

POLITECNICO DI MILANO

Facoltà di Ingegneria dei Sistemi

Corso di Laurea Magistrale in Ingegneria Gestionale



Enel - Endesa: a strategic M&A case study

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Anno Accademico 2009-2010

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1. M&A operations

1.1 The motivations behind an acquisition

In the latest years, rising earning pressure, accelerating global competitions and increased consolidation are driving unprecedented levels of corporate collaboration through mergers, acquisitions and strategic alliances.

When two businesses combine their activities, the combination may take form of an acquisition, also called takeover, or a merger, also called an amalgamation. This primary purpose of any combination should be to increase shareholder wealth, such an increase normally coming from an effect of synergy.

It must be recognised that in practice the synergistic gains anticipated from a combination are often disappointing. this may be because managers generally prefer to grow their businesses through acquisition rather than organically. Many considerations about M&A failure rates lead companies to prefer alliances; in fact only about half of the companies formed through mergers exhibited superior performance with in their industries.

In many situations, mergers and acquisitions are the only options for maintaining competitiveness. Shareholder demand, for instance, often mandates spinning off non-core divisions, and then quickly acquiring new and strategically complementary resources to maximise achievement of core objectives.

In addition, rapid consolidation in vertical industries such as high technology, financial services, and telecommunications means companies must initiate mergers "among equals" or buyout of smaller firms simply to survive. Deregulation of industries, such as utilities is also driving strategic consolidation through acquisitions ensuring the increased size, diversity of resources, and broader industry "playing field" that facilitate international leadership. The rapid internationalization of business has also been a strong influence on merger activity. Many ex-

perts, for example, believe that the euro's emergence is spurring increased interest in mergers among European corporations seeking more favourable global positioning.

As we said before, the risk with unsuccessful M&As is getting bigger because merging companies are originally large and complex, so after a merger, if the performance is not good, the losses may be catastrophic. This aggressive situation needs new research while prerequisite of success are getting fewer for companies. Motives behind manager's decisions are in many experiments given as self evident and they can be summarized as:

- 1) to create a number of new business opportunities and entry new institutional owners support specially this managerial goal of growth; acquirers of healthy companies hold to growth motives more often than those who acquired unhealthy companies
- 2) to reduce earnings volatility
- 3) technical Efficiency and economies of scale
- 4) parallel i.e. contagious M&A's there is a kind of economical "force major" to stay competitive for customers while they are merging. Divestment is an option which management is likely to hold in reserve
- 5) decreased undiversifiable "employment risk", risk of losing job, professional reputation, etc. Managers' personal wealth is linked more to firm size and risk of bankruptcy than to firm performance. The merger offers an opportunity to improve one's social identity as well
- 6) value maximization is specially a shareholder's goal
- 7) use of control position
- 8) synergy
- 9) monopoly
- 10) corporate restructuring is needed industry

- 11) cost reduction
- 12) managerial vs. shareholder interests. Motives for takeovers tend to reflect managerial rather than shareholder interests in abandoned mergers.
- 13) reputation enhancement: local systems do not appear to have lower cost but do appear to enjoy reputation benefits
- 14) innovation performance
- 15) resource redeployment
- 16) power, achievement, sensation seeking and prestige
- 17) horizontal, vertical, product extension, market extension, unrelated Acquisition classes by U.S. Federal Trade Commission.

1.1.1 Why a company may want to be acquired

Many acquisitions are by mutual agreement, so small companies being acquired may welcome such a move. There are a number of possible reasons:

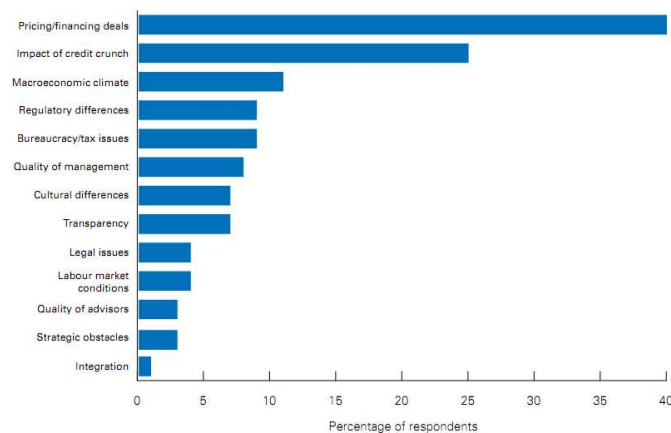
- (a) Personal e.g., to retire, for security, because of the problem of inheritance tax.
- (b) Business an expanding small company may find that it reaches a size where it is impossible to restrain growth, but funds or management expertise are lacking.
- (c) Technical increasing sophistication presents a problem for the small company:
 - (a) cost of research and development may be prohibitive;
 - (b) inability to employ specialized expertise;
 - (c) inability to offer a complete range of services or products to customers.

Such factors can apply to companies that are quite large by most standards.

1.2 M&A in European Market

The decision-making process leading up to M&A is directly related to stock market performance and during the time of negative stock market performance investors are increasingly cautious and only safe strategies and cost cutting measures are implemented while strategic moves such as M&A are avoided.

In the next graphic we can see which are the key obstacles to conducting outbound M&A activity in people opinion.

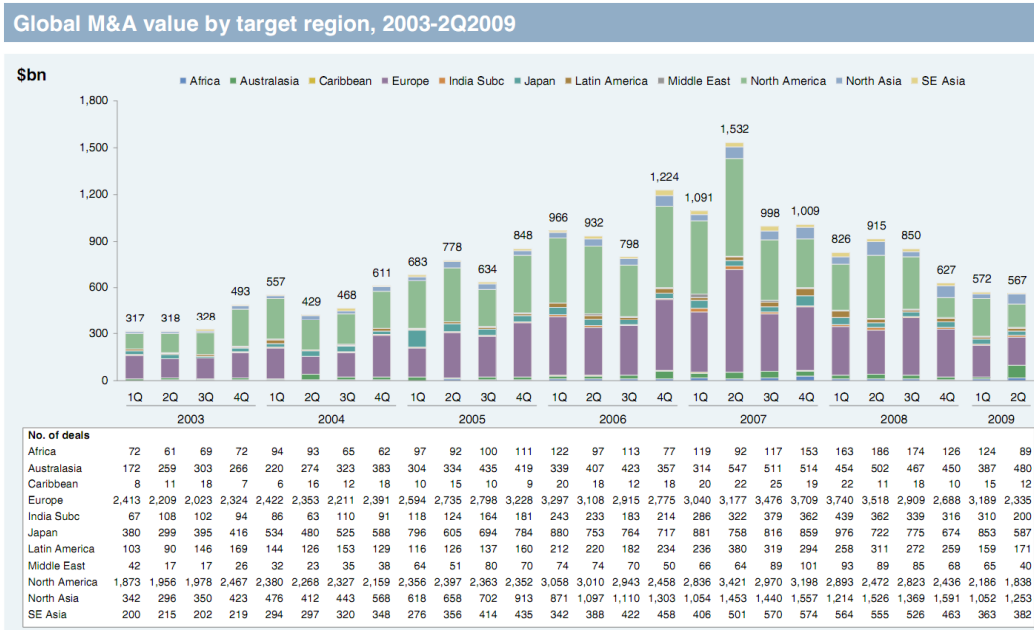


As we can see the 40% of respondents highlighted the pricing and financing of deals as a key obstacle to outbound M&A activity. In second place was the impact of the credit crunch, an obstacle inherently connected to financing, which was selected by 25% of respondents.

According to respondents, pricing/financing obstacles are caused by a wide variety of factors. One respondent in particular talked about the challenge of matching the "gap between buyer and seller expectations."

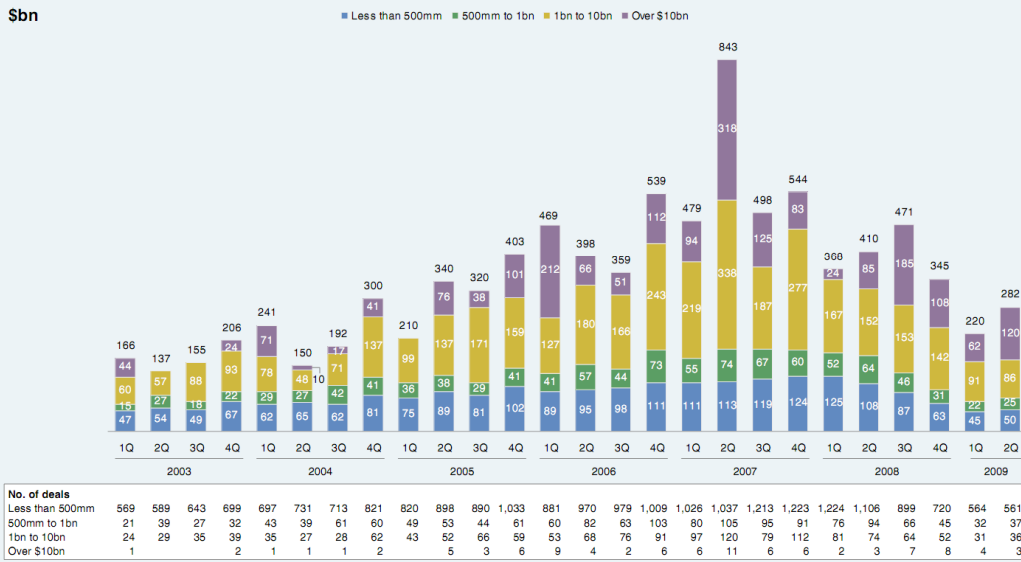
One respondent said that "The levels of leverage at the moment are very high meaning that sellers value their companies at a very high price." Another talked of the "lack of confidence in the banking sector. The international perception of the European market and everything related to the Real Estate and Construction sector."

Looking at the global M&A activity between 2003-2009 we can easily identify that in 2007 was the most active period with a peak of 1.532 billion \$ during the second quarter of the year. After that the value of the activities decrease in the latest years mainly due to the world crisis that occurred in 2008.



Total global deal value by target was flat during the second quarter of 2009 with \$567 billion worth of deals announced compared to \$572 billion during the first quarter of 2009. However deal value when compared to the same period last year fell 38%. Europe recorded a 33% fall in the number of announced deals during the second quarter compared to the same period last year while North America fell by 26%. All other regions also recorded a decrease in the number of announced deals.

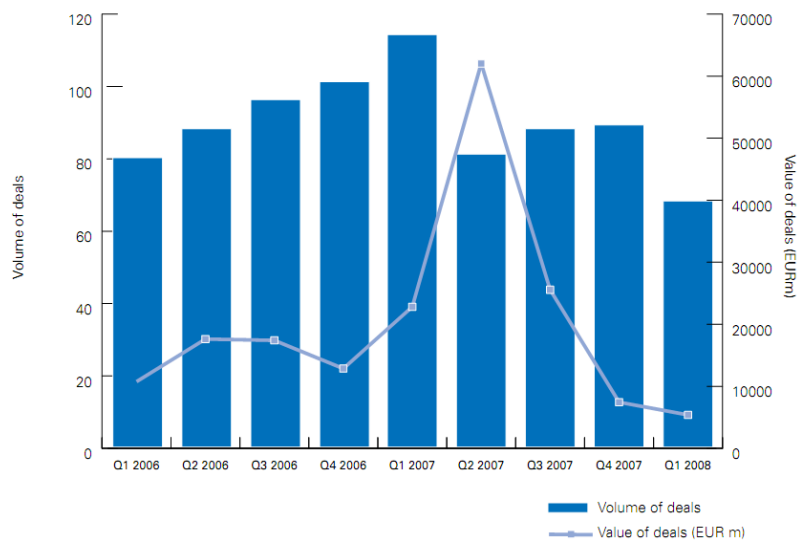
European M&A value by deal size, 2003-2Q2009 (Any European Involvement)



Analysing the European M&A market looking at the value of the activities we notice a similar situation with the peak on the second quarter of 2007 with a overall decrease of the transaction under 500 million of \$ and an increase of the bigger value transaction over 10 billion of \$.

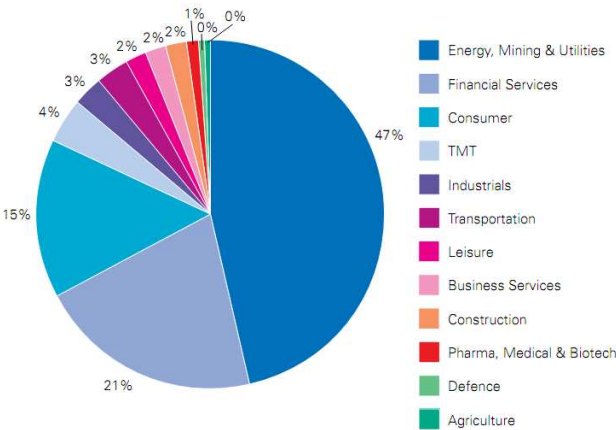
1.2.1 M&A in Spain

Overall Spanish M&A trends



At present Spain's M&A boom appears to have peaked. The strong domestic M&A market of the past few years has been matched by many large high-profile Spanish corporates undertaking cross-border transactions. The year 2007 in particular, saw M&A activity in Spain reach the highest level of the current boom in deal value terms. This is largely because of the resolution of the protracted Endesa situation, which saw the energy giant bought by Enel of Italy for € 44.2bn. Spanish M&A volume, meanwhile, appears to have peaked in 2006, the slump in the Spanish Construction sector will clearly have an effect on M&A going forward.

Sector split of Spanish M&A



The graph above shows that the main sector of Spanish M&A activity is the one about Energy, Mining and Utilities. This is of course highly influenced by the Enel-Endesa acquisition.

However the appreciating Euro is making Spanish export growth harder to maintain. In short, after years of outperformance Spain, along with its European neighbours, entering a challenging period economically that will impact M&A. Indeed, the slowdown is already in evidence in Spain's M&A market, in particular among private equity buyers negotiating a debt-lite arena, but also among corporates where their outlook is understandably more cautious.

1.3 The energy sector

In the latest years the energy sector has shown a continuously increasing activism on financial markets, aimed at the conclusion of concentrations involving more and more often players operating in different national markets.

After the first steps of liberalization were put into effectiveness, i.e. by promoting a vertical separation among generation, wholesale, transmission, distribution and retailing activities both for natural gas and electricity markets, European companies seem to have changed their business strategies. Their interest is now oriented towards the managing of gas activities together with electricity ones, as witnessed by many of the recent mergers occurred at a European level and scrutinized by the European Commission. As to the geographical scope of these operations, the trend towards the creation of pan-European players has been accompanied by a growing tendency towards the construction of national champions as a defensive mechanism from foreign takeovers and as a business opportunity in the light of the forthcoming complete liberalization of the markets.

The first explanation to the current wave of mergers in this industry is the increase in cash liquidity that companies in the energy sector have recorded in the latest years. Having at their disposal a bigger amount of cash to be invested, it is likely some companies have opted for the external growth strategy instead of redistributing their extra-profits to their shareholders under the form of dividends or to invest them in new infrastructural devices. This cash availability can be easily explained by looking at the trend of prices of natural gas and electricity in the most recent years.

Secondly, European companies have decided to broaden their range of activities just in the period antecedent the complete liberalization of the European market in order to be fully ready for the eventual new competition developing in a broader context. In the case the market will be entirely liberalized and investments in infrastructures and interconnectors will allow for the creation of a unique market

for electricity and natural gas, operators will benefit of their broad range of activities in a twofold way. First, as the consequence of a bigger presence in the market, secondly because the broadening of their activities represents a guarantee not to be taken over by other competitors and to play an important role in the unified market.

A third rationale driving energy companies towards their integration can be found in the internalization of some activities and, consequently, the saving of some transaction costs. The electricity sector is more and more based on gas-fired plants, probably both as the effect of emission trading scheme penalizing high emission of CO₂ from coal-fired plants, and as the result of companies' strategies oriented towards the construction of peak units characterized by lower initial fixed costs.

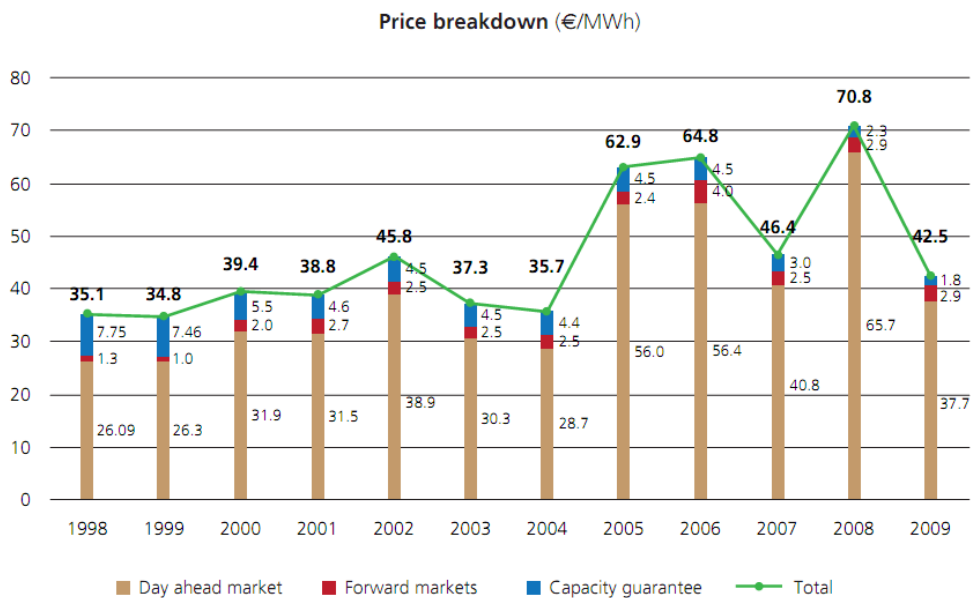
In this light, the sharp increase of gas prices in the latest years can explain why electricity companies, more and more based on gas as a fuel source, are now considering to enter in the natural gas activities to obtain a direct access to the energy resource.

It is clear that this wave of M&As is changing the shape and the structure of the overall energy market in Europe. Some observers expect that the final result will be an oligopoly dominated by pan-European players active in different countries. If this one will reveal to be the outcome, it is conceivable that companies, at this stage, are playing all their efforts in order to expand and remain on the market as one of the player, instead of becoming the likely target of a hostile bid.

1.3.1 The price of the energy

The weighted average price on the spot market in 2007 was Euro 46.4/MWh: 28.6% lower than in 2006. This fall was largely due to the drop in CO₂ prices, which, in the first application of the European Trading Scheme (ETS), stood at Euro 0.02/MWh.

In 2008, with stranded costs in forward markets adding Euro 2.85/MWh to the average price and capacity payments Euro 2.26/MWh, the final year-end price was Euro 70.8/MWh: a year-on-year increase of 61%. This increase was significantly driven by CO₂ prices which averaged Euro 22.31/MWh in 2008, while they were near zero at the end of 2007 as sad before.



