of seven Board Members, that shall be designated by the Board of Directors from among the Non-Executive Board Members, and at least one of the Non-Executive Board Members thereof shall be designated taking into account his or her knowledge and expertise in accounting or audit fields, or in both fields. The members thereof shall be removed from office when they cease to be Board Members or when the Board removes them from the Audit Committee or by reason of the expiry of the period of three years after their appointment, however the members thereof may be re-elected. The majority of the members of the Committee shall be Independent Board Members. As of 31 December 2017, the Audit Committee is comprised of seven Board Members, three proprietary Board Members and four independent Board Members, one of which is the Chairman.

The Board of Directors shall elect the Chairman of the Committee, who shall not have a casting vote and who must be replaced as provided for under the Articles of Association (Article 51 bis) and as provided for at law, and who may be re-elected after the period of one year has elapsed as from the removal from office thereof. The Secretary of the Board of Directors shall act as the Secretary of the Committee.

The Committee, which shall be called by the Chairman thereof, shall meet as often as necessary in order to issue reports or proposals in relation to its functions or when deemed necessary by the Chairman thereof, or at the prior request of at least two of the members thereof and, shall meet at least four times a year. The Committee may invite any manager or employee that it deems necessary to attend the meetings.

The scope of the activities of the Audit Committee extends to:

- > Gas Natural SDG, S.A.
- > Subsidiary companies in which Gas Natural SDG, S.A. holds a majority shareholding
- > Other subsidiary and related companies, in respect of which Gas Natural SDG, S.A., in any form whatsoever, effectively controls or is responsible for the management or operations thereof.

The Internal Auditing, Compliance and Control Unit shall report to the Audit Committee, on a permanent basis, the actions adopted in order to ensure that Gas Natural Fenosa complies with all of the policies, rules and controls of the processes established by the senior management of the group.

Furthermore, the foregoing unit shall also present:

- > The Annual Internal Audit Plan for the approval of the Committee.
- > The degree of execution thereof, as well as the main conclusions and recommendations included in the Internal Audit Reports.

- The assessment of the efficacy of the Control System for the assessment of the operational risks and of the Internal Control of the Gas Natural Fenosa group (including the risks corresponding to the ICSFR and to the Crime Prevention Model), that includes the corresponding Action Plans in order to enhance the level of internal control.
- The degree of implementation by the audited units of the corrective measures that are included in the Audit Reports, in particular the measures proposed by the Audit Committee.

The external auditor notifies the Audit Committee of the significant internal control weaknesses detected during the audit procedures. Furthermore, the external auditors report on the main conclusions that they have reached in relation to the review of the internal control, regarding the assessment of risks and the action plans.

Finally, the external auditor, over and above the periodic meetings with the Audit Committee, also attends the plenary session of the Board of Directors prior to drafting the annual accounts.

F.6 Other relevant information.

As is described in section F.3.1. hereinabove, as part of the assessment model of the Internal Control System on Financial Reporting of Gas Natural Fenosa, an annual internal certification process has been defined by means of which, and through SAP GRC Process Control, the business and corporate units involved in the process for the drafting of the financial reporting certify that within their processes the identified controls are applied and that said controls are valid and sufficient. Moreover, said units report to the Internal Control on Financial Reporting unit of the weaknesses and/or deficiencies that they detect as well as the changes that take place within their processes in order to analyse whether said changes imply the need to develop new controls or modify the existing controls.

During the year 2017, Gas Natural Fenosa has carried out the annual internal certification process, with the result that changes in a limited number of processes have been identified. However, said changes have not implied the modification of the previously identified control activities, and accordingly the risks associated with the drafting of the financial reporting in the affected critical processes are considered to be covered. The main figures from said process are set out hereinbelow:

	Spain	International	Total
Business and corporate units	141	175	316
Processes identified	54	143	197
Controls certified	859	1,276	2,135

Furthermore, action plans have been identified for weaknesses in relation to the documentary evidence of controls, that amount to 25, of which 7 are for Spain. During the year 2017 a total of 48% of the action plans identified in 2016 have been resolved, and new plans have been established during 2017. In any event, the sub-processes affected by said action plans do not significantly affect the quality of the financial reporting.

F.7 Report of the external auditor

State:

F.7.1 Whether the information of the ICSFR that is released to the markets has been submitted to review by the external auditor, in which case the company must include the corresponding report as an annex. Alternatively, the reasons why no report exists must be stated.

Gas Natural Fenosa has considered it appropriate to request the External Auditor to issue a report in relation to the information regarding the Internal Control System on Financial Reporting (ICSFR).

G. Degree of compliance with the Corporate Governance Recommendations

State the degree of compliance of the company in respect of the recommendations regarding the Good Governance Code of Listed Companies.

In the case that any recommendation is not complied with or is only partially complied with, a detailed explanation must be included of the reasons thereof, in order that the shareholders, investors and the market in general have sufficient information in order to assess the decisions of the company. General explanations shall not be accepted.

1. The Articles of Association of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.

Compliant

2. When a dominant and subsidiary company are both listed, they should provide detailed disclosure on:

- a) The activity they engage in and any business dealings between them, as well as between the listed subsidiary and other group companies;

- b) The mechanisms in place to resolve possible conflicts of interest.

