

# Fitch Ratings

## **Fitch: Positive Impact for Utilities from Spanish Royal Decree 6/2009**

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Fitch Ratings-London/Barcelona/Milan-11 May 2009: Fitch Ratings says today that Spanish Royal Decree 6/2009, which was published on 7 May 2009, has an overall positive impact on Spanish utility sector liberalisation and is supportive of companies' liquidity and cash flow profiles.

The law introduces a number of measures that help reduce some of the regulatory uncertainty that the sector has been exposed to. The measures include a gradual abolition of the tariff deficit by 2013, which in Fitch's view is the most significant measure. The tariff deficit has resulted from discrepancies between forecast costs and demand assumptions used by the regulator to establish the tariff, and the actual values.

"The law has been approved at an opportune time and provides liquidity support for the utility sector against a background of still volatile credit markets, which contributed to the failure of a debt auction related to the securitisation of the tariff deficit in September 2008," says Sabrina Ran, Associate Director in Fitch's Energy, Utilities and Regulation team for the EMEA region.

The law states that rights to recover the historical deficit, which currently totals around EUR14bn, (including amounts already securitised) are to be transferred to a structured fund which will issue debt that will be backed by a state guarantee. The fund will contain recovery rights of deficits generated and not passed to third parties of up to EUR10bn at YE08, for which Fitch expects related guaranteed debt to be issued by YE09. The law also establishes recovery rights (also to receive state guarantee) for future ex-ante deficits of up to EUR9.5bn generated between 2009 and 2012 (EUR3.5bn in 2009, EUR3bn in 2010, EUR2bn in 2011 and EUR1bn in 2012). In addition the law establishes rights for deficits over the ex-ante amounts to be included in the next period. At the same time, the law stipulates that access tariffs will increase gradually and should be fully cost-reflective by 2013, with no further deficits after this period.

The expected recovery of the tariff deficit, which to date utility companies largely funded on their balance sheets, is unlikely to affect their ratings. This is partly because Fitch already assumed that related amounts would be recoverable, and calculated adjusted net leverage ratios excluding any tariff deficit amounts. In addition, funding of the tariff deficit generally represents a relatively small portion of companies' total debt, except for Endesa for which around 24% of total debt at end March 2009 (EUR5.1bn) related to the deficit. This compares with Iberdrola (EUR2.6bn; 8%), Union Fenosa (EUR0.8bn at YE08; 12%) and Energias de Portugal (EUR0.4bn at YE08; around 3% through its Spanish subsidiary Hidrocantabrico). While Endesa's expected YE09 net leverage, excluding the tariff deficit, of above 2x is strong for the 'A-' rating level, its ratings have been fully aligned with those of its majority owner Enel.

Another positive feature of the new law is that it abolishes, effective from July 2009, the claw-back mechanism related to costs for freely-obtained CO2 permits, which was introduced in Royal Decree 11/2007. The sector-wide cash flow effect of the claw-back is estimated at below EUR1bn per annum.

From July 2009 until end 2012, electricity generators are obliged to fund a 'social bonus', which covers the difference between the tariff of last resort and a reference tariff for vulnerable customers. It is expected to apply to around 5 million customers on low incomes and with contracted capacity of less than 3kw. Fitch notes that the negative impact of this measure on utilities' cash flows is likely to be limited, as the time frame for its application is relatively short. Fitch estimates that on a sector-wide basis, the 'social tariff' may require a similar cash outflow to the cancelled CO2 claw-back, roughly offsetting each other.

Assumption of nuclear waste liabilities is viewed by Fitch to have a limited potential rating impact on utilities, due to relatively small related costs that will be incurred as a portion of utilities' overall liabilities.

Fitch will monitor the implementation of the new law as well as the timeframe for achieving cost-reflective tariffs and other efforts that should contribute towards further sector liberalisation.

Fitch-rated entities active in the Spanish electricity generation and distribution sector include Iberdrola, S.A. ('A-/Stable), Endesa, S.A. ('A-/Rating Watch Negative), Union Fenosa, S.A. ('A-/Rating Watch Negative), Hidroelectrica del Cantabrico ('A-/Stable), and Gas Natural SDG, S.A. ('A-/Rating Watch Negative).

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