The weighted average price on the day ahead market in 2009 was Euro 37.70/MWh, compared with Euro 65.70/MWh in 2008. In fact in the last year, as stranded costs in forward markets added Euro 2.92/MWh to the average price and capacity payments added Euro 1.85/MWh, the final year-end price was Euro 42.5/MWh: a year-on-year decrease of 40%. The decline was caused mainly by the sharp fall in electricity demand and fuel prices triggered by the international economic crisis.

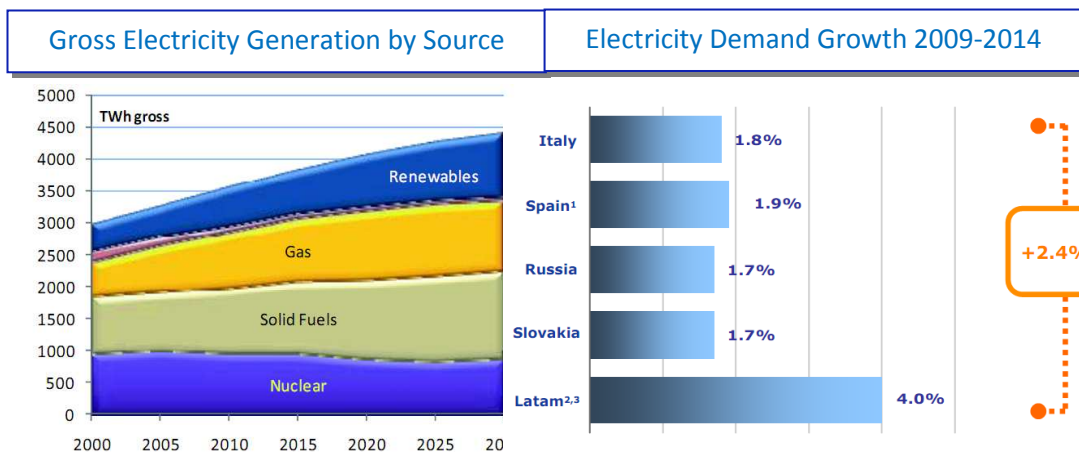
1.3.2 Energy demand

Following soaring electricity demand, power generation is expected to grow considerably given the limited potential for higher electricity imports from outside the EU. Electricity

generation is expected to increase by 35% between 2005 and 2030. An increasing share of electricity will be produced in form of combined heat and power (up 8 percentage points to reach a 21 % CHP share in 2030).

The structure of power generation changes significantly in favour of renewables, natural gas and solid fuels, whereas nuclear and oil lose market shares.

The renewables share in gross power generation rises to 17.4% in 2010, which falls however short of the indicative target of the renewables electricity directive, indicating that the measures implemented in the Member-States by the end of 2006 are not yet sufficient.



In any case, the Baseline scenario shows a dynamic development in renewables penetration in electricity, as the renewables share in gross generation rises further to 20% in 2020 and 23% in 2030. This development is clearly driven by the high growth rates of wind energy, especially in this decade; but growth rates are still impressive in coming decades. In total, wind energy in 2030 provides over 15 times as much electricity as was available from this source in 2000. In 2030, wind power is expected to produce almost as much electricity as hydro.

Biomass use for power generation also rises considerably; solar PV displays high growth rates from a small basis, while the additional contribution from hydro

power is small as a result of limited additional potential and environmental restrictions.

Nuclear declines due to political decisions. The nuclear share falls from over 30% today to only 20% in 2030 despite considerable investment in new nuclear plants in countries without restrictions on nuclear. Overall, the share of indigenous and carbon free sources (renewables plus nuclear) decreases somewhat, from currently 45% it reaches 43% at the end of the projection period.

1.4 Synergies and Value created

The ultimate justification of any policy is that it leads to an increase in value, i.e., it increases shareholder wealth. As in capital budgeting where projects should be accepted if they have a positive NPV, in a similar way mergers should be pursued if they increase the wealth of shareholders.

Some sources of synergy are:

- Operating economies;
- Market power;
- Financial gains
- Others.

1.4.1 Synergy from operating economies

(a) Economies of scale :

Horizontal mergers (acquisition of a company in a similar line of business) are often claimed to reduce costs and therefore increase profits due to economies of scale. These can occur in the production, marketing or finance areas. Note that these gains are not automatic and diseconomies of scale may also be experienced. These benefits are sometimes also claimed for conglomerate mergers (acquisition of companies in unrelated areas of business) in financial and marketing costs.

Just as most of us believe that we would be happier if only we were a little richer, so every manager seems to believe that his or her firm would be more competitive if only it were just a little bigger. Achieving economies of scale is the natural goal of horizontal mergers. But such economies have been claimed in conglomerate mergers, too. The architects of these mergers have pointed to the economies that come from sharing central services such as office management and accounting, financial control, executive development, and top-level management.

Optimistic financial managers can see potential economies of scale in almost any industry. But it is easier to buy another business than to integrate it with yours afterward. Some companies that have gotten together in pursuit of scale economies still function as a collection of separate and sometimes competing operations with different production facilities, research efforts, and marketing forces.

(b) Economies of vertical integration:

Some acquisitions involve buying out other companies in the same production chain, eg, a manufacturer buying out a raw material supplier or a retailer. This can increase profits by ‘cutting out the middle man’.

Vertical mergers seek economies in vertical integration. Some companies try to gain control over the production process by expanding back toward the output of the raw material and forward to the ultimate consumer. One way to achieve this is to merge with a supplier or a customer. Vertical integration facilitates coordination and administration.

(c) Complementary resources and surplus funds:

It is sometimes argued that by combining the strengths of two companies a synergistic result can be obtained. For example, combining a company specializing in

research and development with a company strong in the marketing area could lead to gains.

Ideally such a firm should distribute the surplus cash to shareholders by increasing its dividend payment or repurchasing stock. Unfortunately, energetic managers are often reluctant to adopt a policy of shrinking their firm in this way. If the firm is not willing to purchase its own shares, it can instead purchase another company's shares. Firms with a surplus of cash and a shortage of good investment opportunities often turn to mergers financed by cash as a way of redeploying their capital.

(d) Elimination of inefficiency

If the victim company is badly managed its performance and hence its value can be improved by the elimination of inefficiencies. Improvements could be obtained in the areas of production, marketing and finance.

Cash is not the only asset that can be wasted by poor management. There are always firms with unexploited opportunities to cut costs and increase sales and earnings. Such firms are natural candidates for acquisition by other firms with better management. In some instances "better management" may simply mean the determination to force painful cuts or realign the company's operations. Notice that the motive for such acquisitions has nothing to do with benefits from combining the firms. Acquisition is simply the mechanism by which a new management team replaces the old one.

A merger is not the only way to improve management, but sometimes it is the only simple and practical way. Managers are naturally reluctant to fire or demote themselves, and stockholders of large public firms do not usually have much direct influence on how the firm is run or who runs it. If this motive for merger is important, one would expect to observe that acquisitions often precede a change in the management of the target firm.

1.4.2 Financial Synergies

- (a) *Diversification*: The argument goes that diversification normally reduces risk. If the earnings of the merged companies simply stay the same (i.e., no operating economies are obtained) there could still be an increase in value of the company due to the lower risk. This argument is developed by application
- (b) *Diversification and financing*: If the future cash flow streams of the two companies are not perfectly positively correlated then by combining the two companies the variability of their operating cash flow may be reduced. A more stable cash flow is more attractive to creditors and this could lead to cheaper financing.
- (c) *The "boot strap" or PE game*: It is often argued that companies with high PE ratios are in a good position to acquire other companies as they can impose their high PE ratio on the victim firm and increase its value
- (d) *Other financial benefits*: These largely revolve around the elimination of inefficient financial management practices. Examples include:
 - a. Buying low geared companies with good asset backing in order that they may be geared up to obtain the benefit of the corporation tax shield on debt.
 - b. Buying companies with accumulated tax losses in order that they may be offset against profits of the acquiring company.

1.4.3 Other synergistic effects

- (a) *Surplus managerial talent*: Companies with highly skilled managers can make use of this resource only if they have problems to solve. The acquisition of inefficient companies is sometimes the only way of fully utilizing skilled managers.
- (b) *Surplus cash*: Companies with large amounts of surplus cash may see the acquisition of other companies as the only possible application for these

funds. Of course, increased dividends could cure the problem of surplus cash, but this may be rejected for reasons of tax or dividend stability.

- (c) *Market power*: Horizontal mergers may enable the firm to obtain a degree of monopoly power which could increase its profitability.
- (d) *Speed*: Acquisition may be far faster than organic growth in obtaining a presence in a new and growing market.

1.5 Success and failure factors

1.5.1 Gains from mergers

Acquisition is a popular route to growth and we have noted several arguments to justify expansion based on acquisition. We have also seen that many of these arguments are suspect. Research in this area has two major conclusions:

- (a) Value or synergistic gains are in practice quite small.
- (b) Bidding companies usually pay a substantial premium over the market value of the victim company prior to the bid

1.5.2 Causes of failure

Reasons advanced for the high failure rate of takeovers are:

- (a) Over-optimistic assessment of economies of scale. Such economies can be achieved at relatively small size; expansion beyond the optimum results in disproportionate cost disadvantages.
- (b) Inadequate preliminary investigation combined with an inability to implement the amalgamation efficiently.
- (c) Insufficient appreciation of the personnel problems which will arise.
- (d) Dominance of subjective factors such as the status of the respective boards of directors.

Perhaps the fact that acquisition is often favoured as an alternative to expansion by other means implies a tendency towards laziness in management. It is proba-

bly considered easier to acquire an existing business rather than to subject oneself to the discipline of seeking and justifying more difficult investment projects. Furthermore, the high level of redundancies evidenced in larger groups indicates that mergers and acquisitions create a situation where rationalization (which would otherwise be shirked) may be carried out more acceptably.

Conclusions:

- (a) Not all mergers are failures; some in fact are very successful. On average, however, research shows that expansion based on merger and takeover seems to bring few value gains to acquiring company shareholders.
- (b) Mergers, however, are often in the interests of managers. They view success in a different light from shareholders and are often more concerned with the job security and career prospects brought by sheer size.
- (c) There are alternatives to growth by acquisition. It is sometimes argued that as markets become more global mergers are required to allow companies to be large enough to compete. For example, telecommunications companies need to be very large to support the required research and development overhead. Other industries have, however, found ways round this problem. Joint ventures in the car industry between Honda/BL and Ford/Mazda are examples of alternatives to merger.

1.6 Organization and leadership

Mergers and acquisitions almost always involve some level of transformational change and disruption. Successful post-merger integration demands significant change on the part of both the acquiring and the acquired organization. The acquirer creates boundary disruptions, changes in stated goals, strategies, ways of doing things and customs. The acquirer also must deploy control mechanisms to manage transformational change and achieve the strategic goals that drove the M&A in the first place. For its part, the acquired organization must overcome

any anxieties about being “absorbed” and learn to integrate itself into new corporate procedures and values. In short, a process of mutual adjustments and acculturation must take place for post-merger integration to succeed.

Culture was ranked as the most challenging people issue in M&As. Particularly challenging is to achieve successful alignment between old and new organizational cultures. This is followed, in order, by effective leadership from the top; a well-executed employee communication program; integrating benefits, pay and other rewards programs on a global basis; and correct selection of the top management team.

The "Leadership holds it all together, it is a make or break function." Leadership in fact is the most important driver of employee engagement. During periods of transition and disruption, employees look first to leaders for guidance about how to react and behave, for motivation, and for focus.

Experience shows that what leaders do during mergers and acquisitions has a significant impact on how employees of both organizations react and promote a sense of community and purpose. Positive employee perception of leaders is crucial to successful change.

Employees want to believe that leadership cares about them. When employees are convinced that leaders genuinely do care about them, they become more open and willing to make necessary transitions.

Companies that foster a high degree of leadership visibility and involvement during M&As instill a supportive organizational culture with a better than average chance of success. Leaders set the priorities and create the positive business momentum and discipline required during M&As. They instill in employees the necessary level of commitment, engagement, confidence and comfort to work through difficult transitions. Leaders, who by their statements and actions inspire a shared sense of purpose, coherence, community and trust, enable em-

ployees to focus and to remain highly engaged during M&As and post-merger integration.

Establishing and sustaining cultural alignment during the first 100 days is particularly important in shaping the newly formed organizational culture and employee perceptions of it. Leadership intervention is “a critical symbol” of the new organizational culture.

Placing leaders into the correct roles and ensuring a fit between leadership and the desired organizational culture and business strategy is another key priority in M&A integration. It is very important to engage and develop new leaders early in the integration process, through executive coaching, ongoing feedback and through formal onboarding activities. Properly engaged leaders will be able to focus on three key areas of a

merger and acquisition:

- Due Diligence (leadership research)
- Integration Preparation (leadership strategy, assessment and selection)
- Integration (executive onboarding).

Concluding, success in aligning strategy, leadership and organizational culture can lead to profitable growth after a merger or acquisition. Effective leaders who instill a new organizational culture and values in their HR program design and internal and external communications can engage employees to deliver the brand promise to customers, shareholders and the community, in turn leading to profitable business growth

In mergers and acquisitions, leadership creates and drives the combined organization's culture, the organizational DNA. It is the "forcing function" of a new organizational culture. "Leaders' actions, words, beliefs and behaviours need to be acknowledged and understood at three levels: national, organizational and individual" M&As are more successful than in the past in part because of

greater attention being paid to leadership's role in organizational culture creation, and are now creating, rather than destroying, shareholder value.

Companies can increase the success of M&A deals by focusing on aligning leadership fit and actions with organizational cultures and business strategy.

1.6.1 Culture and value

Another way of looking at how culture impacts the value of a deal is by examining the value curve. In almost every case happens that the productive value of the organisations when the deal is announced goes down. At best, it goes down while everyone stops to talk about the deal, then goes back up when everyone goes back to work. But more often, the productive value of an organisation will significantly lag potentially for a long time, as employees try to figure out what the deal means to them. This lag will happen across the board, including corporate functions, IT functions, sales forces, customer-facing staff and even executive leadership.

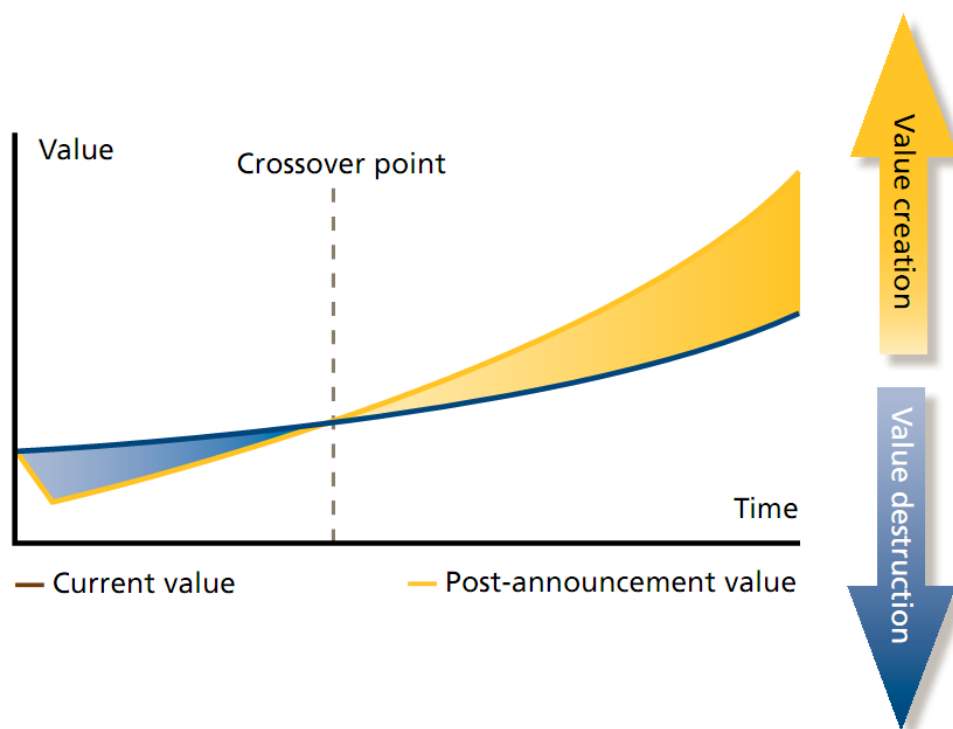
However, if the deal is successful, value generation should start to increase and, at some point in the future, deliver greater value than the two organisations would separately have done the rationale behind M&A transactions.

Even the professionals responsible for managing the financial side of the deals are recognising the impact that culture has on the bottom line of the deal. The Journal of Corporate Accounting and Finance has acknowledged the critical role of culture: "The primary reason that cultural differences, if not uncovered and addressed, can affect the value of the deal is that cultural differences often spell decreased productivity, which leads to lower revenues and income, and hence the combined entity may be worth less than expected."

To be successful in the short and long term, the process of cultural integration must ensure that:

- Outcomes are well-defined and understood in the context of the deal.

- Behaviours are clear in terms of the cultures of each of the parties involved in the deal, and the going-forward culture necessary to deliver the outcomes has been identified.
- Drivers of the desired behaviours are well-understood, prioritised and designed in such a way to influence the desired behaviour patterns.
- An effective change management process is planned and executed.



The graph above shows how the value can be created or destroyed and which are the main factors that impact on the value:

Value creation	Value destruction
<ul style="list-style-type: none"> • Leadership ownership • Clarity of transaction rationale and business case for change • Adaptability and flexibility to move between a deal-making culture and a long-term business-dictated culture • Early understanding of cultural similarities and differences • Clarity of behavioural direction 	<ul style="list-style-type: none"> • Leadership apathy toward change • Lack of recognition of the importance of a deal-making culture • Failure to recognise or reconcile differences in organisational behavioral attributes • Lack of awareness, tolerance or understanding of social drivers of behavior • Inability to effect change • Lack of linkage between requirement of behaviour change and business results

1.7 Type of takeovers

In the market for corporate control, management teams vie for the right to acquire and manage corporate assets and strategies. If an outside group acquires control of a target corporation, the transaction is termed a takeover. There are two basic methods of effecting a corporate acquisition: a friendly takeover and a hostile takeover. In a friendly takeover, the board of directors of the target firm is willing to agree to the acquisition.

By contrast, a hostile takeover occurs when the board of directors is opposed to the acquisition. Friendly takeovers often involve firms with complementary skills and resources in growing industries. Hostile offers generally involve poorly performing firms in mature industries. In these cases, the suitor desires to replace the existing management team and sell off underperforming business units.

1.7.1 Friendly

Friendly takeovers can involve either the acquisition of the assets of the company or the purchase of the stock of the target. There are several advantages associated with the purchase of assets. First, the acquiring firm can purchase only those assets that it desires. Second, the buyer avoids the assumption of any contingent liabilities of the target. Third, the purchase of assets is easier to negotiate since only the board of directors, and not the shareholders, need approve the acquisition.