Not applicable

3. During the General Shareholders Meeting the Chairman of the Board of Directors should verbally inform shareholders in sufficient detail of the most relevant aspects of the company's corporate governance, supplementing the written information circulated in the annual corporate governance report. In particular:

- a) Changes taking place since the previous General Shareholders Meeting.

- b) The specific reasons for the company not following a given Good Governance Code recommendation, and any alternative procedures applied in respect thereof.

Compliant

4. The company should draw up and implement a policy of communication and contacts with shareholders, institutional investors and proxy advisors that complies in full with market abuse regulations and accords equitable treatment to shareholders in the same position.

This policy should be disclosed on the company's website, complete with details of how it has been put into practice and the identities of the relevant interlocutors or those charged with its implementation.

Compliant

5. The Board of Directors should not make a proposal to the general meeting for the delegation of powers to issue shares or convertible securities without pre-emptive subscription rights for an amount exceeding 20% of capital at the time of such delegation.

When the Board of Directors approves the issuance of shares or convertible securities without pre-emptive subscription rights, the company should immediately post a report on its website explaining the exclusion as envisaged in company legislation.

Compliant

6. Listed companies drawing up the following reports on a voluntary or compulsory basis should publish them on their website well in advance of the General Shareholders Meeting, even if their distribution is not obligatory:

- a) Report on auditor independence.
- b) Reports of the operation of the Audit Committee and the nomination and remuneration committee.
- c) Audit committee report on related party transactions.
- d) Report on corporate social responsibility policy.

Compliant

7. The company should broadcast its general meetings live on the corporate website.

Compliant

8. The Audit Committee should strive to ensure that the Board of Directors can present the company's accounts to the general meeting without limitations or qualifications in the auditor's report. In the exceptional case that qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.

Compliant

9. The company should disclose its conditions and procedures for admitting share ownership, the right to attend general meetings and the exercise or delegation of voting rights, and display them permanently on its website.

Such conditions and procedures should encourage shareholders to attend and exercise their rights and be applied in a non-discriminatory manner.

Compliant

10. When an accredited shareholder exercises the right to supplement the agenda or submit new proposals prior to the general meeting, the company should:

- a) Immediately circulate the supplementary items and new proposals.
- b) Disclose the model of attendance card or proxy appointment or remote voting form duly modified so that new agenda items and alternative proposals can be voted on in the same terms as those submitted by the Board of Directors.
- c) Put all these items or alternative proposals to the vote applying the same voting rules as for those submitted by the Board of Directors, with particular regard to presumptions or deductions about the direction of votes.
- d) After the general meeting, disclose the breakdown of votes on such supplementary items or alternative proposals.

Not applicable

11. In the event that a company plans to pay for attendance at the general meeting, it should first establish a general, long-term policy in this respect.

Not applicable

12. The Board of Directors should perform its duties with unity of purpose and independent judgement, according the same treatment to all shareholders in the same position. It should be guided at all times by the company's best interest, understood as the creation of a profitable business that promotes its sustainable success over time, while maximising its economic value.

In pursuing the corporate interest, it should not only abide by laws and regulations and conduct itself according to principles of good faith, ethics and respect for commonly accepted customs and good practices, but also strive to reconcile its own interests with the legitimate interests of its employees, suppliers, clients and other stakeholders, as well as with the impact of its activities on the broader community and the natural environment.

Compliant

13. The Board of Directors should have an optimal size to promote its efficient functioning and maximise participation. The recommended range is accordingly between five and fifteen members.

Explain

Currently, the Board of Directors of Gas Natural SDG, S.A., within the minimum of 10 members and the maximum of 20 members, as provided for under Article 41 of the Articles of Association, by virtue of the resolution adopted at the General Shareholders Meeting held on 23 June 2003, is comprised of 17 members. Said number of members exceeds the number established in Recommendation 13 of the Good Governance Code by 2 members, but represents the minimum number that enables the Company to fulfil two objectives: on the one hand, to respect and abide by the legal mandate of proportional representation and, on the other hand, to have a sufficient number of independent Board Members that are able to carry out, with the sufficient degree of dedication, the numerous functions that are conferred upon them pursuant to applicable regulations and in particular, to be able to participate at the different committees which they are required to attend. In order to obtain a Board with fewer members, the principle of proportional representation would require a total of four independent Board Members which would adversely affect the working capacity thereof, for example they would all be required to be members of the Audit Committee. In any event, the number of 17 does not limit or restrict the efficient and participative functioning of the Board or of its committees in any way whatsoever.

14. The Board of Directors should approve a director selection policy that:

a) Is concrete and verifiable.

b) Ensures that appointment or re-election proposals are based on a prior analysis of the Board's needs; and.

c) Favours a diversity of knowledge, experience and gender.

The results of the prior analysis of Board needs should be written up in the Nomination Committee's explanatory report, to be published when the general meeting is convened that will ratify the appointment and re-election of each director.

The director selection policy should pursue the goal of having at least 30% of total Board appointments occupied by women directors before the year 2020.

The Nomination Committee should run an annual check on compliance with the director selection policy and set out its findings in the annual corporate governance report.

Partially compliant

The director selection policy ensures that the selection procedures of the Company are not subject to any implicit bias that could imply any type of discrimination whatsoever, within the framework of the strict adherence to the right of proportional representation of the shareholders that is provided for at law. The director selection policy aims to ensure adequate diversity in the composition of the Board of Directors, which means that the members of the Board have different but complementary professional profiles and experience, as the Company believes that said diversity provides for the better functioning of the Board. Within the foregoing framework, the Board pays attention to the question of gender diversity. Although the policy does not expressly state the objective that in the year 2020 at least a third of the members of the Board must be women directors, it is true that within a brief period of time (2014-2016) the percentage of women directors has increased from 0% to 17.64%, a percentage that is currently being maintained, and equality has been established in relation to the independent directors.

This position is due to the Company's special shareholding structure and the consequences this has for the functioning of the Board, meaning that the Board, when making its proposals to the Shareholders' Meeting, must not only consider the recommendations but also ensure that they are in keeping with the mandatory corporate regulations. In addition, the Company must fully respect the right of the shareholders who hold a stake of over 5.88% (100% divided by 17) to propose the people they deem appropriate as members of the Board of Directors. The Board's efforts are therefore focused on covering the positions of the Independent Directors. The requirement to ensure that the number of female Directors reaches 30% of the members of the Board of Directors by the year 2020 could lead to a situation in which, due to the existence of 6 Independent Directors in the Board's current configuration (due to the requirements of the proportional representation mandate), only female candidates can be considered when proposing candidates to exercise the duties of Independent Director, with the absolute exclusion of male candidates. Whilst the Company supports the good intentions behind increasing the presence of women on the Board up to at least this sort of figure, as indeed it has been doing in recent years, it is considered that the uncritical following of the recommendation, without considering other legal considerations, could give rise to an undue restriction when exercising the duties of the Appointments and Remuneration Committee as it could become counter-productive when appointing the best possible candidate, especially if male candidates cannot even be considered for appointment as Independent Directors (regardless of whether they are elected or not).

For these purposes, it is worth mentioning that, in terms of Independent Directors, equality has been reached in a short period of time; three female Directors out of a total of six Independent Directors.

- 15. Proprietary and independent directors should constitute an ample majority on the Board of Directors, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.**

Compliant

- 16. The percentage of proprietary directors out of all non-executive directors should be no greater than the proportion between the ownership stake of the shareholders they represent and the remainder of the company's capital.**

This criterion can be relaxed:

- a) In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings.
- b) In companies with a plurality of shareholders represented on the Board of Directors but not otherwise related.

Compliant

17. Independent directors should be at least half of all Board Members.

However, when the company does not have a large market capitalisation, or when a large cap company has shareholders individually or concertedly controlling over 30 per cent of capital, independent directors should occupy, at least, a third of Board appointments.

Explain

As of 31 December 2017, one third of the directors are independent directors, although the Company cannot be classified as having low market capitalisation and does not have shareholders that act jointly and that control more than 30% of the share capital. Accordingly, it must be taken into account that three shareholders of the Company have shareholdings that are equal to or that exceed 20% however they do not act jointly, the representation thereof on the Board of Directors complies with the principle of proportional representation. On the other hand, it must be stated that the establishment of qualified majorities for certain matters has provided the independent directors with the capacity to block the decisions thereof.

Respect for the current legislation and the Company's special shareholder structure determine that, for legal reasons, this recommendation cannot be met if the shareholders with more than 5.88% of the share capital wish to exercise their right to proportional representation, as is the case. The current legislation establishes the proportional representation principle, so the Company is obliged to respect the legitimate exercising of this right by its shareholders.

The current number of Independent Directors is 6 out of a total of 17 Directors, that is, they represent 35.29% of Directors. The Company's significant shareholders hold, as a whole, 64.52% of the capital and have proposed 58.8% of the directors (a total of 10 out of 17). Whilst this situation continues, due to respecting the legal mandate of proportionality, the number of Independent Directors cannot equal half of the total number of Directors. In any case, the figure of 6, apart from being that which is quantitatively correct given the law, is of qualitative importance: an amendment to the Board Regulations has established that, for matters of greater importance, a qualified two-thirds majority is required. This is equivalent to a possible blocking of decisions by one third, so the Independent Directors as a whole, by themselves, have this blocking capacity.

18. Companies should disclose the following director particulars on their websites and keep them regularly updated:

- a) Background and professional experience.
- b) Directorships held in other companies, listed or otherwise, and other paid activities they engage in, of whatever nature.
- c) Statement of the director class to which they belong, in the case of proprietary directors indicating the shareholder they represent or have links with.
- d) Dates of their first appointment as a Board Member and subsequent re-elections.
- e) Shares held in the company, and any options on the same.

Compliant

19. Following verification by the Nomination Committee, the annual corporate governance report should disclose the reasons for the appointment of proprietary directors at the urging of shareholders controlling less than 3 per cent of capital; and explain any rejection of a formal request for a Board appointment from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary directorship.

Not applicable

20. Proprietary directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary directors, the latter's number should be reduced accordingly.

Not applicable

21. The Board of Directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the Articles of Association, except where they find just cause, based on a proposal from the Nomination Committee. In particular, just cause will be presumed when directors take up new posts or responsibilities that prevent them allocating sufficient time to the work of a Board Member, or are in breach of their fiduciary duties or come under one of the disqualifying grounds for classification as independent enumerated in the applicable legislation.