The second type of friendly takeover involves the purchase of the stock of the target. In this instance, the acquiring firm does assume the liabilities of the target firm. The target firm continues to operate as an autonomous subsidiary or it may be merged into the operations of the acquiring firm. The approval of the target's shareholders is necessary for this type of acquisition.

1.7.2 Hostile

Hostile takeovers occur when the board of directors of the target is opposed to the sale of the company. In this instance, the acquiring firm has two options if it chooses to proceed with the acquisition: a tender offer or a proxy fight. A tender offer represents an offer to buy the stock of the target firm either directly from the firm's shareholders or through the secondary market. This method tends to be an expensive way of acquiring the stock since the share price is bid up in anticipation of a takeover. Often, acquiring firms will first propose an offer to buy the company's stock to the target company's board of directors, with an indication that if the offer is turned down, it will then attempt a tender offer.

Federal securities regulations require the disclosure of the acquiring firm's intent with respect to the acquisition. Under the Williams Act, the acquiring firm must give 30 days' notice to both the management of the target firm and the Securities and Exchange Commission. This enables the target firm to formulate a defensive strategy to maintain its independence.

In a proxy fight, the acquirer solicits the shareholders of the target firm in an attempt to obtain the right to vote their shares. The acquiring firm hopes to secure enough proxies to gain control of the board of directors and, in turn, replace the incumbent management. Proxy fights are expensive and difficult to win, since the incumbent management team can use the target firm's funds to pay all the costs of presenting their case and obtaining votes.

1.7.3 Form of takeovers

The form of the takeover is often heavily influenced by income tax laws. A simple exchange of shares of common stock, while rarely used in takeovers, is considered a nontaxable exchange. The tax basis of the new shares is simply that of the old. Should the takeover use cash and/or debt to pay for the target's common shares, however, this generates a taxable transaction and the target's shareholders will be subject to capital gains taxes.

1.7.4 Defensive tactics

There are a number of manoeuvres that can be used to ward off an unwanted suitor. These can be divided into two basic categories: preoffer tactics and post-offer tactics. Preoffer tactics are those that may be employed prior to the receipt of a hostile bid. For example, private companies are almost invulnerable to takeovers since blocking stakes of more than 50 percent of the outstanding shares are usually held by an individual or an affiliated group.

Hostile takeovers are often generated by investors who believe the shares of the target firm are undervalued. Therefore, a high stock price will also fend off many potential acquirers since it will be difficult for the acquirer to earn a sufficiently high return on its investment in the target. In other cases, size alone may pose a valid defence. Also, high-tech firms in the defence industry may be immune to takeovers because of the political ramifications.

Target companies can also decrease the likelihood of a takeover through charter amendments. With staggered terms for the board of directors, the board is di-

vided into three groups, with only one group elected each year. Thus, a suitor cannot obtain control of the board immediately even though it may have acquired a majority ownership of the target via a tender offer. Under a supermajority amendment, a higher percentage than 50 percent, generally two-thirds or 80 percent is required to approve a merger. A fair price amendment prohibits two-tier bids, where the first 80 percent of the shares tendered receive one price, whereas the last 20 percent receive a lower price for their stock.

Other preoffer tactics include poison pills and dual class recapitalizations. With poison pills, existing shareholders are issued rights that, if a bidder acquires a certain percentage of the outstanding shares, can be used to purchase additional shares at a bargain price, usually half the market price. Dual class recapitalizations distribute a new class of equity with superior voting rights. This enables the target firm's managers to obtain majority control even though they do not own a majority of the shares.

Postoffer tactics occur after an unsolicited offer is made to the target firm. The target may file suit against the bidder alleging violations of antitrust or securities laws. Alternatively, the target may engage in asset and liability restructuring to make it an unattractive target. With asset restructuring, the target purchases assets that the bidder does not want or that will create antitrust problems or sells off the "crown jewels," the assets that the suitor desires to obtain. Liability restructuring manoeuvres include issuing shares to a friendly third party to dilute the bidder's ownership position or leveraging up the firm through a leveraged recapitalization making it difficult for the suitor to finance the transaction. Other postoffer tactics involve targeted share repurchases (often termed "greenmail" in which the target repurchases the shares of an unfriendly suitor at a premium over the current market price) and golden parachutes, which are lucrative supplemental compensation packages for the target firm's management.

These packages are activated in the case of a takeover and the subsequent resignations of the senior executives.

2. The Case Study

2.1 The Transaction

2.1.1 Enel

The Enel Group is the leading electricity operator in both Italy and Spain and one of the leading global operators in the fields of generation, distribution and sales of electricity.

Listed on the Milan stock exchange since 1999, Enel is the Italian company with the highest number of shareholders, (some 1.2 million retail and institutional investors in 2008) and is present in 23 countries with a generating capacity of approximately 95,000 MW, serving about 61 million power and gas customers.

Enel is also the second-largest Italian operator in the natural gas market, with approximately 2.7 million customers and a 10% market share in terms of volumes.

Enel owns a 92.06% equity stake in Endesa S.A. (“Endesa”), the leading operator in the Spanish electricity sector with significant operations in other European countries and in Latin America. In 2007 the Group acquired 67.05% of Endesa and purchased the additional 25.01% on 25 June 2009.

The Group had operational generation plants (thermal, hydroelectric, geothermal and other plants) with a total net efficient capacity of 95.4 GW as of 30 June 2009 and 83.3 GW as of 31 December 2008.. In 2008, the Group’s net production of electricity amounted to 253.2 TWh, while its distribution of electricity amounted to 393.5 TWh.

The Enel Group is one of the principal international operators in the development and management of energy production from renewable resources, with over 500 operational plants and a net efficient capacity of 95,415 MW, as of 30 June 2009, split among wind, solar, geothermal and hydroelectric plants, as well as production from biomasses.

The Group also imports, distributes and sells natural gas in Italy, Spain and elsewhere. The Group sold approximately 8.2 billion cubic meters of gas worldwide per year.

As of 30 June 2009, the Group employed a total of 83,749 employees, of which 39,594 were employed in Italy and 44,155 were employed abroad (including all of Endesa's employees as of the period end).

The Company is incorporated under the laws of Italy as a joint stock company (*società per azioni*).

2.1.2 Endesa

Endesa is the leading utility in the Spanish electricity system and the number one private electricity company in Latin America. It is a significant player in the energy sector of the European Mediterranean region. It also has a growing presence in the Spanish natural gas market and is advancing rapidly in the area of renewable energy

Endesa provides power to more than 24 million customers in 11 countries (50% Spanish customers) on 3 continents. A subsidiary of Italian power giant Enel, Endesa is Spain's number one electric utility and has a generating capacity of 39,700 MW from nuclear, fossil-fueled, hydroelectric, and renewable energy plants. Endesa is the primary electricity company in Chile, Argentina, Colombia and Peru and also operates in Brazil. Endesa serves more than 397,200 natural gas customers in Spain. The company is also investing heavily in renewable energy to meet Spain's commitment to greenhouse gas reduction

2.1.3 The story of the acquisition

The story of the full acquisition starts on 2005 and is still continuing but we can summarize the timeline main events considering all the milestones that led to the acquisition.

On September 5th, 2005 Gas Natural launched an unsolicited offer for the entire share capital of Endesa for a consideration of €7.34 in cash and 0.569 shares of Gas Natural for each Endesa share (the “GasNat Offer”), valuing each share of Endesa at €21.3. This implied a 14.8% premium to the previous day close (based on the price of Gas Natural before announcement), an offer value of €22.6bn and a transaction value of €55.0bn.

In conjunction with the GasNat Offer announcement, Gas Natural announced it had reached an agreement with Iberdrola S.A. (“Iberdrola”) to transfer certain assets of the combined entity to Iberdrola, subject to the transaction being completed, (“the Iberdrola Agreement”). The assets would be transferred at fair market value as determined by independent investment banks. The objectives of the Iberdrola Agreement were to show proactiveness in relation to anti-trust issues and address part of the financing of the GasNat Offer.

Following the offer announcement, on September 6th the Board of Endesa issued a formal statement considering the offer as hostile.

On November 15th, 2005 the European Commission stated that the transaction did not have European dimension and therefore the Spanish authorities should rule the transaction. The regulatory approval process in Spain requires the Government to approve or block a transaction after having reviewed non-binding reports by the National Energy Commission (“CNE”) and the Competition Defence Tribunal (“TDC”).

On February 21st, 2006, E.ON publicly announced the launch of a counteroffer for Endesa offering €27.50 in cash per share, (the “E.ON Offer”). The E.ON Offer represented a 48.2% premium to Endesa’s undisturbed closing price on September 2nd 2005 and a 24.5% premium to the nominal value of the GasNat Offer as of February 24th. Endesa’s Board of Directors welcomed the fact that the

E.ON Offer was superior in value to the GasNat Offer, but still considered that the price offered did not adequately reflect the real value of Endesa.

On March 3rd, 2006, Endesa Board of Directors recommended its shareholders not to tender their shares to Gas Natural, since GasNat Offer did not recognize, in their opinion, the fair valuation of Endesa. On February 27th, this Committee approved the issuance of a fairness opinion letter to the Board of Endesa, in which GasNat Offer was qualified as inadequate to Endesa's shareholders from a financial point of view (see Appendix B Fairness Opinion Letter provided in relation with GasNat Offer).

On March 22nd, 2006, the Mercantile Court of Madrid N° 3 suspended GasNat Offer, on the grounds that the Iberdrola Agreement could violate the Treaty of the European Union, and therefore, GasNat Offer should be suspended until the Mercantile Court came to a final resolution on this point. Effectiveness of the suspension of GasNat Offer was conditional on Endesa making a deposit of €1,000 million.

On April 21st, 2006, the Spanish Supreme Court, also suspended GasNat Offer on the basis that the resolution from the Spanish Government that authorized with conditions GasNat Offer could be illegal since it did not follow the recommendation from the TDC. Effectiveness of the suspension of GasNat Offer was conditional on Endesa making a deposit of €1,000 million

On April 26th, 2006, the European Commission authorised E.ON offer since the potential acquisition of Endesa by E.ON was estimated not to have any negative effects on competition in the energy markets in Europe.

On July 3rd, 2006, Endesa paid an extraordinary dividend of €2.095 per Endesa. As a consequence of that, Gas Natural reduced the consideration of its offer to €5.983 and 0.569 shares of Gas Natural for each Endesa share and E.ON reduced

the value of its offer to €25.405 for each Endesa share (the “Adjusted E.ON Offer”).

On July 27th, 2006, the CNE authorised the acquisition of Endesa by E.ON subject to compliance with 19 conditions summarised in Appendix II.

The resolution from the CNE was appealed by E.ON in front of the Ministry of Industry. On November 4th, 2006, the Ministry of Industry authorised the acquisition of E.ON by Endesa and eliminated all the conditions imposed by the CNE related to mandatory disposals.

On September 25th, 2006, Acciona acquired a 10% of Endesa and requested authorisation from the CNE to increase its stake up to 25%, minimum threshold beyond which a mandatory takeover was required under current Spanish takeover code. The CNE granted Acciona such authorisation and Acciona increased its stake up to 21%.

On September 27th 2006, E.ON announced its commitment to increase its offer to €35 per each Endesa share, all in cash (“E.ON Second Offer”).

On November 16th 2006, the CNMV approved E.ON’s offer. However, based on Spanish regulation, E.ON’s offer was filed at a price of €25.405 per ELE share with a commitment to increase the offer up to €35.0 per ELE share. On November 20th, 2006 this Committee appointed the issuance of a fairness letter to the Board of Directors of Endesa, in which the Adjusted E.ON Offer was qualified as inadequate to Endesa’s shareholders from a financial point of view (see Appendix C Fairness Opinion Letter provided in relation with Adjusted E.ON Offer). Upon CNMV approval, E.ON’s offer was also affected by the suspension of GasNat Offer and therefore could not proceed further. However, as committed to the market, Endesa requested removal of the suspension that was affecting GasNat Offer, once E.ON’s offer was approved. Such removal was finally granted on January 23rd, 2007.

On January 2nd, 2007 Endesa distributed an ordinary dividend of €0.50/sh. and therefore E.ON updated its adjusted offer to €24.905 and its second offer to €34.5/sh.

On January 25th, 2007, the acceptance period for both offers started and, based on Spanish take-over code, both companies were requested to present in a closed envelope their best and final offers by February 2nd, 2007.

- On February 1st, 2007, Gas Natural filed an *Hecho Relevante* with the CNMV in which it announced it had pulled-out from the bid process;
- On February 2nd, 2007, E.ON increased its offer up to €38.75 per E share and the success of the tender offer was subject to two conditions: (i) Minimum acceptance threshold of 50% and (ii) Bylaws modification of some articles to allow E.ON to gain control of Endesa (“E.ON Third Offer”).

On February 4th, 2007 E.ON held a meeting with the press and a conference call for research analysts and investors to explain the rationale of its increased offer. In those meetings E.ON announced its target to achieve €600m in synergies by 2010 (best practice transfer in Iberia: €235m, best practice transfer in LatAm: €90m, procurement synergies: €220m and overlapping markets: €55m).

On February 5th, 2007, this Committee approved the issuance of a fairness opinion letter to the Board of Endesa, in which E.ON Third Offer was qualified as fair to Endesa’s shareholders from a financial point of view (see Appendix D Fairness Opinion Letter provided in relation with E.ON Third Offer).

Between February 27th and March 2nd, 2007, Enel acquired a 10.0% stake of Endesa and signed swap agreements for an additional 13%, together with Acciona (21.0%), unofficially opposed to E.ON’s offer. Once Enel was authorized by the CNE to increase its stake above 10%, Enel executed the outstanding swap agreements and increase its stake to 25%.

On March 23rd, 2007, the Spanish Market Regulator (CNMV) issued a statement regarding the potential intentions from Acciona and Enel to jointly acquire a stake in excess of 50% in Endesa based on which:

- E.ON was authorized to increase the value of its offer until March 26th, 2007 and the acceptance period was extended;
- Enel and Acciona were not allowed to launch any tender offer for Endesa in 6 months unless E.ON tender offer was declared unsuccessful.

On March 26th, 2007, (i) E.ON increased its offer for Endesa to €40/sh. (“E.ON Fourth Offer”) (ii) Caja Madrid, signalling support to E.ON offer, agreed to sign an equity swap with E.ON that granted the German utility the economic rights of its 9.9% for two years while Caja Madrid retained its voting rights in Endesa and (iii) Enel and Acciona announced an agreement for the joint management of Endesa that included the launch of a tender offer for Endesa offering at least €41/sh. as soon as legally possible (see Appendix III for further detail on agreement).

- The agreement between Enel and Acciona was subject to the condition that E.ON did not acquire a 50% of Endesa.

On March 26th, 2007, this Committee approved the issuance of a fairness opinion letter to the Board of Endesa, in which E.ON Fourth Offer was qualified as fair to Endesa’s shareholders from a financial point of view (see Appendix E Fairness Opinion Letter provided in relation with E.ON Fourth Offer).

On April 2nd, 2007, Acciona/Enel/E.ON reached an agreement to avoid a potential situation in which none of the parties would achieve any control of Endesa and the shareholder structure would result unsustainable in the medium to long term (see Appendix IV for further detail on the agreement).

- E.ON undertook not to waive the minimum acceptance condition to which its tender offer was subject to so that, once E.ON Fourth offer was de-

clared unsuccessful, Acciona/Enel could immediately launch a tender offer for Endesa;

- Acciona/Enel agreed the disposal of certain assets from Endesa in Europe and Spain to E.ON in the event that they managed to gain control of Endesa;
- Enel undertook to sell Viesgo to E.ON.

On April 10th, 2007, as expected, E.ON Fourth Offer was declared unsuccessful since it was only accepted by 6.01% of Endesa share capital.

On April 11th, 2007, Acciona/Enel launched a full tender offer for Endesa for €41.3/sh. fully in cash. This consideration results from the € 41 price per share of Endesa previously committed by Acciona and Enel increased by the interest that would accrue on such amount at a three-month EURIBOR rate for the period running from March 26, 2007 until May 31, 2007 (see Appendix V for further details on Acciona/Enel tender offer).

On July 2nd, Acciona/Enel reduced the tender offer price to adjust it for the distribution of a dividend of €1.14/Sh. by Endesa. The Acciona/Enel Offer price is, therefore, €40.16/sh. in cash.

On July 4th, Acciona/Enel Offer received the conditional approval by the CNE (under Function 14). Most restrictive conditions are linked to the Italian Government's presence in the shareholding of Enel (a detailed description of the conditions can be found in Appendix V).

- Enel and Acciona, which have a month to appeal, are studying the conditions and will decide in the coming days whether to appeal or not.
- The European Commission has stated that it will study CNE's ruling to check if it violates the EU law that gives the Commission exclusive powers to analyze the transaction.

On July 5th, 2007, Acciona/Enel joint offer received the unconditioned approval by European Commission as it concluded that the proposed transaction would not significantly impede effective competition in the European Economic Area or any substantial part of it.

2.1.4 Motivations

There are lots of motivations behind the acquisition and each part that is involved tries to achieve most benefits as possible.

Enel's benefits in this transaction are:

- a strong contribution to industrial and financial growth
- Wider a European footprint mitigates regulatory risk
- Potential for industrial synergies and combinations of skills and best practices
- Scale benefits on procurement activities

On the impact of gas-electricity mergers for the development of the Single European Electricity Market. The authors of the Endesa report believe that: "(a) national gaselectricity mergers create dual-fuel barriers to entry by foreign utilities; (b) gaselectricity conglomerates have a lower incentive to grow beyond their borders; and (c) *the clearance of anti-competitive mergers will give raise to disputes among Member States concerning the goal of the Single Market for electricity in Europe*"

First, there is no presumption in economics against the merger of large gas and electricity companies. Economic theory and evidence do not justify claims suggesting that the combination of two large companies is necessarily bad for consumer welfare. Furthermore, economists view with suspicion claims suggesting that mergers between companies producing and commercializing products that are largely complementary (such as gas and electricity) are anti-competitive.

Second, the evidence suggests that in Europe the so-called national champions in electricity and gas have been actively growing their businesses beyond their borders. For example, E.On (a German gas-electricity incumbent), which according to the Endesa report stopped investing abroad after its merger with Ruhrgas, has just entered the Italian energy market. Focusing on Spain, Enel controls Viesgo, active in electricity distribution, generation, and supply, and EDP (the Portuguese dominant electricity player) controls Hidrocantábrico, which is active both in electricity and gas.

Third. A merger control policy based on economic principles does not, as the authors of the Endesa report suggest, take into account the implications of the merger on the relationships between Member States or for their ability to pursue wider policy goals. Furthermore, as noted by the UK Department of Trade and Industry, *“Mergers are subject primarily to a competition test - not one based on the nationality of the purchaser”*.

On the assessment of remedies in mergers involving electricity companies. The authors of the Endesa report conclude: *“(a) merger control in electricity markets should be “more cautious and stringent than in other sectors”, as electricity mergers may easily result in higher prices for consumers and are unlikely to produce significant efficiencies; (b) the use of merger remedies in electricity mergers is a “risky game”; and it is preferable “being wrong in prohibiting a merger or imposing severe pro-competitive remedies rather than to take the risk of being wrong in clearing a merger with possibly ineffective remedies”*.

On the one hand, their price effects need not be higher than those in other sectors of the economy. On the other, there is substantial evidence on the existence of economies of scale and scope in the regulated and non-regulated activities of the gas and electricity industries.

There is no reason to adopt a bias against the adoption of remedies in electricity mergers. In fact, it may be easier to devise and implement appropriate merger

remedies in the gas and electricity sectors: structural remedies, such as the divestiture of plants are easy to identify and implement; behavioral remedies are also more likely to be effective than in other sectors, given that the gas and electricity industries are constantly under the supervision of sector-specific regulators with the know how required to police those remedies.

2.1.5 The Rule of Gas Natural on the acquisition

On the competitive impact of the proposed acquisition of Endesa by Gas Natural. The authors of the Endesa report say that the proposed transaction would remove an effective and growing competitor from the Spanish wholesale electricity market; eliminates a strong and effective (dual fuel) competitor in the Spanish retail electricity market; and may have nefarious vertical effects on the Spanish wholesale electricity and gas markets.

First of all we are not aware of any academic study, other than the Endesa report, that has contemplated the competitive effects of this transaction thus far. It is therefore somewhat adventurous to speak of an “academic consensus” on this matter. Second, the analysis presented in the Endesa report misses a number of key facts and contains some factual errors. Although the purpose of our paper is not the detailed analysis of the competitive effects of the proposed transaction, we note that some of the facts of the industries concerned suggest that this transaction may open the door to a restructuring of the electricity and gas industries in Spain, which benefits consumers in both the short run and the long run. For example, in the electricity sector, the divestiture of some of the generation assets of the merged entity could be used either to consolidate a third player in the industry or to create a de novo competitor. In the gas sector, the proposed asset transfers could consolidate the position of Iberdrola or a third party as a dual fuel competitor to Gas Natural.

The views expressed in the Endesa report are the perfectly legitimate opinions of some reputed academics, but do not represent the consensus view of the aca-

demia as they are characterized. The academic consensus with regard to merger control is, I believe, that any proposed concentration should be considered on its merits, taking into account the nature of the transaction and the characteristics of the markets where the merging parties operate. The transaction should be cleared if, once the competition authorities have had the opportunity to review the facts of the case and properly considered the remedies offered by the parties, they conclude that the net effect of the transaction on consumer welfare is positive. Or, in other words, a proposed concentration should be approved unless it significantly lessens competition in the affected markets. This is precisely the test embodied in the Spanish and EC merger regulations. According to the Spanish "*Ley de Defensa de la Competencia*", a concentration will be prohibited if it "can hinder the maintenance of effective competition on the market". Likewise, a merger will be prohibited under the "EC Merger Regulation" if it "significantly impedes effective competition, in the common market or in a substantial part of it, in particular as a result of the creation or strengthening of a dominant position".¹⁶ It is well accepted that it is burden of the competition authorities to demonstrate that a merger should be blocked.

The proposed acquisition of Endesa by Gas Natural, like any other transaction, should be assessed under this standard, which is firmly grounded in economics. There is no justification in economics for choosing a different standard for this transaction.

This is not to provide a detailed analysis of the competitive effects of the proposed acquisition of Endesa by Gas Natural. I defend that this transaction should be analyzed on its merits, taking into account the characteristics of the markets where the merging parties operate and the remedies offered by Gas Natural. The merger should be approved or blocked only after an in-depth investigation of its pro-competitive and anti-competitive effects. And it will be the burden of the competition authorities to show that the merger has to be blocked. There is no

academic consensus against mergers involving national gas and electricity companies. It all depends on the facts of the case.

Although the Endesa report broadly agrees with this recommendation, it appears to suggest that the anti-competitive implications of this deal are likely to offset its potential efficiency gains. There is no evidence in the report in support of this conclusion.

First, there is no estimate in the Endesa report of the likely efficiencies resulting from the merger. These may take several forms: reduction in fixed costs, economies of scale in the procurement of gas, economies of scope in the management of the gas and electricity networks as well as in the management of commodity risk, and demand-side efficiencies related to the development of new product offerings in the electricity and gas supply markets.

Second, some of the anti-competitive effects of the merger are based on incorrect facts and presumptions. For example, as regards electricity generation, the installed generation capacity in Spain would grow from 51,390 MW in 2005 to 63,628 MW in 2008, i.e., approximately 24%, whereas peak demand will grow approximately 17%. This increase in the reserve margin implies a reduction in market power and may mitigate any potential anti-competitive effect of the merger.

The Endesa report also assumes that any assets divested to resolve potential competition concerns will be sold to the largest competitor of the merged entity. But, as far as we are aware, that assumption is incorrect since Gas Natural has not excluded other alternatives

Third, there is no attempt to balance the alleged anti-competitive effects of the merger with its efficiency effects.

In short the commission's proposal of prohibition is based on an in-depth analysis of the potential vertical and horizontal anticompetitive effects as well as the remedies offered by the parties. The Competition Commission has been right to

take a cautious approach *vis-a-vis* the creation of a Spanish gas electricity champion.

2.1.6 The Rule of E.On on the acquisition

E.On is the world's largest private power and gas company, with over 30 million customers in more than 20 European countries and the United States and unaudited sales in 2005 amounting to more than €50 billion. Since its establishment in 2000, E.ON has focused on power and gas supply having successfully developed new markets in the United States, the United Kingdom, Central and Eastern Europe as well as Scandinavia. E.On holds leading positions in each of these markets and by the end of 2008 will have spent, according to its investment plan, €18.6 billion mainly on the expansion and modernization of power stations and networks throughout its markets.

E.On announced on February 21, 2006, an offer for Endesa, Spain's largest electricity company, to create the world's leading power and gas company serving more than 50 million customers in more than 30 countries.

E.On is offering to acquire 100 percent of the share capital of Endesa at a price of €27.50 per share in cash, which represents a premium of 48.2 percent to Endesa's undisturbed closing share price on September 2, 2005. The consideration for 100 percent of the ordinary share capital of Endesa is a total of approx. €29.1 billion. The enterprise value is approx. €55.2 billion including net debt, provisions and minorities of approx. €26.1 billion. The transaction meets all of E.ON's stated financial criteria.

The combination will:

- Strengthen E.On's position as the leading power and gas company in the world. E.On and Endesa's combined 2005 sales would amount to 608 billion kWh of electricity and 945 billion kWh of gas, supplying more than 50 million customers, and employing more than 107,000 people;

- Establish a strong presence and active competitive position in all of the important regional power and gas markets in Europe. E.On will be well-positioned to create significant long-term value from the ongoing integration of European power and gas markets;

Position E.On as the market leader in the high growth Iberian power generation and retail energy market and, in a single step, allow E.On to gain strong market positions across a number of key Latin American countries, one of the world's fastest growing energy markets.

On completion of the transaction, E.On intends to leverage its scale and expertise to benefit consumers and shareholders through the application of best practice standards across its business and its ability to fund capital expenditure plans and absorb risk.

Wulf H. Bernotat, E.On's Chief Executive Officer said: "This transaction not only gives E.ON a new dimension but it also offers significant advantages to Endesa and its employees. *The company will remain intact, which is something that will also benefit Spanish consumers. As part of a major, international energy group, Endesa will give new impetus to competition in Spain. The combination of E.ON and Endesa will create a leading competitive player with operations in all key European countries. It represents an important step towards creating a single European energy market.*"

Good value for Endesa's shareholders

The offer price represents a premium of: 48.2 percent to the closing price of Endesa's shares on September 2, 2005, the last day of trading before the disclosure of an unsolicited offer for Endesa; 52.7 percent to the average price of the six months preceding September 2, 2005; 7.9 percent to its closing share price (February 20, 2006).

If Endesa shareholders are paid a dividend prior to the transaction's completion, the offer price of € 27.50 per share will be reduced by the amount of the per-share dividend.

E.On will build on Endesa's strength in its core markets

E.On is organized into five market units. Following completion, E.On intended to form a new Southern European and Latin American market unit to be headquartered in Madrid, operating as a Spanish company. This market unit consists of Endesa's existing operations and E.ON's current operations in Italy, and will be E.On's second largest market unit by revenue and the largest single contributor to E.On's Ebitda. Endesa's management and employees would play a critical and important role in growing those businesses further. Furthermore, E.ON intended to expand Endesa's Centre for Excellence in Distribution based in Barcelona, into its Global Centre of Excellence, which would serve as a key resource for the entire E.ON Group.

Wulf H. Bernotat, in those days, added: *"I very much look forward to welcoming all of Endesa's employees to our Group and supporting them as they further develop the business. Integration of the acquired businesses will be a priority, and we will work closely with Endesa's management and employees to maximize efficiency by the application of best practice processes across all of our market units and businesses."*

Endesa was the market leader in Spain with 22,000 MW of installed generation capacity, 11 million electricity customers and 550,000 gas customers. Together with Endesa, E.On intended to be an important competitor and contributor to the further development of the Spanish market, including realizing opportunities in gas-power convergence. Capital expenditure would be focused on Endesa's "Progress in Capacity" plan, continuing Endesa's investment in the construction of new CCGT facilities, LNG capacity and the development of renewables and CHP activities.

The combination of experience and best practice from E.ON and Endesa would benefit all stakeholders in Spain, generating increased competition and contributing to the further development of the Spanish energy market. The new company's diversified gas sourcing would secure longterm supply in Spain. By building on Endesa's competitive position it would also ensure that the Spanish market benefits from E.ON/Endesa's balance of supply and generation assets.

In Italy, Endesa's number three position in the power market with 6,600 MW and access to new LNG import capacity combined well with E.On's planned 800MW CCGT plant in Livorno Ferraris and existing 750,000 gas customers. Endesa's position in France, with 2,500 MW of generation capacity, allowed E.On to compete for the opportunities which deregulation would brought, and also would permitted further interconnection.

In Latin America, E.On intended to build on Endesa's strong and stable cash generative business and a customer base of 11 million. In particular Chile, the core country of Endesa's Latin American business with approximately half of the proportional EBITDA of Enersis, the largest utility player in Latin America, represented an attractive opportunity for future growth. The combined customer, energy and risk management experience would be a critical asset of the new combined company.

A financially attractive transaction

The transaction met E.On's strict financial criteria, and was expected to be earnings enhancing in the first full year of acquisition. The transaction was also expected to deliver returns above E.On's cost of capital. E.On's current dividend policy was unaffected by the acquisition, including the special dividend relating to the Degussa disposal.

Financing for the acquisition would come from E.On's new credit facilities provided by HSBC, Citigroup, JP Morgan and Deutsche Bank, and from existing funds. The company continued to have the financial strength needed for further

investments in the energy sector, and the capital expenditure plans of E.ON and Endesa were expected to remain in place. E.On remained committed to maintaining a “single A flat” (A/A2) credit rating post completion of the transaction. Wulf H. Bernotat commented: “E.ON and Endesa are a strategically excellent fit, securing attractive domestic growth and strengthening E.ON’s position as the European *market moves towards integration. E.ON is offering a very attractive price within its stated investment returns criteria.*”

Board of Directors’ Opinion of the E.ON Offer

Endesa’s Board of Directors, by unanimous vote of those present, confirmed its preliminary assessment of the Offer, which was issued on 21 February, 2006, in response to the announcement of the Offer. Accordingly, and without prejudicing its position set out below on price, the Board viewed positively the fact that the Offer was made entirely in cash, unlike the competing offer made by Gas Natural SDG, S.A., improving the consideration proposed pursuant to this. In addition, the Board views as positive the Offeror’s intentions to maintain ENDESA’s industrial project, particularly its investment plan and its staff, as well as its goal of furthering the development of the Spanish gas and electricity markets.

Nevertheless, Endesa’s Board of Directors, also by unanimous vote, recommended not accepting the Offer at its current price of Euro 25.405 per share, given the Offeror’s irrevocable commitment to raise the price to a minimum of Euro 35 per share.

It was made expressly clear that this report issued by Endesa’s Board of Directors did not address the increased Offer price announced by the Offeror, which had been properly considered in accordance with the provisions of Royal Decree 1197/1991 once it has been formalised by E.On, either in accordance with the normal offer increase procedure in the event that Gas Natural, SDG, S.A. with-

draws its offer or, otherwise, in accordance with the sealed envelope bidding process prescribed for competing offers.

Endesa's Board of Directors has received the opinion of its financial advisors: Citigroup Global Markets Limited, Deutsche Bank AG London, J.P. Morgan Plc, Lehman Brothers (Europe) Limited and Merrill Lynch Capital Markets España, S.A., S.V.

2.1.7 The Rule of Acciona on the acquisition

Acciona is one of the foremost Spanish business corporations, leader in the development and management of infrastructure, renewable energy, water and services. Listed on the selective Ibex-35 stock exchange index, it is a benchmark for the market. The Company was set up over a century ago and is made up of more than 35,000 employees and has a presence in more than 30 countries on five continents.

Less than a decade ago, Acciona was one of the main construction companies in Spain, but by immersing itself in a process of diversification and looking for business opportunities at the international level, Acciona has succeeded in reinventing itself. During 2008, and after exiting Endesa in 2009, Acciona completed its transformation into a pioneering company in development and sustainability, converting itself into a global leader in the development, production and management of renewable energies, water and infrastructures with the minimum environmental impact.

The acquisition of capital of Endesa by Acciona towards the end of September 2006 caused a landslide in the markets, the media, the business world and the political scene. From the start, Acciona claimed the strategic nature of its investment. The Chair-man of Endesa himself declared the pillars of this strategic bet to the top management of Endesa:

1. *“The leadership of Endesa in Spain and Latin America makes this company a unique platform to contribute towards a change in the world-wide energy*

model. The concentration of the origin of fossil fuels, the growing socio-political instability of the main producing countries and the almost certain lack of these resources in a not very distant future, turn us into a decisive part in solving the great energy challenges of the future.”

2. “The efficient and diversified competitive generation mix of Endesa, together with the great capacity for generating cash-flow, gives this company a privileged position to take on the investments required for such a deep change.”

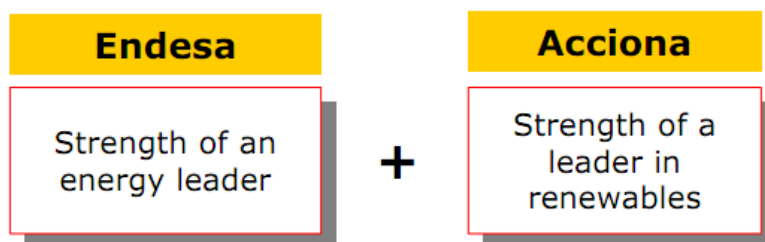
3. “A business plan with great potential for the creation of value which together with the additional contributions of Enel and Acciona, will reinforce the position of the company, its contribution to the countries in which we operate, the returns for shareholders, and professional development of its human team.”

4. “The possibility of creating, with Acciona, the worldwide renewable energy leader.”

The Endesa intent with Acciona was to have a strong business and a great value:

- Lead the global transition to a sustainable energy model
- Creation of the global leader in renewable energies
- Transform Endesa's financial and growth profile into the most attractive within the utility sector
- Additional value creation from an aligned shareholding – management structure
- Exploit the combination of strong and recurrent cash flows (traditional energies) and solid growth potential (renewables)
- Leverage on Endesa's strong market positions (Spain, LatAm, France & Italy) to accelerate growth in renewables through Acciona's management dynamism
- Strong re-rating potential of the combined renewable asset base

- Opportunity to secure wind turbine availability through Acciona's manufacturing capacity
- Opportunity to jointly pursue IWPP Projects (Independent Water and Power Production)
- Opportunity to undertake non-organic growth (currently not envisaged in the company's
- Business Plan) through the combination of Endesa's leverage capacity (up to 1.4x), and Acciona's management capabilities/value creation track record



Impact of Endesa

The impact of Endesa on Ebitda (429 million euro) and revenues (1.203 billion euro) is due to proportionate consolidation of 25% of Endesa in the fourth quarter of 2007. The impact of 318 million euro on the EBT (earnings before taxes) line is due to the dividends distributed by Endesa, net of the expenses associated with the acquisition of the stake, in the first nine months of the year, plus proportionate consolidation of the 25% stake in the fourth quarter. At 31 December 2007, Acciona owned 264,793,905 shares of Endesa, representing 25.01% of its capital stock, acquired for an amount of 9.272 billion euro, i.e. equivalent to approximately 35 euro per share. The investment is part of the strategic plan to expand in the electricity business. The acquisition was financed in such a way as to preserve Acciona's capacity to invest.

Capital expenditure

Capital expenditure amounted to 3.114 billion euro, mainly to acquire an additional 4.7% of Endesa. The remainder of capital expenditure was principally to drive organic growth at Acciona Energy, Acciona Infrastructures, Acciona Urban & Environmental Services and Acciona Real Estate. As a result of the investment in Endesa, consolidation of 25% of its debt (5.312 billion euro) and Acciona's ongoing investment policy, net financial debt at 31 December 2007 amounted to 17.804 billion euro, i.e. 276% of equity.

The opportunities

"We have the great luck, opportunity and challenge of working with an objective that should cover all our professional and personal aspirations: sustainability, understanding this to be economic growth, ecological balance and social progress". This was the definition given to the top management of Endesa by José Manuel Entrecañales, just appointed chairman of the electricity company, of the spirit that will govern his management and which includes the values of Acciona, as could not be otherwise. 18th October was the day powers were transferred in Endesa. After more than two years of uncertainty, the Management Board of Endesa has been renewed and several top managers have been appointed to complete the current management team of Endesa. A joint Acciona-Enel Management Board, with the Executive Chairmanship and the casting vote corresponding to José Manuel Entrecañales, opened up a new stage that "will allow Endesa to capitalize on the excellence and strengths of its reference shareholders which, together with our own, make us one of the most thrilling business projects in the world energy panorama", according to his own words at a meeting that same afternoon with the top management of Endesa. José Manuel Entrecañales took the opportunity to insist on the strategic guidelines always present in the management project ACCIONA shares with Enel.

Management principles

Endesa will have full operational responsibility in complying with its business plan. Preserving the corporate identity of Endesa as an independent, Spanish company is “the best way of adding value to the human team, the shareholders and society in general”.

Supply and growth: The commitment towards the societies and markets in which Endesa operates includes guaranteeing energy supply and making use of its growth potential.

Innovation: Endesa will bet on leading innovation in all the energy alternatives available. Encouraging innovation in the energy world is “a strategy that cannot be delayed any longer if the competitiveness of the company is to improve and, with this, the social and economic progress of our society”. Improving the quality of supply, already higher than the national average, and that of the services provided to clients is one of the constant features that will continue governing the management of Endesa.