The removal of independent directors may also be proposed when a takeover bid, merger or similar corporate transaction alters the company's capital structure, provided the changes in Board Membership ensue from the proportionality criterion set out in recommendation 16.

Compliant

22. Companies should establish rules obliging directors to disclose any circumstance that might harm the organisation's name or reputation, tendering their resignation as the case may be, and, in particular, to inform the Board of Directors of any criminal charges brought against them and the progress of any subsequent trial.

The moment a director is indicted or tried for any of the offences stated in company legislation, the Board of Directors should open an investigation and, in light of the particular circumstances, decide whether or not he or she should be called on to resign. The Board of Directors should give a reasoned account of all such determinations in the annual corporate governance report.

Compliant

23. Directors should express their clear opposition when they feel a proposal submitted for the Board's approval might damage the corporate interest. In particular, independents and other directors not subject to potential conflicts of interest should strenuously challenge any decision that could harm the interests of shareholders lacking Board representation.

When the Board of Directors makes material or reiterated decisions about which a director has expressed serious reservations, then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next recommendation.

The terms of this recommendation also apply to the Secretary of the Board of Directors, even if he or she is not a director.

Compliant

24. Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the Board of Directors. Whether or not such resignation is disclosed as a material event, the motivating factors should be explained in the annual corporate governance report.

Not applicable

25. The Nomination Committee should ensure that non-executive directors have sufficient time available to discharge their responsibilities effectively.

The Board of Directors regulations should lay down the maximum number of company boards on which directors can serve.

Partially compliant

In light of the extensive participation and attendance by the members of the Board at the meeting sessions of the governing bodies, the Company has not yet established rules regarding the number of company boards on which directors can serve, without prejudice to the fact that the Company has verified the adequate functioning of the Board of Directors, both in terms of the number of meetings, that have exceeded the recommended number, as well as in qualitative terms.

26. The Board of Directors should meet with the necessary frequency to properly perform its functions, eight times a year at least, in accordance with a calendar and agendas set at the start of the year, to which each director may propose the addition of initially unscheduled items.

Partially compliant

In accordance with article 23 of the Board Regulations, the Chairman of the Board of Directors is responsible for promoting and leading the Company's activities. In the exercising of these powers, the Company understands that the establishment of the items on the agenda of the meetings corresponds essentially to the Chairman of the Board, or whoever acts on his behalf. Furthermore, 1/3 of the directors may propose other items on the agenda that were not initially foreseen.

The reason why this number of directors is established for the inclusion of items on the agenda relates to the need to balance the scope of the management duties held by the full Board of Directors in the Company with the need to speed up and facilitate its operation, in order to guarantee the Company's diligent management. It must be taken into account that, in accordance with art. 5 of the Board Regulations, in section III a very significant number of management duties have been reserved for the board itself instead of delegating them to the Managing Director, which affects the workload of the Board. This is why it is deemed appropriate that, given this heavy workload, the Board focus on analysing those matters, in addition to the exhaustive ordinary list, for which there is a minimum degree of consensus, namely that of 6 directors. This number is important, as it allows the Independent Directors to make proposals and, on the other hand, limits the individual power to propose of the group of proprietary directors representing a significant shareholder, in such a way that the proprietary directors corresponding to a significant shareholder cannot impose an item on the agenda by themselves.

27. Director absences should be kept to a strict minimum and quantified in the annual corporate governance report. In the event of absence, directors should delegate their powers of representation with the appropriate instructions.

Partially compliant

The recommendation is partially met, although it is true that in the majority of cases of delegation there are voting instructions. There is a small number of cases where these have not been included. Nevertheless, the Company considers that complying 100% with this recommendation is not necessarily optimal as in specific cases it may be justifiable for the represented party not to give specific instructions to the representative, insofar as it is considered beneficial for the representative to vote on the basis of the debates that take place within the Board of Directors.

28. When Directors or the Secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, they should be recorded in the minute book if the person expressing them so requests.

Compliant

29. The company should provide suitable channels for directors to obtain the advice they need to carry out their duties, extending if necessary to external assistance at the company's expense.

Compliant

30. Regardless of the knowledge directors must possess to carry out their duties, they should also be offered refresher programmes when circumstances so advise.

Compliant

31. The agendas of Board meetings should clearly indicate on which points directors must arrive at a decision, so they can study the matter beforehand or gather together the material they need.

For reasons of urgency, the Chairman may wish to present decisions or resolutions for Board approval that were not on the meeting agenda. In such exceptional circumstances, their inclusion will require the express prior consent, duly minuted, of the majority of directors present.

Compliant

32. Directors should be regularly informed of movements in share ownership and of the views of major shareholders, investors and rating agencies on the company and its group.

Compliant

33. The Chairman, as the person charged with the efficient functioning of the Board of Directors, in addition to the functions assigned by law and the company's Articles of Association, should prepare and submit to the Board of Directors a schedule of meeting dates and agendas; organise and coordinate regular evaluations of the Board of Directors and, where appropriate, the company's chief executive officer; exercise leadership of the Board of Directors and be accountable for its proper functioning; ensure that sufficient time is given to the discussion of strategic issues, and approve and review refresher courses for each director, when circumstances so advise.

Compliant

34. When a lead independent director has been appointed, the Articles of Association or Board of Directors regulations should grant him or her the following powers over and above those conferred by law: chair the Board of Directors in the absence of the Chairman or Deputy Chairman, if applicable; give voice to the concerns of non-executive directors; maintain contacts with investors and shareholders to hear their views and develop a balanced understanding of their concerns, especially those to do with the company's corporate governance; and coordinate the Chairman's succession plan.

Not applicable

35. The Secretary of the Board of Directors should strive to ensure that the Board's actions and decisions are informed by the governance recommendations of the Good Governance Code of relevance to the company.

Compliant

36. The plenary session of the Board of Directors should conduct an annual evaluation, adopting, where necessary, an action plan to correct weakness detected in:

- a) The quality and efficiency of the Board's operation.
- b) The performance and membership of its committees.
- c) The diversity of Board Membership and competences.
- e) The performance of the Chairman of the Board of Directors and the company's chief executive.
- f) The performance and contribution of individual directors, with particular attention to the Chairmen of Board committees.

The evaluation of Board committees should start from the reports they send the Board of Directors, while that of the Board of Directors itself should start from the report of the Nomination Committee.

Every three years, the Board of Directors should engage an external facilitator to aid in the evaluation process. This facilitator's independence should be verified by the Nomination Committee.

Any business dealings that the facilitator or members of its corporate group maintain with the company or members of its corporate group should be detailed in the annual corporate governance report.

The process followed and areas evaluated should be detailed in the annual corporate governance report.

Compliant

37. When a Steering Committee exists, its membership mix by director class should resemble that of the Board of Directors. The Secretary of the Board of Directors should also act as Secretary to the Steering Committee.

Compliant

38. The Board of Directors should be kept fully informed of the business transacted and decisions made by the Steering Committee. To this end, all Board Members should receive a copy of the committee's minutes.

Partially compliant

At each meeting of the Board the matters that have been discussed at the Steering Committee, at the Audit Committee and at the Appointments and Remuneration Committee are set out. The Minutes of the Committees are provided to the members thereof for their approval and are available to all of the directors.

However, above all, the Secretary begins each meeting session of the Board of Directors by setting out all of the matters discussed, as well as the decisions adopted, not only by the Steering Committee but also by all of the Committees that have been held as from the last plenary session of the Board. This system is more effective than the system provided for in the recommendation as it enables the plenary session of the Board to understand (i) in real time and not with a month's delay, of all of the matters discussed and (ii) not only the matters discussed at the Steering Committee, but rather all of the matters discussed at all of the Committees.

39. All members of the Audit Committee, particularly its Chairman, should be appointed with regard to their knowledge and experience in accounting, auditing and risk management matters. A majority of committee places should be held by independent directors.

Compliant

40. Listed companies should have a unit in charge of the internal audit function, under the supervision of the Audit Committee, to monitor the effectiveness of reporting and control systems. This unit should report functionally to the Board's non-executive Chairman or the Chairman of the Audit Committee.

Partially compliant

The Internal Auditing, Compliance and Control Unit monitors and ensures, *inter alia*, the proper functioning and internal control of the reporting and control systems and reports to the Managing Director, who is the CEO. The aforementioned Internal Auditing, Compliance and Control Unit reports its activities, in turn, to the Audit Committee that also authorises the annual budget thereof. The reporting to the Managing Director is due to the fact that he is the Company's leading executive and the entire workforce directly or indirectly reports to him, without, given the current organisation, it been deemed relevant or appropriate for any employee to report directly to the Audit Committee or the Chairman, in his capacity as Proprietary Director. Regardless of the foregoing, the Audit and Appointments and Remuneration Committees are responsible for evaluating the annual performance of the Audit, Compliance and Internal Control Director, for the purposes of their remuneration.

41. The head of the unit handling the internal audit function should present an annual work programme to the Audit Committee, inform it directly of any incidents arising during its implementation and submit an activities report at the end of each year.

Compliant

42. The Audit Committee should have the following functions over and above those legally assigned:

1. With respect to internal control and reporting systems:

- a) Monitor the preparation and the integrity of the financial reporting prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.
- b) Monitor the independence of the unit handling the internal audit function; propose the selection, appointment, re-election and removal of the head of the internal audit service; propose the service's budget; approve its priorities and work programmes, ensuring that it focuses primarily on the main risks the company is exposed to; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.
- c) Establish and supervise a mechanism whereby staff can report, confidentially and, if appropriate and feasible, anonymously, any significant irregularities that they detect in the course of their duties, in particular financial or accounting irregularities.

2. With regard to the external auditor:

- a) Investigate the issues giving rise to the resignation of the external auditor, should this come about.
- b) Ensure that the remuneration of the external auditor does not compromise its quality or independence.
- c) Ensure that the company notifies any change of external auditor to the CNMV (Spanish Securities and Exchange Commission) as a material event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.
- d) Ensure that the external auditor has a yearly meeting with the plenary session of the Board of Directors to inform it of the work undertaken and developments in the company's risk and accounting positions.
- e) Ensure that the company and the external auditor adhere to current regulations on the provision of non-audit services, limits on the concentration of the auditor's business and other requirements concerning auditor independence.