Sustainability: The final touch to these management principles, closing and putting all the rest into context, will be to “contribute towards economic development, social progress and the ecological balance of our environment”. ACCIONA stands out in the field of renewable energies and Endesa will be working with even greater intensity in the field of conventional energies, spearheading energy efficiency and savings and the capture of CO₂.

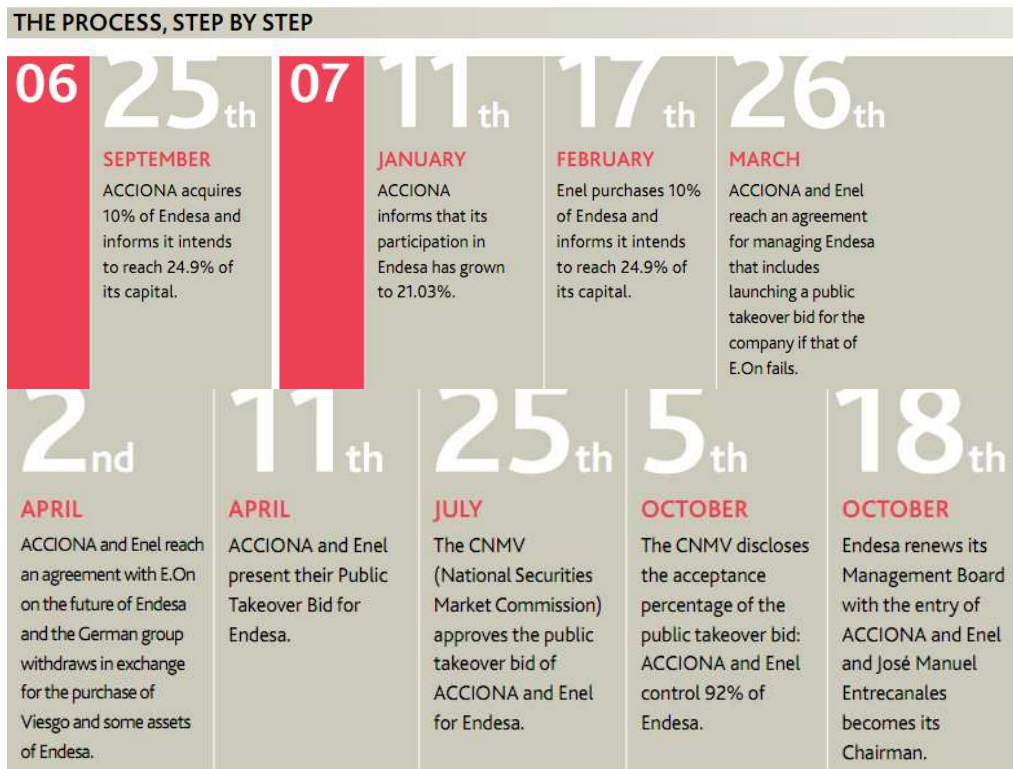
2.1.8 The story of the Enel acquisition

Acquisition of shares

On February 27, 2007, Enel, acting through its subsidiary Enel Energy Europe Srl (Enel Energy Europe), purchased 105,800,000 shares of Endesa SA (Endesa), Spain's leading electricity generator, equal to 9.99% of that company's share capital, at a price of €39 per share for a total of €4,126.2 million. The Endesa shares, acquired through an off-market transaction with institutional investors, were financed with cash flow and existing lines of credit, without any involvement of other Endesa shareholders.

On June 6, Enel Energy Europe's stake in Endesa rose from 9.99% to 24.97%, with a total of 264,401,597 shares, by way of settlement of the equity swaps entered into in March with UBS and Mediobanca in which the underlying was represented by 158,601,597 shares of Endesa (14.98% of the share capital).

Agreement between Enel - Acciona for the joint management of Endesa



On March 26, 2007, Enel signed an agreement with Acciona, one of the leading Spanish groups operating at the international level in the development and operation of infrastructure, services and energy from renewables, for the joint management of Endesa, to be implemented also through a public tender offer.

The agreement was subject to the condition (subsequently satisfied) that E.On. not acquire more than 50% of Endesa through its own tender offer under way at the time the agreement was signed. In addition to establishing the relations associated with their equity stakes in Endesa, the parties also specified the mechanisms that would govern their joint control should the offer be successful. Among the various clauses of the agreement, Acciona was granted a put option for all the shares that it directly or indirectly holds. The option may be exercised one time only, on the terms and conditions specified in the agreement, at any time between the start of the fourth and the end of the tenth year from the signing date of the accord.

Agreement between Enel- Acciona and E.On

On April 2, 2007, Enel and Acciona signed an agreement with E.On under which the latter agreed, where the tender offer launched by E.On should be unsuccessful, to refrain from any direct or indirect attempt to acquire a holding in Endesa in the four years subsequent to the agreement. At the same time, Enel and Acciona agreed to transfer to E.On, subject to acquiring effective control of Endesa through a tender offer, in line with the agreement of March 26, 2007, a number of assets owned by Endesa and Enel. The assets had been transferred to E.On in 2008, once they have been valued and the necessary administrative authorizations have been received.

Following the acquisition of joint control of Endesa and in implementation of the agreement with E.On, on October 18, 2007, in accordance with the antitrust conditions set by the European Union, a trustee was established for the indepen-

dent management of the company until the date the equity investments that Enel has agreed to sell to E.On are effectively transferred.

Until the closing of the transaction, Enel will be the sole beneficiary of the results of those equity investments as well as the price paid in the planned transfer. Similarly, a second trustee has been established for the independent management of the assets held by Endesa mentioned above, with the exception of its other assets in Spain, that form part of the disposal agreed with E.On in the agreement of April 2, 2007. Once again, until the closing of the transaction Endesa will be the sole beneficiary of the results of those assets and the price paid in the planned transfer.

Public tender offer for Endesa

On April 11, 2007, following the announcement of the failure of the E.On public tender for Endesa, Enel (acting through its subsidiary Enel Energy Europe) and Acciona presented Spain's Comisión Nacional del Mercado de Valores (CNMV) a joint offer for 100% of Endesa shares.

On October 5, 2007, the Comisión Nacional del Mercado de Valores announced that acceptance of the offer amounted to 46.05% of Endesa's share capital, of which 45.62% (equal to 483,060,017 shares) was tendered in the offer in Spain and 0.43% (equal to 4,541,626 ADSs) was tendered in the offer in the United States. In accordance with the agreements between Enel and Acciona, following completion of the takeover bid, Enel, through Enel Energy Europe, acquired 42.08% of the share capital of Endesa (equal to 445,522,261 shares), while Acciona acquired 3.97% (equal to 42,079,382 shares). Therefore, following completion of the takeover bid, Enel (through Enel Energy Europe) owns 67.05% of Endesa's share capital (equal to 709,923,858 shares), while Acciona directly and indirectly holds 25.01% (equal to 264,793,905 shares).

On October 18, 2007, the Board of Directors of Endesa appointed a number of new board members in order to ensure that its composition reflects the ownership structure resulting from the outcome of the public tender offer.

How to finance the operation

In order to meet the financial commitments of the above transaction, on April 9, 2007, the Board of Directors of Enel SpA also voted to obtain a syndicated line of credit totaling €35 billion, which is intended to fully meet the obligations in respect of the acquisition of Endesa shares. The interest rate varied in relation to Enel's rating and the line of credit may be repaid early in full or in part without penalty. In addition, for the purposes of financing the transaction as well as restructuring the Group's debt, the Board of Directors also approved:

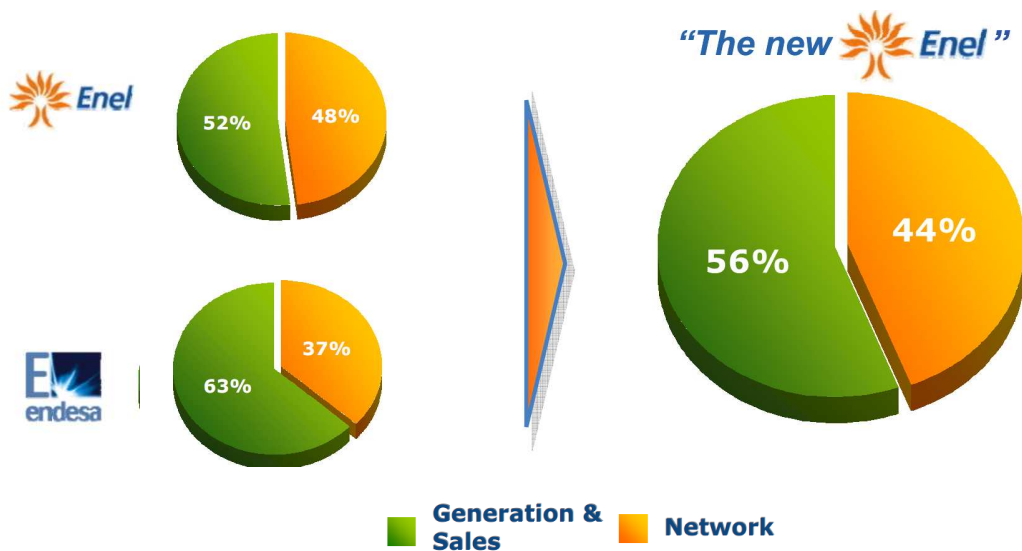
- the renewal of the program for the issue of Global Medium-Term Notes, raising the amount from €10 to €25 billion.
- the issue by Enel, as part of the above program, of one or more bonds in euro or foreign currency to be placed with institutional investors by December 31, 2007, in the total amount of €5 billion.

In execution of that resolution, on June 13, 2007 Enel carried out a multi-tranche issue totaling €3.4 billion and £1.1 billion. The transaction, conducted by a pool of banks, was more than twice over-subscribed. Following the issue, the syndicated credit facility of €35 billion was lowered to €30 billion.

On July 26, 2007, the Enel's Board of Directors approved the issue of one or more bonds to be placed with institutional investors or retail investors, to be listed (in whole or in part) on one or more regulated markets by June 30, 2008, with a total maximum amount of €10 billion.

In execution of that resolution on September 13, 2007, Enel, through its subsidiary Enel Finance International, carried out a multi-tranche bond issue for a total value of \$3.5 billion (about €2.5 billion).

The facility was fully hedged by Enel with cross currency swaps that linked each tranche to a fixed rate in euro. The bond issue, lead by a pool of banks, received subscriptions of about \$6 billion, much greater than supply.



In addition, from November 19 to December 7, 2007, a €2 billion retail bond was issued on the Italian market. The size of the issue was raised to €2.3 billion (€1.0 billion fixed rate and €1.3 billion floating rate) as a result of excess demand. The bond, with a maturity of 7 years and 1 month, will be paid in full at maturity (January 2015). Of the total of €2.3 billion, €2 billion was used to reduce the original €35.0 billion credit facility, which was thereby reduced to €19.5 billion (the facility had been lowered to €30 billion in June, €28 billion in September, €23 billion in October and €21.5 billion in November 2006).

Complete the acquisition with the 25,01% of Acciona

On February 20, 2009, Enel signed an agreement for the acquisition of the 25.01% of Endesa owned directly and indirectly by Acciona.

The price of €11,107.4 million Euros was determined in accordance with the criteria set out in the agreement between Enel and Acciona of March 26, 2007, the provisions of which have therefore ceased to have effect. As provided for in the agreement, the price was adjusted to take account of interest accrued up to the

transaction date and dividends paid by Endesa to Acciona. The agreement, which also involved the early exercise of the put option by Acciona (the original exercise date was March 2010), was subject to a number of suspensory conditions, such as regulatory and antitrust approval and other legislative conditions, and also provided for the transfer to Acciona from Endesa of certain operational wind and hydro assets.

On June 25, 2009, Enel and Acciona, after the conditions governing the agreement of February 20, 2009 had been met, implemented the accord with the transfer to Enel Energy Europe (wholly-owned by Enel SpA) of the 25.01% of Endesa held directly and indirectly by Acciona.

Enel SpA, acting through Enel Energy Europe, paid Acciona €9,627.1 million in cash for the transfer.

The amount was determined by subtracting the Endesa dividends received by Acciona after February 20, 2009 (€1,561.5 million) from the value of the holding established on the basis of the criteria set out in the agreement of February 20, 2009 (€11,107.4 million) and adding interest accrued as from that date (about €81 million) and applied to the share of the debt taken on, directly and indirectly, by Acciona to acquire the 25.01% stake in Endesa.

Following the transaction, Enel, through Enel Energy Europe, now holds a 92.06% stake in Endesa, Spain's largest electricity company, giving it full control.

To help finance the purchase, Enel SpA, jointly with its subsidiary Enel Finance International, contracted a loan of €8 billion agreed on April 16, 2009 (the "Credit Agreement 2009") with a pool of 12 banks. The financing was structured as an increase in the syndicated credit line with an original amount of €35 billion (the "Credit Agreement 2007"), the terms of which included the option of increasing (up to a maximum of €8.5 billion) the Ctranche (equal to €10 billion falling due in 2012) in the event of the exercise of the put option by Acciona in 2010.

The Credit Agreement 2009 comprises:

- a "facility C increase" raising the €10 billion C tranche of the Credit Agreement 2007 by a further €8 billion falling due in 2012;
- a "rollover" agreement, in the amount of €8 billion intended to replace and renew the "facility C increase" as from 2012 with two new tranches, the first totaling €5.5 billion falling due in 2014 and the second amounting to €2.5 billion falling due in 2016.

As envisaged for the original Credit Agreement 2007, the Credit Agreement 2009 bears a floating rate of interest that is pegged to Enel's rating.

2.2 Enel

2.2.1 Organizational structure

In compliance with the current regulations applicable in Italy to companies with listed shares, the organizational structure of the Company includes:

- Board of Directors entrusted with the management of the Company;
- Board of Statutory Auditors responsible for (i) ensuring compliance with the law and the Company's bylaws, as well as the observance of correct management principles in the carrying out of the Companies activities, (ii) checking the adequacy of the Company's organizational structure, internal auditing system, and administration and accounting system, and (iii) ascertaining how the corporate governance rules provided by the Self-regulation Code are actually implemented;
- Shareholders' Meetings, called to resolve, in either an ordinary or an extraordinary session, on, among other things, (i) the appointment and removal of members of the Board of Directors and the Board of Statutory Auditors, as well as their compensation and responsibilities, (ii) the approval of the financial statements and the allocation of net income, (iii) the acquisition and sale of own shares, (iv) stock-option plans, (v) amendments of the Company's bylaws, and (vi) the issue of convertible bonds.

The external audit of the Company's and Group's accounts is entrusted to a specialized firm registered with the CONSOB and expressly appointed, after the Board of Statutory Auditors has made a grounded proposal, by a Shareholders' Meeting.

Board of Directors: role and powers

The Board of Directors plays a central role in the Company's organization and is entrusted with the powers and the responsibility for strategic and organizational policies, as well as with verifying the existence of the controls necessary for

monitoring the performance of the Company and the Group. In consideration of its role, the Board of Directors meets regularly and is organized and works so as to ensure the effective performance of its duties.

In this context, and in accordance with the provisions of the law and specific resolutions of its own (and, in particular, of the one adopted in June 2008), the Board of Directors:

- establishes the corporate governance system for the Company and the Group and sees to the constitution and the definition of the duties of the Board's internal committees, whose members it appoints;
- delegates and revokes the powers of the Chief Executive Officer, defining their content, limits, and the procedures, if any, for exercising them. In accordance with the delegations in force, the Chief Executive Officer is vested with the broadest powers for the management of the Company, with the exception of those that are assigned otherwise by the law or by the Company's bylaws or are reserved to the Board of Directors according to resolutions of the latter, which are described below;
- receives, together with the Board of Statutory Auditors, constant and exhaustive information from the Chief Executive Officer regarding the activities carried out in the exercise of his powers, which is summarized in a special quarterly report. In particular, with regard to all the most significant transactions carried out using the powers of his office (including atypical or unusual transactions or ones with related parties whose approval is not reserved to the Board of Directors), the Chief Executive Officer reports to the Board on (i) the features of the transactions, (ii) the parties concerned and any relation they might have with the Group companies, (iii) the procedures for determining the considerations concerned, and (iv) the related effects on the income statement and the balance sheet;

- determines, on the basis of the proposals made by the dedicated Committee and after receiving the opinion of the Board of Statutory Auditors, the compensation of the Chief Executive Officer and of the other Directors who hold specific offices;
- evaluates, on the basis of the analyses and proposals made by the dedicated Committee, the criteria adopted for the compensation of the Company's and the Group's executives with strategic responsibilities and decides with regard to the adoption of the stock options plans addressed to executives to be submitted to Shareholders' Meetings for approval;
- evaluates the adequacy of the Company's and the Group's organizational, administrative, and accounting structure and resolves on the changes in the organizational structure proposed by the Chief Executive Officer;
- establishes the corporate structure of the Group and checks if it is appropriate;
- examines and approves the strategic, business, and financial plans of the Company and the Group. In this regard, the current division of powers within the Company specifically provides for the Board of Directors to resolve on the approval of:
 - the annual budget and the long-term plan (which includes the aggregates of the annual budgets and long-term plans of the Group companies);
 - strategic agreements, also determining, upon proposal by the Chief Executive Officer and after the Chairman has expressed his opinion, the strategic objectives of the Company and the Group;
- examines and approves beforehand the transactions of the Company and the Group that have a significant impact on their strategy, balance sheets, income statements, and cash flows, particularly in cases where they are

carried out with related parties or are otherwise characterized by a potential conflict of interest.

In particular, all financial transactions of a significant size, by which is meant taking on loans exceeding the value of €50 million, as well as granting loans and issuing guarantees in favor of third parties exceeding the value of €25 million, must be approved beforehand (if they concern the Company) or evaluated (if they regard the Group companies) by the Board of Directors.

In addition, the acquisition and disposal of equity investments amounting to more than €25 million must be approved beforehand (if they are carried out directly by the Company) or evaluated (if they concern Group companies) by the Board of Directors. Finally, the latter approves agreements (with ministries, local governments, etc.) that entail expenditure commitments exceeding €25 million;

- provides for the exercise of voting rights at shareholders' meetings of the main companies controlled by the Parent Company and designates the directors and statutory auditors of the aforesaid companies;
- appoints the General Manager and grants the related powers;
- evaluates the general performance of the Company and the Group, with particular reference to conflicts of interest, using the information received from the Chief Executive Officer and verifying periodically the achievement of the objectives set;
- formulates proposals to submit to Shareholders' Meetings and reports during the latter on the activities that have been carried out and planned, seeing that the shareholders have adequate information on the elements necessary for them to participate in a well-informed manner in the decisions that are within the authority of such Meetings.

Appointment, replacement, composition, and term

Pursuant to the provisions of the Company's bylaws, the Board of Directors consists of from three to nine members, who are appointed by an Ordinary Shareholders' Meeting (which determines their number within such limits) for a term not exceeding three accounting periods and may be reappointed at the expiration of their term. To them may be added a non-voting Director, whose appointment is reserved to the Italian government in virtue of the legislation regarding privatizations and a specific provision of the bylaws (as previously explained). To date, the Italian government has not exercised such power of appointment.