Compliant

43. The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

Compliant

44. The Audit Committee should be informed of any fundamental changes or corporate transactions the company is planning, so the committee can analyse the operation and report to the Board of Directors beforehand on its economic conditions and accounting impact and, when applicable, the exchange ratio proposed.

Compliant

45. Risk control and management policy should identify at least:

a) The different types of financial and non-financial risk the company is exposed to (including operational, technological, financial, legal, social, environmental, political and reputational risks), with the inclusion under financial or economic risks of contingent liabilities and other off-balance-sheet risks.

b) The determination of the risk level the company sees as acceptable.

c) The measures in place to mitigate the impact of identified risk events should they occur.

d) The internal control and reporting systems to be used to control and manage the above risks, including contingent liabilities and off-balance-sheet risks.

Partially compliant

The Company has a risk control and management system supervised by the Audit Committee, resulting in a risks map that groups together the main risk factors and defines both the overall risk profile and those responsible for determining the risk limits. In its meeting on 6 February 2018, the Board of Directors consolidated the essential aspects of the risk control and management system.

46. Companies should establish a risk control and management function in the charge of one of the company's internal department or units and under the direct supervision of the Audit Committee or some other dedicated Board committee. This function should be expressly charged with the following responsibilities:

a) Ensure that risk control and management systems are functioning correctly and, specifically, that major risks the company is exposed to are correctly identified, managed and quantified.

b) Participate actively in the preparation of risk strategies and in key decisions about their management.

c) Ensure that risk control and management systems are mitigating risks effectively in the frame of the policy drawn up by the Board of Directors.

Compliant

47. Appointees to the nomination and remuneration committee – or of the Nomination Committee and remuneration committee, if separately constituted – should have the right balance of knowledge, skills and experience for the functions they are called on to discharge. The majority of their members should be independent directors.

Partially compliant

As of 21 September 2016, with the increase in the number of members of the Committee from 3 to 5, the Independent Directors ceased to be a majority, as a result of the application, in this case, of the principle of proportional representation contained in the Capital Companies Act.

48. Large cap companies should operate separately constituted nomination and remuneration committees.

Explain

The Company estimates that, at least in its case, it is not necessary or efficient to separate the powers of the Appointments and Remuneration Committee into two Committees, one for Appointments and one for Remuneration. The existence of a single Committee does not harm or limit the exercising of the powers granted to the Appointments and Remuneration Committee by law and also enables the Company to minimise costs insofar as this avoids the payment of additional remuneration to the directors asked to sit on the two split committees. Furthermore, the Company believes that this split could be counter-productive since the presence of a significant number of independent directors on the Board's Committees is important for the Company. Given the restrictions on the number of independent directors imposed by the current legislation, in application of the principle of proportional representation, the number of independent directors on the Board of Directors is currently 6. In order for there to be a significant number of independent directors in the two split Committees, as well as in the Audit Committee (where they must be a majority by law) and in the Executive Committee (where they must have a proportional presence), the creation of a new committee would lead to these directors being overloaded with work.

49. The Nomination Committee should consult with the company's Chairman and chief executive, especially on matters relating to executive directors.

When there are vacancies on the Board of Directors, any director may approach the Nomination Committee to propose candidates that it might consider suitable.

Compliant

50. The remuneration committee should operate independently and have the following functions in addition to those assigned by law:

- a) Propose to the Board of Directors the standard conditions for senior officer contracts.
- b) Monitor compliance with the remuneration policy set by the company.
- c) Periodically review the remuneration policy for directors and senior officers, including share-based remuneration systems and their application, and ensure that their individual compensation is proportionate to the amounts paid to other directors and senior officers in the company.
- d) Ensure that conflicts of interest do not undermine the independence of any external advice the committee engages.
- e) Verify the information on director and senior officers' pay contained in corporate documents, including the annual directors' remuneration statement.

Compliant

51. The remuneration committee should consult with the company's Chairman and chief executive, especially on matters relating to executive directors and senior officers.

Compliant

52. The terms of reference of supervision and control committees should be set out in the Board of Directors regulations and aligned with those governing legally mandatory Board committees as specified in the preceding sets of recommendations. They should include at least the following terms:

- a) Committees should be formed exclusively by non-executive directors, with a majority of independent directors.
- b) They should be chaired by independent directors.
- c) The Board of Directors should appoint the members of such committees with regard to the knowledge, skills and experience of its directors and each committee's terms of reference; discuss their proposals and reports; and provide report-backs on their activities and work at the first plenary session of the Board following each committee meeting.
- d) They may engage external advice, when they feel it necessary for the discharge of their functions.
- e) Meeting proceedings should be minuted and a copy made available to all Board Members.