According to the current legislation, all the Directors must possess the requisites of honorableness required of (i) company representatives of financial intermediaries, as well as (ii) statutory auditors of listed companies.

In compliance with the legislation regulating privatizations and in accordance with the amendments made at the end of 2005 to the Unified Financial Act, the bylaws also provide for the appointment of the entire Board of Directors to take place according to the "slate-vote" mechanism aimed at ensuring the presence on the Board of Directors of members nominated by minority shareholders amounting to three-tenths of the Directors to be elected. In the event this number is a fraction, it is to be rounded up to the nearest integer.

Each slate must include at least two candidates possessing the requisites of independence established by the law (that is to say, those provided for the statutory auditors of listed companies), distinctly mentioning such candidates and listing one of them first on the slate.

The slates must list the candidates in numerical order and may be presented by the outgoing Board of Directors or by shareholders who, individually or together with other shareholders, represent at least 1% of the share capital. The slates must be filed at the Company's registered office and published in newspapers with a nation-wide circulation sufficiently in advance of the date of the Shareholders' Meeting concerned – 20 days in advance being the deadline if the slate

is presented by the outgoing Board of Directors and 10 days if the slates are presented by shareholders – so as to ensure a transparent process for the appointment of the Board of Directors. In this regard, it should be noted that, in occasion of the election of the Board of Directors held in June 2008, shareholders were requested to file their slates at least 15 days before the date of the Shareholders' Meeting in compliance with the recommendations of the Self-regulation Code and according to a specific note contained in the notice of the Meeting.

It should be noted that the question of the deadlines and the quorum required for the presentation, as well as the procedures for filing and publishing, slates for the election of the Board of Directors will be subject to significant changes following Italy's recent implementation of Directive 2007/36/EC – regarding the exercise of several rights of the shareholders of listed companies – through Legislative Decree 27 of January 27, 2010, whose important innovations will apply to shareholders' meetings of which the notice is published after October 31, 2010.

A report with exhaustive information regarding the personal and professional characteristics of the candidates, accompanied by a statement as to whether or not the latter qualify as independent according to the provisions of law and of the Self-regulation Code, must be filed at the Company's registered office together with the slates, as well as published promptly on both the Company's and Borsa Italiana's websites.

For the purposes of identifying the Directors to be elected, candidates listed on slates that receive a number of votes amounting to less than half the percentage required for presenting the aforesaid slates are not taken into account (i.e. 0.5% of the share capital).

For the appointment of Directors who, for whatever reason, are not elected according to the "slate-vote" system, a Shareholders' Meeting resolves in accordance with the majorities required by the law, ensuring in any case the presence

of the necessary number of Directors possessing the requirements of independence established by the law (that is to say, at least one Director if the Board consists of no more than seven members or two Directors if the Board consists of more than seven members).

The replacement of Directors is regulated by the provisions of the law. In addition to such provisions, the bylaws provide that:

- if one or more of the Directors leaving their office vacant were drawn from a slate also containing candidates who were not elected, the replacement must be made by appointing, in numerical order, persons drawn from the slate to which the Directors in question belonged, provided that said persons are still eligible and willing to accept the office;
- in any case, in replacing Directors who leave their office vacant, the Board of Directors must ensure the presence of the necessary number of Directors possessing the requirements of independence established by the law;
- if the majority of the Directors appointed by a Shareholders' Meeting leave their office vacant, the entire Board is to be deemed to have resigned and the Directors still in office must promptly call a Shareholders' Meeting to elect a new Board.

The Board of Directors confirmed, that it can defer the creation within itself of a special nomination committee, because to date there has been no evidence that it is difficult for shareholders to find suitable candidates, so as to achieve a composition of the Board of Directors that conforms to the provisions of the law and is in line with the recommendations of the Self-regulation Code.

As resolved by the Ordinary Shareholders' Meeting, the incumbent Board of Directors consists of nine members, whose term expires when the financial statements for 2010 are approved. As a result of the appointments made at the aforesaid Shareholders' Meeting, the Board thus currently consists of the following

members, whose professional profiles are summarized below, together with the specification of the slates on which they were nominated. The slates were presented by the Ministry for the Economy and Finance (which at the time owned 21.10% of the Company's share capital) and by a group of 15 institutional investors (which at the time owned a total of 1.02% of the Company's share capital).

2.2.2 Enel financial evolution:

<i>Million of €</i>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Revenues					
Revenues from sales and services	693,0	721,6	1.058,0	1.113,8	1.079,0
Other revenues	13,3	12,7	20,9	72,4	26,0
Total	706,3	734,3	1.078,9	1.186,2	1.105,0
Costs:					
Electricity purchases and consumables	316,7	349,2	603,3	621,3	607,0
Services, leases and rentals	308,2	288,5	389,5	252,7	211,0
Personnel	97,2	104,8	100,2	87,4	91,0
Other operating expenses	11,5	55,8	43,4	39,5	176,0
Total	733,6	798,3	1.136,4	1.000,9	1.085,0
Gross operating margin	-27,3	-64,0	-57,5	185,3	20,0
Depreciation, amortization and impairment losses	8,7	15,4	16,0	25,0	195,0
Operating income	-36,0	-79,4	-73,5	350,2	1.312,0
Net financial income/(expense) and income from equity investments					
Income from equity investments	4.481,8	3.187,2	3.891,8	3.074,4	1.312,0
Financial income	2.510,8	4.061,9	1.814,9	778,2	1.563,0
Financial expense	3.792,8	4.529,9	1.953,5	788,2	639,0
Total	3.199,8	2.719,2	3.753,2	3.064,4	833,0
Income before taxes	3.163,8	2.642,9	3.679,7	3.414,6	2.681,0
Income taxes	-296,6	-100,9	-207,7	67,9	-14,0
NET INCOME FOR THE YEAR	3.460,4	2.740,7	3.887,4	3.346,7	2.695,0

Revenues:

Revenues from sales and services totaled €1,114 million (€1,079 million in 2005) and regard:

- revenues from electricity sales, of €880 million, mainly attributable to sales of imported electricity to the Single Buyer in the amount of €717 million and the sale of energy in France on the free market in the amount of €155 million;
- revenues from services, of €234 million (€229 million in 2005), essentially in respect of assistance and consulting services provided to subsidiaries (€230 million, compared with €220 million in 2005).

The increase of €35 million in revenues from sales and services between 2005-2006 is mainly attributable to the increase in the average unit price of electricity while volumes were broadly unchanged.

The decrease of €282.2 million in revenues from electricity sales in 2007 compared with 2006 is attributable to lower sales to the Single Buyer (down €375.2 million) as a result of the impossibility of importing electricity purchased from EDF into Italy, which resulted in greater sales in France at a lower average price than in 2006.

The increase of €226.3 million in revenues from services on the previous year is largely due to the increase in assistance and consulting services provided to subsidiaries, notably the charge-through to Enel Energy Europe of costs incurred in connection with the acquisition of Endesa (€149.7 million)

The decrease of €206.2 million in revenues from electricity sales in 2008 compared with 2007 is attributable to lower sales in France on the free market (€256.0 million) as a result of the expiry of the contract with EdF on December 31, 2007, partly offset by greater revenues from sales to the Single Buyer (€44.6 million).

The decrease of €130.2 million in revenues from services on the previous year is largely due to a decline in charges passed through to Group companies in respect of international acquisitions. In 2007 revenues from services for Group companies included the charge-through of the expenses in respect of the Endesa

acquisition to the subsidiary Enel Energy Europe (an overall total of €149.7 million).

The decrease of €62.9 million from electricity sales in 2009 compared with 2008 was mainly due to the decrease in the average price of electricity sales to the Single Buyer.

The increase of €46.4 million in revenues from services on the previous year is largely due to increased charges passed through to Enel Energy Europe SL (€48.9 million) in connection with the acquisition, completed on June 25, 2009, of an additional 25.01% of Endesa from Acciona.

Costs:

During this five years costs generally decreased. Operating expenses amounted to €39 million in 2006, a decline of €137 million on the previous year. In 2005 the item included an accrual of €45 million to the provision for risks and charges, the effect of the fair value measurement of the Terna bonus shares in the amount of €33 million, charges for green certificates totaling €37 million and charges generated by the application of Resolution no. 20/04 of the Authority for Electricity and Gas in the amount of €16 million.

The overall increase of "Costs for services, leases and rentals" of €136.8 million on 2006 is mainly attributable to the charges incurred in relation to international acquisitions, especially that of Endesa, which have a corresponding increase in revenues as a result of the debiting of the costs to Enel Energy Europe.

The overall decrease of €101.0 million on 2007 is mainly attributable to the net effect of lower costs incurred for international acquisitions and increased spending for professional and technical services and fees due to the Market Operator, mainly congestion fees associated with the long-term contract for electricity imports from Switzerland.

The overall increase of €19.7 million in 2009 compared with 2008 is mainly attributable to the net effect of increased costs incurred for international acquisi-

tions, increased spending for the organization of conferences and meetings by Enel SpA.

Operating income:

Operating income amounted to €351 million in 2006, a decline of €961 million with respect to December 31, 2005. Excluding "income from equity exchange transaction and disposal of significant equity investments" for both 2006 and 2005, operating income rose by €336 million, mainly attributable to the improvement in the gross operating margin and lower depreciation, amortization and impairment losses in 2006.

In 2007 the Operating income amounted to a negative €73.5 million, a fall of €423.7 million on the previous year. The decrease came to €234.0 million, mainly attributable to the deterioration in the gross operating margin, partially offset by lower provisions and impairment losses in 2007.

In 2008 amounted to a negative €79.4 million, an improvement of €5.1 million on the previous year, mainly attributable to the improvement in the gross operating margin and lower depreciation and amortization in 2008 following the disposal of the assets associated with the purchasing unit transferred to Enel Servizi with effect from January 1, 2008.

In December 2009 Operating income amounted to a negative €36.0 million, an improvement of €40.3 million on the previous year, attributable to the improvement in the gross operating margin and the absence of impairment losses in 2009.

2.2.3 Analysis of the financial structure: Debt

<i>(Million of €)</i>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Long term debt:					
Bank loans	5.948,8	14.933,3	12.176,8	27,4	59,0
Bonds	13.256,8	13.080,3	13.679,4	7.566,5	7.095,0
Debt assumed from subsidiaries	10.806,4	11.031,2	521,0	571,4	0,0
Long term debt	30.012,0	39.044,8	26.337,8	8.165,3	7.154,0
Financial receivables from others	-148,4	-6,1	-2,6	-962,0	0,0
Debt assumed and loans to subsidiaries	-198,0	-232,0	-479,1	-1.504,3	-1.568,0
Net long-term debt	29.665,6	38.806,7	25.896,1	5.699,0	5.586,0
Short-term debt (liquidity):					
Short-term portion of long-term debt	779,5	431,3	1.141,8	84,8	678,0
Short-term bank debt	790,3	1.304,4	1.009,0	441,2	754,0
Other short-term financial payables	536,0	1.636,0	0,0	0,0	14,0
Short-term debt	2.105,8	3.371,7	2.150,8	526,0	1.446,0
short-term portion of long-term financial receivables	-0,3	-0,3	-962,0	0,0	0,0
Short-term portion of loans assumed/granted	-0,3	-247,3	-1.025,5	-63,0	-87,0
Net short-term financial position with Companies	-17.918,1	-32.663,0	-19.753,4	-5.095,0	-4.094,0
Cash at banks and short-term securities	-995,2	-614,2	-10,4	-77,8	-46,0
Net short-term financial debt/(liquidity)	-17.701,3	-30.153,1	-19.600,5	-4.709,8	-2.781,0
NET FINANCIAL DEBT	11.964,3	8.653,6	6.295,6	989,2	2.805,0

At December 31, 2006 net financial debt came to €989 million, a decrease of €1,816 million on December 31, 2005. Specifically, net long-term debt increased by €113 million while net liquidity improved by €1,929 million.

Long-term debt primarily rose as a result of the combined effect of:

- the assumption by Enel SpA of all the bonds originally issued by Enel Investment Holding BV, with a total value of €984 million. As a result, Enel SpA has an obligation in respect of third parties in the amount of €413 million and in respect of Enel Investment Holding BV in the amount of €571 million;
- the recognition of the receivable of €962 million for the disposal of Weather;
- the issue by Enel SpA of two new tranches of a bond placed privately with leading Italian insurance companies totaling €97 million maturing in 2024.

The rise in liquidity is mainly attributable to the increase in net financial receivables from Group companies (€1,001 million) and the decrease in the current portion of long-term loans and bonds (€593 million) and short-term bank debt (€313 million), essentially as the result of the disposal of 26.1% of Weather for €1,962 million (of which €1,000 million received on December 21, 2006)

At December 31, 2007 net financial debt came to €6,295.6 million, an increase of €5,306.4 million on December 31, 2006. Specifically, net long-term debt increased by €20,197.1 million while net liquidity improved by €14,890.7 million

The increase in long-term debt reflects the acquisitions made abroad and primarily regards:

- the issue on June 13, 2007 of a public multi-tranche bond under the Global Medium-Term Notes program for institutional investors in the euro market for a total of about €4,979 million;

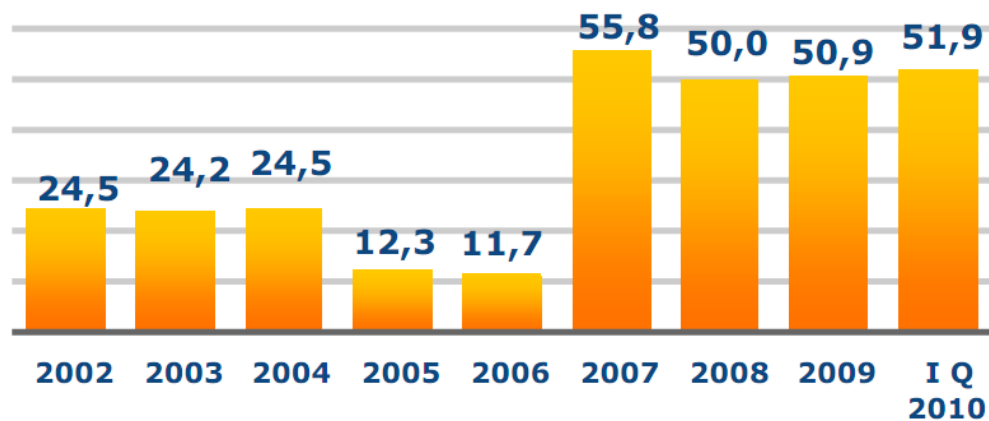
- the drawing of €11,496.6 million on the syndicated credit line with an original amount of €35 billion, subsequently reduced to €19.5 billion (of which €11.7 billion pertaining to Enel SpA and €7.8 billion to Enel Finance International);
- the issue on December 12, 2007, of a multi-tranche bond for Italian retail investors with a value of €2.3 billion;
- the drawing of €700 million in December 2007 on the revolving 5-year credit line of €5 billion (renewable for a further two years) granted in November 2005;
- the issue, in May and November 2007 of two new tranches of a bond placed privately with leading Italian insurance companies with a value of €97 million maturing in 2025.

The rise in liquidity of €14,890.7 million was mainly attributable to the increase of €14,658.4 million in net financial receivables due from Enel Group companies.

In particular, receivables increased with Enel Energy Europe in the amount of €24,969.7 million in connection with the acquisition of Endesa, with Enel Produzione in the amount of €1,006.8 million and with Enel Distribuzione in the amount of €2,050.6 million, net of the increase in short-term payables to other Enel Group companies, including Enel Finance International in the amount of €11,912.3 million and Enel Ireland Finance in the amount of €1,190.6 million.

The increase in liquidity was also attributable by the reclassification from long to short term of the receivable in respect of the sale of Weather (€962.0 million) and the short-term portion of debt assumed by Enel Produzione falling due in 2008 (€1,025.5 million), partially offset by the decrease in cash at banks (€67.4 million) and an increase in short-term bank debt (€67.8 million).

Net financial debt (€bn)



Net financial debt was equal to €49,967 million at December 31, 2008, a decline of €5,824 million over December 31, 2007. This decrease reflects the benefit resulting from the completion of the sale of assets related to Endesa Europa and Viesgo to E.On, in the amount of €6,773 million, partially offset by the financing needs generated by the completion of the acquisition of the controlling interest in OGK-5, in the amount of €831 million, as well as by the acquisition of a 64.4% stake in Electrica Muntenia Sud (now Enel Distributie Muntenia and Enel Energie Muntenia) for €827 million and the distribution of dividends (including interim dividends) during the year.

Net financial debt of assets held for sale at December 31, 2008, totaled €795 million and is related exclusively to the net debt of the Endesa renewable energy assets to be transferred to Acciona Energia and the debt of Enel Rete Gas. At December 31, 2007, the item also included the net financial debt pertaining to the assets of Endesa Europa and Viesgo sold to E.On in the first half of 2008.

Net long-term financial debt decreased by €2,662 million as the result of the decrease in gross long term debt in the amount of €1,110 million and the increase in long-term financial receivables of €1,552 million.

In particular, bank loans in the amount of €29,392 million increased by €1,049 million, reflecting drawings of €18.7 billion on the 36- and 60-month tranches of the original €35 billion syndicated credit line and drawings of €3,773 million on the €5 billion revolving credit facility held by Enel SpA. Net short-term financial debt, in the amount of €1,813 million at December 31, 2008, decreased by €3,162 million compared with the end of 2007, owing to an increase of €3,725 million in cash and cash equivalents and short-term financial receivables, a rise of €427 million in additional short-term bank debt and an increase of €136 million in other loans.

In particular, other short-term debt in the amount of €6,409 million include the issues of commercial paper by Enel Finance International, Endesa Internacional BV (now Endesa LatinoAmerica), and Endesa Capital SA in the amount of €3,792 million, as well as the bonds maturing within one year in the amount of €2,364 million, some €420 million of which related to bonds issued by Enel SpA and the remainder to bond issued by the Endesa Group.

Cash and cash equivalents and short-term financial receivables amounted to €6,764 million, up €3,725 million due essentially to the cash and cash equivalents related to the completion of the sale of the Endesa assets to E.ON at the end of June.

At December 31, 2009, net financial debt amounted to €11,964.3 million, up €3,310.7 million compared with December 31, 2008 as the net result of a decrease in net long-term financial debt in the amount of €9,141.1 million and the decrease in net short-term liquidity of €12,451.8 million.