Not applicable

53. The task of supervising compliance with corporate governance rules, internal codes of conduct and corporate social responsibility policy should be assigned to one Board committee or split between several, which could be the Audit Committee, the Nomination Committee, the corporate social responsibility committee, where one exists, or a dedicated committee established ad hoc by the Board of Directors under its powers of self-organisation, with at the least the following functions:

- a) Monitor compliance with the company's internal codes of conduct and corporate governance rules.
- b) Oversee the communication and relations strategy with shareholders and investors, including small and medium-sized shareholders.
- c) Periodically evaluate the effectiveness of the company's corporate governance system, to confirm that it is fulfilling its mission to promote the corporate interest and catering, as appropriate, to the legitimate interests of remaining stakeholders.
- d) Review the company's corporate social responsibility policy, ensuring that it is geared to value creation.
- e) Monitor corporate social responsibility strategy and practices and assess compliance in their respect.
- f) Monitor and evaluate the company's interaction with its stakeholder groups.
- g) Evaluate all aspects of the non-financial risks the company is exposed to, including operational, technological, legal, social, environmental, political and reputational risks.
- h) Coordinate non-financial and diversity reporting processes in accordance with applicable legislation and international benchmarks.

Compliant

54. The corporate social responsibility policy should state the principles or commitments the company will voluntarily adhere to in its dealings with stakeholder groups, specifying at least:

- a) The goals of its corporate social responsibility policy and the support instruments to be deployed.
- b) The corporate strategy with regard to sustainability, the environment and social issues.
- c) Concrete practices in matters relative to: shareholders, employees, clients, suppliers, social welfare issues, the environment, diversity, fiscal responsibility, respect for human rights and the prevention of illegal conducts.
- d) The methods or systems for monitoring the results of the practices referred to above, and identifying and managing related risks.
- e) The mechanisms for supervising non-financial risk, ethics and business conduct.
- f) Channels for stakeholder communication, participation and dialogue.
- g) Responsible communication practices that prevent the manipulation of information and protect the company's honour and integrity.

Compliant

55. The company should report on corporate social responsibility developments in its directors' report or in a separate document, using an internationally accepted methodology.

Compliant

56. Director remuneration should be sufficient to attract individuals with the desired profile and compensate the commitment, abilities and responsibility that the post demands, but not so high as to compromise the independent judgement of non-executive directors.

Compliant

57. Variable remuneration linked to the company and the director's performance, the award of shares, options or any other right to acquire shares or to be remunerated on the basis of share price movements, and membership of long-term savings schemes such as pension plans should be confined to executive directors.

The company may consider the share-based remuneration of non-executive directors provided they retain such shares until the end of their mandate. This condition, however, will not apply to shares that the director must dispose of to defray costs related to their acquisition.

Compliant

58. In the case of variable awards, remuneration policies should include limits and technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, or circumstances of that kind.

In particular, variable remuneration items should meet the following conditions:

- a) Be subject to predetermined and measurable performance criteria that factor the risk assumed to obtain a given outcome.
- b) Promote the long-term sustainability of the company and include non-financial criteria that are relevant for the company's long-term value, such as compliance with its internal rules and procedures and its risk control and management policies.

c) Be focused on achieving a balance between the delivery of short, medium and long-term objectives, such that performance-related pay rewards on-going achievement, maintained over sufficient time to appreciate its contribution to long-term value creation. This will ensure that performance measurement is not based solely on one-off, occasional or extraordinary events.

Compliant

59. A major part of variable remuneration components should be deferred for a long enough period to ensure that predetermined performance criteria have effectively been met.

Compliant

60. Remuneration linked to company earnings should bear in mind any qualifications stated in the external auditor's report that reduce their amount.

Explain

The variable remuneration of the Managing Director does not expressly take into account the qualifications that may exist in the external auditor's report and that reduce the sum thereof, nor is the foregoing a situation that has existed at the Company in the past. Notwithstanding the foregoing, the Appointments and Remuneration Committee only established the degree of compliance with the variable remuneration objectives after the audited accounts of the Company have been received, and accordingly the Committee is able to take into account any qualifications that exist therein, if applicable, when determining the degree of compliance of the objectives.

Consequently, the degree of compliance with the objectives established by the Board of Directors, mainly associated with the audited annual accounts, is reviewed and validated by the Internal Audit Department prior to the approval of its favourable report by the Company's Appointments and Remuneration Committee and is carried out at the same time as the annual accounts are drawn up.

61. A major part of executive directors' variable remuneration should be linked to the award of shares or financial instruments whose value is linked to the share price.

Explain

The Board has chosen a different mechanism to achieve the objective sought by the recommendation, which is to align the interests of the Executive Directors with those of the shareholders. Moreover, a change of this nature would require a review of the contractual conditions applicable to the Company's Managing Director which existed prior to the appearance of the recommendation. Within this framework, the Board chose to achieve the objective of creating value for the shareholders through the establishment, in the Managing Director's variable remuneration, of a target with this content and assigning it a significant weight, without amending his contract, in the certainty that the objective sought by the recommendation is fully safeguarded. Therefore, as explained in the Remuneration Report, the multi-annual variable remuneration (PREMP) of Mr. Villaseca is directly linked to the profitability for the shareholders in one of the indicators, whilst also being indirectly linked through the remaining 3 applicable indicators. As indicated in the IARC, section A.1, this multi-annual variable remuneration represents a significant percentage of his total remuneration.

62. Following the award of shares, share options or other rights on shares derived from the remuneration system, directors should not be allowed to transfer a number of shares equivalent to twice their annual fixed remuneration, or to exercise the share options or other rights on shares for at least three years after their award.

This condition, however, will not apply to shares that the director must dispose of to defray costs related to their acquisition.

Not applicable

63. Contractual arrangements should include provisions that permit the company to reclaim variable components of remuneration when payment was out of step with the director's actual performance or based on data subsequently found to be misstated.

Explain

The contract executed with the current Managing Director was formalised in 2005 and does not contain said provision. However, this issue was reviewed by the Board at the beginning of 2017, and he has been included in all variable remuneration programmes launched in 2017.

64. Termination payments should not exceed a fixed amount equivalent to two years of the director's total annual remuneration and should not be paid until the company confirms that he or she has met the predetermined performance criteria.

Explain

The contract signed with the Managing Director is from 2005 and it established remuneration greater than that indicated in the Recommendation. This cannot be amended without this entailing a cost for the Company. This is why the agreements are being maintained, with the amendments explained in the IARC and transcribed below: the Managing Director's contract was amended in 2016, removing the contract termination clause due to a significant change in the entity's shareholding and extending its duration to his entire existing mandate as Director of the Company. It contains a clause on a period of notice by the Managing Director of six months except in cases of force majeure, a clause on exclusivity during the exercising of his duties and a clause on confidentiality, both during the term of the contract, and once this term has expired. The Managing Director's contract establishes an indemnity in the amount of three years of total remuneration at the date of the contractual modification for certain cases of termination of the contractual relationship: by decision of the company, unless there is a very serious and culpable breach of his professional obligations which causes serious prejudice to the interests of Gas Natural SDG S.A., by decision of the Managing Director or by termination of the contract. In addition, and as a post-contractual non-competition agreement for one year, an indemnity equivalent to one year of total remuneration is established.

H. Other information of interest

1. If there are any significant aspects regarding corporate governance at the company or at entities of the group that is not included in the other sections of this report, but should be included in order to provide more complete and well-reasoned information regarding the corporate governance structure and practices at the entity or its group, briefly describe them.
2. In this section, you may also include any other information, clarification, or comment relating to the prior sections of this report to the extent they are relevant and not repetitive

Specifically, state whether the company is subject to laws other than Spanish laws regarding corporate governance and, if applicable, include such information as the company is required to provide that is different from the information required in this report.

3. The company may also state whether it has voluntarily adhered to other international, industrial, or other codes of ethical principles or good practices. If so, identify the code in question and the date of adherence thereto. In particular, mention whether there has been adherence to the Code of Good Tax Practices of 20 July 2010.

The Board of Directors, at its meeting of September 17, 2010, agreed to the adhesion of Gas Natural Fenosa to the Code of Good Tax Practices. In accordance with the provisions of the aforementioned Code, it is expressly stated that Gas Natural Fenosa has effectively complied with its content and, in particular, that at the meeting held on 6 February 2018, the Board has been informed, through the Audit Committee, about the position and the fiscal policies followed by the Group during the 2017 financial year.

Likewise, the Board of Directors, in its meeting held on 9 January 2018 and with the favourable report of the Audit Committee, has approved the Tax Strategy and Tax Risk Control and Management Policy establishing the basic principles that should guide the tax function of Gas Natural Fenosa, as well as the main lines of action to mitigate and guide the correct control of tax risks.

Note to C.1.12.- Clarification of the position

Mrs. Cristina Garmendia Mendizábal is President of the Supervisory Board at SYNIGS AG.

Note to C.1.45

The Appointments and Remuneration Committee is informed of such contracts. Amendments to the Managing Director's contract or the new contractual schemes of the members of the Management Committee must be approved by the Board of Directors.

The Managing Director's contract has been approved by the Company's Board of Directors.

Note to D.4

In February 2nd, 2018 the change of the registered office of Buenergía Gas & Power, Ltd to Puerto Rico was completed.

Note to G.10

This circumstance has not occurred throughout 2017. The applicable regulations would have given rise to different voting rules for the proposed resolutions drawn up by the Board and those drawn up by other shareholders. In the first case, votes corresponding to present or represented shares, deducting votes against, abstentions and votes from shareholders who had left the room before the vote, would be considered as votes in favour, and recorded as such. In the second case, votes corresponding to present or represented shares would be considered as votes against, and abstentions and votes from shareholders who had left the room before the vote would be considered as votes in favour, and recorded as such.

Although this practice does not reflect the tenor of Recommendation 10, it does better in achieving the final objective of Principle 7 of the Good Governance Code, which expressly refers to the OECD Principles of Corporate Governance, which indicate that the procedures used in the Shareholders' Meetings they must guarantee the transparency of the recount and adequate registration of the votes, especially in situations of struggle of vote, of new points of the agenda and alternative proposals of agreements, because it is a measure of transparency and guarantee of coherence in the exercise of the right to vote.

This annual corporate governance report has been approved by the company's board of directors at its meeting on 6 February 2018.

Indicate whether there have been directors who have voted against or abstained in connection with the approval of this Report.

No

Name or company name of director who has not voted in favour of approving this report

Reasons (against, abstention, non-attendance)

Explain the reasons

Registered Office:

Avenida de San Luis, 77
28033 Madrid

Barcelona Head Office:

Plaza del Gas, 1
08003 Barcelona

www.gasnaturalfenosa.com

Published by:

Communication and Institutional
Relations Department

Graphic Design:

Addicta Diseño Corporativo
www.addicta.es



www.gasnaturalfenosa.com