The decrease in net long-term financial debt is mainly due to:

- contractual and voluntary repayments totaling €5,000.6 million of the tranche falling due in 2010 of the original €35 billion syndicated credit line following the extraordinary corporate transactions represented by Endesa's payment of dividends from the sale of assets to E.ON (mandatory repayment of €1,139.2 million), the sale of the high-voltage grid by

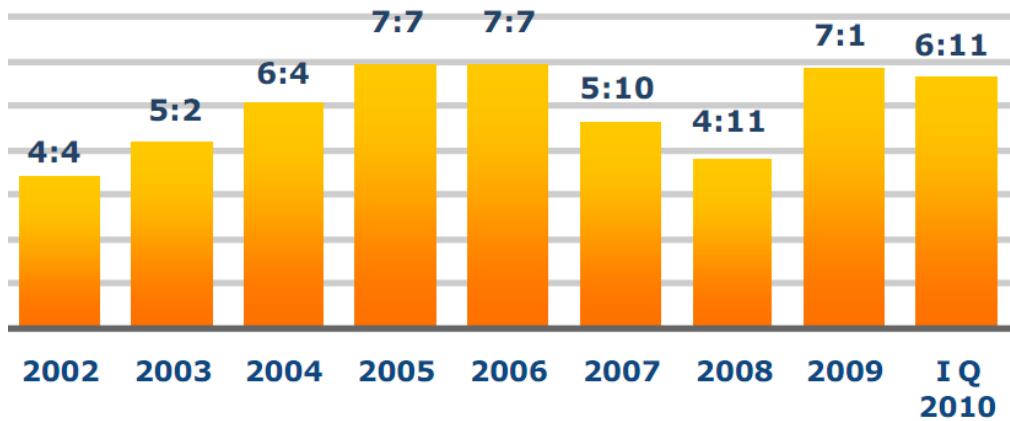
Enel Distribuzione to Terna (voluntary repayment of €340.9 million) and the capital increase of Enel SpA (mandatory repayment of €3,520.5 million);

- contractual and voluntary repayments totaling €5,111.2 million following Endesa's sale of assets to Acciona and the issue of bonds in the European and US markets by Enel Finance International, of which:
 - €1,498.6 million related to the tranche maturing in 2010;
 - €1,750.9 million related to the tranche maturing in 2012;
 - €1,258.0 million related to the tranche maturing in 2014;
 - €603.7 million related to the tranche maturing in 2016;
- a reduction of €3,273.4 million compared with December 31, 2008, in drawings on the 5-year, €5 billion revolving credit line (extendable for another two years) obtained in November 2005;
- repayment of maturing bond tranches in the total amount of €417.6 million; partially offset by:
- the drawing on June 25, 2009, of €4,978.5 million on the Credit Agreement 2009 to finance the acquisition of an additional 25.01% of Endesa held by Acciona;
- the issue of a new tranche of the bond placed privately with leading Italian insurance companies in the amount of €97.0 million maturing in 2027.

The decline in net short-term liquidity of €12,451.8 million was essentially the result of the reduction in the financing requirements of the Group companies on the intercompany current account (€14,744.9 million), especially Enel Energy Europe after its recapitalization carried out by way of Enel SpA's partial waiver of its receivable in respect of that account (€12,300.0 million), partially offset by the reduction in the debtor position in respect of Enel Finance International (€1,100.0 million), cash collateral paid in respect of OTC derivatives on interest

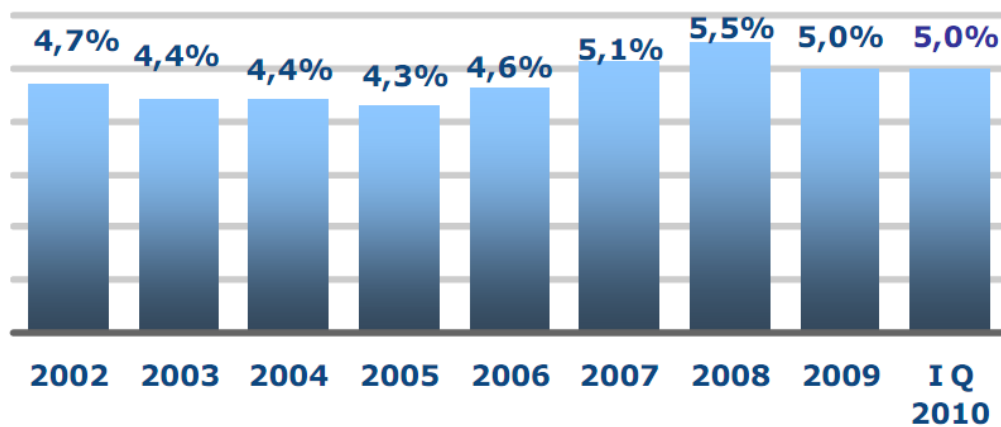
and exchange rates (893.2 million), and the improvement in the short-term position with banks (€514.1 million).

Average residual maturity



The Leverage

Average cost of debt



2.2.4 Shareholders

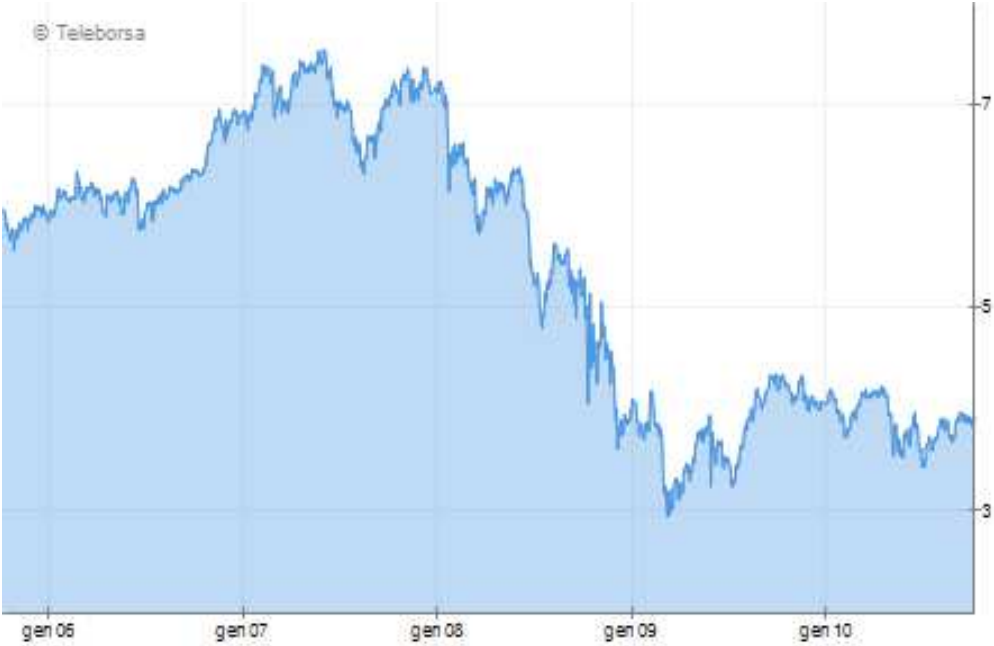
Enel's share capital amounts to 9,403,357,795 €, consisting of 9,403,357,795 ordinary shares with a nominal value of 1 €.

By virtue of the company's international development and the growing profitability, along with a strong environmental and sustainability policy, as well as the adoption of best practices on transparency and corporate governance, Enel's

shareholders include national and international investment funds, insurance companies, pension and ethical funds, as well as over a million small savers.



2.2.5 The Share Price



	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Dividend per share (€)	0,63	0,49	0,49	0,49	0,25
Market capitalization (milions of €)	41.543	47.988	50.585	27.033	38.176
Share price High (€)	7,48	7,89	8,56	7,23	4,35
Share price Low (€)	6,32	6,54	7,18	3,61	2,91

2.3 Endesa

2.3.1 Governance

Board of directors, Organisation and functioning

Endesa, S.A. is governed by a Board of Directors which, in accordance with its Corporate Bylaws, shall be composed of a minimum of nine and a maximum of fifteen members. Under article 36 of the Corporate Bylaws and in accordance with article 141 of the Public Limited Companies Act (Ley de Sociedades Anónimas or LSA) the Board regulates its organization and functioning under its own Regulations. Article 37 of the Corporate Bylaws establishes that the Shareholders' Meeting is responsible for appointing and removing Directors, while the office of Director may be waived, revoked and the subject of reappointment. Proposals by the Board for the appointment or reappointment of Directors, as established by article 5 of the Board Regulations, will fall to persons of renowned prestige who possess the suitable professional experience and knowledge to perform their functions and give a commitment to provide a sufficient level of dedication to perform the tasks of the office.

The Board will meet at least once every two months, and whenever the Chairman sees fit or when the majority of its members so requests. Resolutions will be adopted by an absolute majority of the Directors attending the Meeting in person or by proxy. In the event of a tie, the Chairman, or whoever stands in for him/her at the meeting, will have the casting vote.

Functions of the Board of Directors

In accordance with the LSA and the Corporate Bylaws, the Board of Directors shall govern and manage the Company.

The following general functions shall be discharged by the Board sitting in plenary session or through its committees:

- To establish the corporate strategy and management guidelines.

- To oversee the conduct of senior executives, hold them accountable for their decisions and assess their performance.
- To ensure the transparency of the Company's relations with third parties. In implementing the provisions of the Corporate Bylaws, the Board will define the general strategy of the Business Group formed with holdings in other companies.

In accordance with legal requirements and the Company Bylaws, and under article 141 of the LSA, the Board will regulate its own functioning and that of its committees, draw up its regulations, which will be binding on the members of the Board, and act in plenary session or through its committees.

Delegation of Powers

On 23 June 1972, the Board of Directors of Endesa, in accordance with the provisions of the Corporate Bylaws, created an Executive Committee to which it delegated all its functions on a permanent basis, except those which, by law or by resolution of the Shareholders' Meeting, fall within its exclusive jurisdiction. Furthermore, on 27 May 2005, the Board of Directors delegated to the Chief Executive Officer, Rafael Miranda Robredo, each and every one of the powers of the Board of Directors delegable by law or under the Bylaws. In accordance with the provisions of article 149 of the Mercantile Registry Regulations, the powers delegated to the Chief Executive Officer will be exercised by the Chief Executive Officer jointly with respect to the powers vested in the Board of Directors' Executive Committee.

On 18 October 2007 the Board of Directors delegated to the Company's Executive Chairman, José Manuel Entrecanales Domecq, each and every one of the powers of the Board of Directors delegable by law or under Corporate Bylaws. These powers shall be exercised jointly with the Chief Executive Officer. On 18 October 2007 the Board of Directors modified the powers delegated to the Chief Executive Officer, Rafael Miranda Robredo.

These powers shall now be exercised jointly with the Chairman of the Board of Directors. The powers delegated to the Executive Chairman, José Manuel Entrecanales Domecq, will be exercised by him jointly with respect to the powers vested in the Board of Directors' Executive Committee, in the same way as those exercised by the Chief Executive Officer, Rafael Miranda Robredo.

Executive Committee

The Executive Committee will be composed of at least five and not more than seven Directors, including the Chairman and the Chief Executive Officer. The appointment of the members of the Executive Committee will require the vote in favour of at least two-thirds of the members of the Board. The Chairman of the Board of Directors will chair Executive Committee meetings and the Board Secretary will act as its Secretary. The rules on substituting these officers are as established for the Board of Directors.

Audit and Compliance Committee

The Audit and Compliance Committee will be composed of a minimum of four and a maximum of six members of the Board, designated by the affirmative vote of the majority of the Board itself. The majority of Committee members must be Directors whose relationship with the Company is confined to their status as Board members.

The Chairman of the Committee will be designated from among its members by the Board, by the vote in favour of the majority of the Board itself. The Chairman must be replaced every four years, and may be reappointed one year after standing down. In the absence of the Chairman, the member of the Committee provisionally appointed by the Board of Directors will stand in for him/her and, in the absence of this member, the eldest member of the Committee.

The Audit and Compliance Committee will meet as often as called by its Chairman, when the majority of its members so decides, or at the request of the Board

of Directors. Committee meetings will take place at the Company's registered office or elsewhere as determined by the Chairman and stated in the call notice.

The Committee will be validly convened when a majority of its members are present. Resolutions must be adopted by the affirmative vote of the majority of the Directors attending the meeting. In the event of a tie, the Chairman, or whoever is performing his/her functions, will have the casting vote.

The Secretary of the Board of Directors will be the Secretary of the Committee and will draw up minutes of the resolutions adopted, on which he/she will report to the Board.

Opinion of the board of directors about the offer

The Board of Directors of Endesa has voted unanimously in favour of the economic terms of the Offer, based on its belief that these terms are fair to the shareholders of Endesa from a financial standpoint.

In reaching this conclusion, the Board of Directors considered the fairness opinions rendered by Endesa's financial advisors: BNP Paribas S.A. Sucursal en España, Citigroup Global Markets Limited, Deutsche Bank AG London Branch, J.P. Morgan Plc, Lehman Brothers (Europe) Limited and Merrill Lynch Capital Markets España, S.A. all of which state that, in their respective opinions, the consideration offered by Acciona and Enel is fair, from a financial point of view, to the shareholders to which the Offer is extended. To support the conclusions contained in their respective fairness opinions, these advisors relied on valuation methods and other widespread criteria, such as comparable company trading multiple analysis, comparable M&A transaction multiple analysis, analysis of premiums paid to market value, discounted cash flow analysis and analysis of Endesa's historic share price performance and its performance in relation to other indices or benchmarks.

In addition, the Board of Directors took into consideration the fact that the Offer comes in the wake of a protracted period of failed takeover bids, a process

which began with the bid presented by Gas Natural SDG, S.A. on 5 September 2005, which prompted E.On to launch a rival offer.

Throughout the process, Endesa's Board of Directors and management team has held fast to the overriding goal of maximizing value for the Company's shareholders. Specifically, the Board views favourably the fact that the Offer is significantly higher than Endesa's closing price of Euro 18.56 per share on 2 September, 2005, the last trading day prior to the announcement of Gas Natural's bid, and significantly higher than the consideration offered by Gas Natural, which valued Endesa's shares at Euro 21.30 on the date it announced it was launching a takeover bid. It has also born in mind that the consideration offered by the Offerors is higher than that offered by E.On, whose final and enhanced bid stood at Euro 40 per share, the highest offer presented during the rival bidding process.

Finally, Endesa's Board of Directors has considered the fact that the joint offer made by Acciona and Enel is an all-cash bid extending to shares representing 100% of the Company's share capital.

2.3.2 Endesa Financial Evolution:

Revenues:

The Company's total revenues in 2006 amounted to Euro 19,637 million, an increase of 12.2 percent on the year before, outstripping growth in physical electricity sales. Sales growth was greater by value than by volume because of increases in electricity prices in the countries where the Company operates due to higher power generation costs. The growth in sales in 2006 covered the 11.5 percent increase in purchases and service expenses (variable costs), which was caused by increases in fuel costs and energy purchases.

Revenues in 2007 totaled Euro 21,931 million, i.e. +6.6% vs. 2006. Sales totaled Euro 21,222 million, up 8.1%. Variable costs* rose by 7.8%, due mainly to the

higher cost of electricity and gas purchases for sale and higher generalized fuel costs.

In Spain and Portugal totaled Euro 10,437 million in 2007, a like-for-like increase of 5.8% on 2006, despite netting fewer freely allocated CO2 rights as revenues.

As a result, in 2008 Endesa reported revenue growth of 26.4% whilst variable expenses increased by 47%, leading to an 8% rise in the gross margin.

In Spain and Portugal in 2008, an increase of 31.3%. Of this amount, sales accounted for Euro 12,632 million, year-on-year growth of 28%.

Despite the decline in electricity generated, Endesa reported a 12.5% increase in revenues in 2009 to Euro 25,692 million, due to higher sales margins in all business lines. At the same time, variable costs rose by 15.7% and fixed costs were up by 14.7%.

Meanwhile, gains of Euro 494 million were made during the year as a result of the synergy plan implemented jointly with Enel, which achieved 113% of the original target. The main savings were made in the following areas: Euro 164 million from improved distribution practices, Euro 157 million relating to improved practices and developments in the generation and fuel supply businesses and Euro 173 million from efficiencies obtained in specific developments in the areas of infrastructure, general services and information systems.

Net income:

ENDESA reported net income of Euro 2,969 million in 2006, 6.7 percent less than in 2005 when net capital gains of Euro 1,115 million from the sale of Auna, the Spanish telecommunications group were recorded.

Stripping out capital gains from asset sales from both years, net income in 2006 was Euro 2,576 million, up 40 percent over 2005.

These results reflect Endesa's best estimate of the impact of Royal Decree Law 3/2006 based on information available as of the 2006 close, specifically the pro-

visions of the aforementioned legislation and the National Energy Commission's (CNE) interpretation thereof.

The business in Spain and Portugal posted net income of Euro 1,843 million in 2006, an increase of 35.7 percent over 2005. This includes Euro 186 million of higher compensation, net of tax, from the non-mainland generation deficit for the period 2001-2005 pursuant to the Ministerial Orders passed on 30 March, 2006 and is Euro 137 million lower due to the reduction in deferred taxes as a result of lower corporate tax rates enacted in Spain for the coming years.

In Europe, net income advanced 16 percent to Euro 493 million. This figure includes Euro 118 million, net of minority interests, related to a write-up in the valuation of this business as Endesa Italia revalued the tax bases of its fixed assets to their book values, as allowed by current legislation in Italy. Finally, net income for Latin America was Euro 462 million, 76.3 percent more than in 2005. This figure includes Euro 101 million, net of minority interests, from a tax credit carry forward derived from the corporate restructuring operations being implemented in the region.

In 2007 Net income of Endesa reported Euro 2,675 million, Euro 294 million less than in 2006.

To compare both years in like-for-like terms we note that in 2006 there were five highly significant non-recurring items:

- Recognition of stranded costs for non-mainland generation for 2001-2005 (Euro 227 million), and for corresponding interest (Euro 31 million), with a combined impact of Euro 197 million on net income.
- A negative impact amounting to Euro 137 million on net income related to the effect on deferred taxes of the reduction in the prevailing corporate tax rate in Spain. This effect was partially offset by the cancellation of tax provisions amounting to Euro 75 million. Accordingly, the net impact of the two accounting entries was negative in the amount of Euro 62 million.

- The tax effect relating to Endesa Italia's revaluation of the tax bases of its assets to their book values, as permitted by current legislation in Italy. The amount of this tax effect was Euro 148 million and its impact on net income after minority interests stood at Euro 118 million.
- The tax impact of the merger between Elesur and Chilectra, which was Euro 170 million, with an impact on net income after minority interests of Euro 101 million.
- Income generated from asset disposals, which amounted to Euro 432 million, with an impact of Euro 365 million on net income and minority interests. After discounting these five effects from the 2006 accounts in addition to the income obtained from asset disposals in 2007, net income increased by 14.2% in 2007.

In 2008 net income of Euro 7,169 million, had an increase of Euro 4,494 million compared to 2007. This includes income from discontinued operations; i.e. capital gains from the sale of the company's entire shareholding in Endesa Europe, and the Los Barrios and Tarragona thermal plants in Spain, to E.On, in addition to income generated by these assets during the period of the year in which they were owned by Endesa.

Stripping out discontinued operations, income from continuing operations attributable to Endesa shareholders was Euro 2,371 million, an increase of 5.8% on 2007.

In Spain and Portugal net income was Euro 2,217 million in of 2008, Euro 432 million more than 2007. This figure includes income from discontinued activities, including both income from sale of the Los Barrios and Tarragona plants to E.On and after-tax income from both of these plants until the date of their sale.

Stripping out the result of discontinued operations, net income from continuing activities attributable to Endesa shareholders corresponding to business in Spain and Portugal was Euro 1,873 million in 2008, a rise of 7.8% vs. 2007

In 2009 net income of Euro 3,430 million is 1% higher than the result posted in 2008 as the prior year included the capital gain from the sale of assets to E.On in the first half (Euro 4,798 million net of taxes and minorities), while figures for 2009 include net income from the sale of assets to Acciona (Euro 1,035 million). In Spain and Portugal the income was Euro 550 million, or 24.9%, higher than the figure seen in 2008. This represents 80.4% of the company's total net income. Over the past two years results in this business line have been affected by the capital gains generated by the sale of assets to Acciona and E.On.

2.3.3 Endesa Financial structures:

Debt

Endesa's net debt was Euro 19,840 million at year-end 2006, 8.5 percent higher than at year-end 2005. The increase in debt in Spain and Portugal is due to the Euro 609 million increase in receivables related to the tariff deficit on regulated activities in 2006 and the non-mainland generation deficit. It also reflects the Euro 1,341 million dividend payment made in July in connection with the capital gains realized in 2005 and which led to a debt reduction in that year.

The distribution of this income to its shareholders was approved at the General Shareholders' Meeting.

In Europe, the Euro 388 million increase in debt was caused by the extraordinary corporate income tax payment the Company had to make in 2006 in order to take advantage of tax credits generated by the increase in the tax basis of the business' assets and to investments made during the year resulting in the assumption of debt. This debt derives from a one-off income tax payment in the second quarter of 2006 linked to tax credits obtained in 2005 and 2006 and to the acquisition in the third quarter of majority shareholdings in Centro Energia Teverola and Centro Energia Ferrara, owners of the CCGTs, and the assumption of their debt.

Net debt at Endesa's Latin American business stood at Euro 5,618 million at 31 December, 2006, a reduction of Euro 491 since the start of the year. This decrease is due, among other factors, to the appreciation of the euro vis-à-vis the currencies in which Endesa's Latin American subsidiaries' debt is denominated. This accounted for Euro 486 million of the reduction.

At year end 2006, 76 percent of Endesa's total debt was denominated in Euros, 11 percent in dollars and the remaining 13 percent in Latin American currencies. Endesa follows a policy whereby its companies' debt is always in the currency in which its cash flows are generated.

The 65 percent of total debt was either fixed-rate or hedged while the remaining 35 percent was at a variable rate. This level of coverage limits the volatility of financial expenses in the Group's P&L.

Endesa covered most of its financing requirements in the first half of 2007, tapping the favorable conditions existing in the financial markets during that period, when the banking market was highly liquid and credit spreads in the capital markets were tightening. Endesa, S.A. and its direct subsidiaries (excluding the Enersis Group) signed new long-term loans for a total of Euro 1,775 million. It also extended the term of its bank debt and long-term credit lines which total Euro 6,917 million, and it issued a long-term bond for Euro 300 million.

As a result of these operations, the average life of debt at these companies was 4.9 years in December 2007. Liquidity totaled Euro 5,552 million, of which Euro 5,139 million were amounts unconditionally available in long-term credit lines, equivalent to 17-month debt maturities.

Enersis and its subsidiaries also took advantage of the favorable situation in the local financial markets and obtained long-term financing under competitive conditions. The average life of debt of these companies was 5.2 years at year-end and liquidity totaled Euro 1,215 million, of which Euro 431 million corresponded to credit lines and the remaining Euro 784 million were cash. These amounts are equivalent to 15-month debt maturities.

Net debt at Endesa's electricity business in Europe stood at Euro 1,822 million at the close of 2007, an increase of Euro 148 million, or 8.8%, over the debt balance at year-end 2006. Net financial loss amounted to Euro 79 million in 2007, Euro 23 million more than in 2006.

Net debt in Latin American business stood at Euro 5,519 million at 31 December 2007, Euro 99 million less than at the start of the year.

The 77% of total debt at the Endesa Group was euro-denominated and 9% was dollar-denominated at the end of 2007; the remaining 14% was denominated in Latin American currencies. The 56% of the Group's total debt was fixed rate or hedged while the remaining 44% bore a variable rate.

In 2008 Endesa reported a net finance expense of Euro 1,009 million with an increase of 8.9%.

However, the following two factors should be taken into account when comparing the two periods. In 2007, higher interest rates:

- triggered a Euro 76 million gain in this heading, due to the reduction in the present value of provisions recognized, particularly those related to employment restructuring costs. In 2008, this caused a Euro 28 million loss in this heading.
- Lower capitalization of financial expenses of Euro 60 million in 2008 compared to 2007.

Stripping out the effect of these two factors, the net finance expense fell by 8.2% in 2008, despite higher interest rates during the first nine months of the year, as a result of the significant reduction in net debt in 2008.

Furthermore the crisis has heavily impacted the various monetary areas with growth expectations being cut; interest rates have also been affected as have commodity prices.

Against this backdrop, Endesa, S.A. and its subsidiaries, excluding the Enersis Group, entered into long-term financing operations totaling Euro 1,334 million

as well as short-term debt issues in the capital markets worth Euro 9,035 million.

As a result of these operations, the average life of debt at these companies was 4.3 years at December 2008. Liquidity totaled Euro 10,781 million, of which Euro 7,482 million corresponded to undrawn sums on unconditional long-term credit lines, sufficient to cover debt maturities for the next 39 months.

In this regard, the Enersis Group was able to tap both the domestic and the international financial markets. The average life of debt of the group was 5.1 years at year-end 2008 and liquidity totaled Euro 2,098 million, of which Euro 610 million corresponded to credit lines and the remaining Euro 1.488 million to cash. These amounts are sufficient to cover debt maturities falling due in the next 17 months.

In the end of 2009, Endesa had net debt of Euro 18,544 million, an increase of Euro 4,541 million, or 32%, on the year-end 2008 figure.

In the Spanish and Portuguese business at 31 December 2009 stood at Euro 13,865 million versus Euro 8,732 million at the end of 2008. This increase was mainly due to the net effect of the payment of a dividend of Euro 6,243 million against 2008 earnings, which included the distribution to shareholders of the capital gains resulting from the sale of assets to E.On and the collection of Euro 2,814 million from the sale of assets to Acciona. In Latin American business reported net debt of Euro 4,679 million, down Euro 592 million year-on-year.

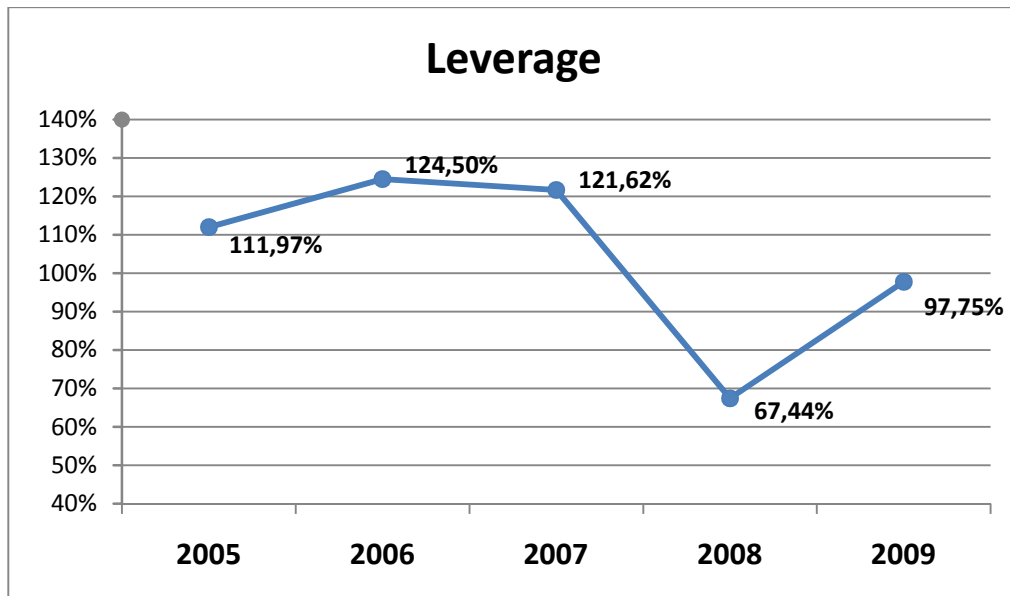
The Cost of Debt

The average cost of Endesa's total financial debt was 5.45 percent, similar to the 2005 figure of 5.46 percent. We would highlight that against a backdrop of rising interest rates the Group has managed to maintain its average cost of debt. The average cost of debt of Endesa and its direct subsidiaries (excluding Enersis) in 2006 was 4.19 percent compared to 4.05 percent in 2005.

Meanwhile, the average cost of debt of Enersis in 2006 was 9.12 percent, lower than the 2005 figure of 9.37 percent despite the larger proportion of local currencies in the debt structure.

The average cost of debt increase to 5.86% in 2007. For Endesa, S.A. and its direct subsidiaries (excluding Enersis) in 2007 was 4.5% compared to 4.19% in 2006. It is worth highlighting how small this increase was, in view of the substantial increase in Euro interest rates in 2007. The Enersis Group increase a bit to 9.71%, higher than the 2006 figure of 9.12%, due to the larger proportion of local currencies in the debt structure, mainly the Brazilian Real and the Colombian Peso. The average life of the Endesa Group's debt* at 31 December 2007 was 5 years. The average cost of debt in 2008 was 6.37% against 5.93% in 2007. In 2009 the cost of ENDESA's total debt decreased to 4.3% because of Enersis Group cost of debt that decreased until 7.3% compared to 10.1% in 2008. Net financial expenses were Euro 449 million, down 13.3% or Euro 69 million year-on-year due to the 2.63 point reduction in the average cost of debt.

(Millions of €)	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Equity	16.327	15.936	17.130	20.764	18.970
Debt	18.281	19.840	20.834	14.003	18.544
Leverage	111,97%	124,50%	121,62%	67,44%	97,75%



The increase in Group equity offset the increase in net financial debt to leave leverage at 125% at 31 December 2007, as compared to 124.5% at 2006 year-end. If we factor regulatory receivables into net debt, the leverage ratio would be 105.2%.

At 31 December 2008, Endesa had a leverage ratio of 67.4%, i.e. 54 points lower than the ratio seen at year-end 2007, due mainly to the sale of assets to E.On.

Dividend policy

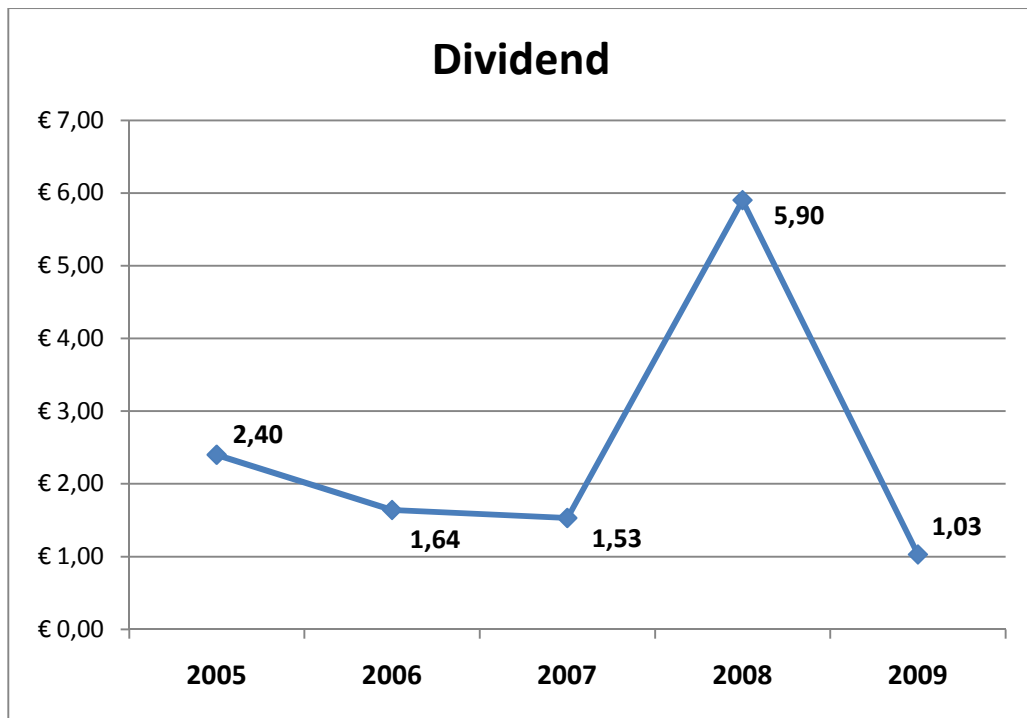
Endesa's strategy is based on creating shareholder value and distributing that value in the form of dividends.

The Strategic Plan: "Endesa: Stronger business, greater value" presented to the markets on the end of 2005, contains a dividend policy that mainly entails:

- A CAGR for ordinary dividends of 12 percent, i.e., in line with expectations for bottom-line net profit growth.
- Distribution of 100 percent of capital gains generated on disposals of non-core assets.

According to the Company's stated targets, this policy would entail the pay-out of more than Euro 9.9 billion in dividends between 2005 and 2009.

Endesa always continued its commitment to increase shareholder returns via dividends.



At the General Shareholders' Meeting of in 2006, approval was given for the payment of a total gross dividend of Euro 2.4 per share, charged against 2005 earnings. The total amount of this dividend was Euro 2.541 billion. This represents a 225 percent increase over the previous year and was the highest dividend in the company's history.

This dividend is the sum of the Euro 0.305 per share interim dividend paid on 2 January 2006, and ordinary final dividend of Euro 0.8284 per share and the pay-out of Euro 1.2666 per share of the total net capital gains obtained from the sale of Euro 1.34 billion of non-core assets in 2005.

The ordinary final dividend of Euro 0.8284 per share and the Euro 1.2666 per share from the net capital gains resulting from the sale of non-core assets, which

together amount to Euro 2.095 per share, were paid on 3 July 2006. This total dividend of Euro 2.4 per share, represents a total pay-out of 79.9 percent of net profit for the year. Stripping out these net capital gains, the pay-out is 65.2 percent.

In 2007 the Company agreed to pay a gross dividend of Euro 1.64 per share against 2006 results, entailing a total payment of Euro 1,736 million. In addition, in the first quarter they distributed a gross attendance bonus of Euro 0.15 per share and another attendance bonus of Euro 0.15 per share after the Extraordinary General Shareholder Meeting.

In all, Endesa's governing bodies agreed in 2007 to pay its shareholders Euro 2.44 per share, entailing total payment of Euro 2,561 million. Endesa has paid its shareholders a total of Euro 5,102 million since 2005 with a 58.5% of payout. At the General Shareholders' Meeting held on 30 June 2008, the company agreed to pay a gross dividend of Euro 1.531 per share against 2007 results, as previously mentioned, entailing a total payment of Euro 1,621 million.

This amount is the sum of the interim dividend paid on 2 January 2008 of Euro 0.5 per share and the final dividend of Euro 1.031 per share paid on 8 July. This total dividend of Euro 1.531 per share implies a payout of 60.6%.

In March 2009 the Company paid out an interim dividend against 2008 earnings of Euro 5.897 per share, with a total payout of Euro 6,243 million. This dividend, which implied a total payout of Euro 6,243 million, included an ordinary dividend of Euro 1.5934 per share and Euro 4.3036 per share relating to the distribution of 100% of the net capital gain obtained in 2008 on the sale of assets to the German group E.On.

This ordinary dividend, equivalent to a distribution of Euro 1.5934 gross per share, represented a 12% increase on the total ordinary dividend paid to shareholders against 2007 earnings. Additionally, at its meeting held on 14 December 2009, Endesa's Board of Directors agreed to pay a gross dividend to sharehold-

ers of Euro 0.50 per share against 2009 earnings. This was paid on 4 January 2010 and involved a total payout of Euro 529 million.

2.3.4 Share price

Endesa's share performance was seriously affected by the impact of the world financial crisis on Spain, which was especially noticeable after the summer of 2008. One of its most marked effects was an unprecedented level of volatility in the market.

After a first half year in which prices declined slightly, the company's shares fell sharply in July, coinciding with the first bankruptcies of major players in the international financial sector. The shares recovered part of this loss in September but in October there were sharper downturns in all sectors, leading to Endesa closing at a low of Euro 18.63 per share on October 10; a level similar to that recorded in September 2005 shortly before the first takeover bid was launched for the company by Gas Natural.

The last quarter of 2008 was still marked by extremely volatile conditions, although the share price managed to climb away from lows to end the year at Euro 28.6, 21.32% lower than a year earlier.

It should be noted that of the 35 companies listed on the Ibex- 35 only Unión Fenosa ended the year with gains (up 15.13% as a result of Gas Natural's takeover bid for the company at Euro 18.33 per share in July). Other companies in the Spanish electricity sector ended the year with losses which were even greater than that sustained by Endesa, in line with Ibex-35 averages. Although Endesa's share price fell in this unfavourable economic climate, it performed better than market benchmark indices (the Ibex-35 was down by 39.43% while the Eurostoxx 50 fell by 44.28%) and sector benchmark indices, such as the Eurostoxx Utilities (down by 38.01%).

Shareholder return

PER SHARE DATA (€)	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
Earnings	3,01	2,80	2,53	6,77	3,24
Dividend	2,40	1,64	1,53	5,90	1,03
Cash flow	3,98	4,39	5,02	4,92	4,95
Shareholders' equity	10,95	10,66	11,32	16,13	13,44
Total shareholder return (%)	32,80	72,10	6,90	-17,10	4,34
P/E ratio (Price/Earnings (x))	7,38	12,8	14,37	4,22	7,39

The shareholder return in 2006, in addition to the dividend payments we must bear in mind the significant rise marked by Endesa's shares on the stock markets. The stock rose 61.3% on the Spanish equities market, much more than the Ibex 35 which rose only 31.8% placing the company's market capitalization at around Euro 38,000 million at year-end 2006. Meanwhile, on the New York Stock Exchange Endesa's American Depositary Receipts (ADRs) rose 78.9% to end the year at a record high of US\$46.52 compared to the global ADR index's average rise of just 24.2%.

In short, the dividend payment combined with the share's rises generated a total shareholder return of 72.1% in 2006, the highest in Endesa's history. In 2007, Endesa's shareholders received a 6.9% return, including the appreciation in share value, dividends approved and attendance bonuses for Extraordinary General Shareholders' Meetings.

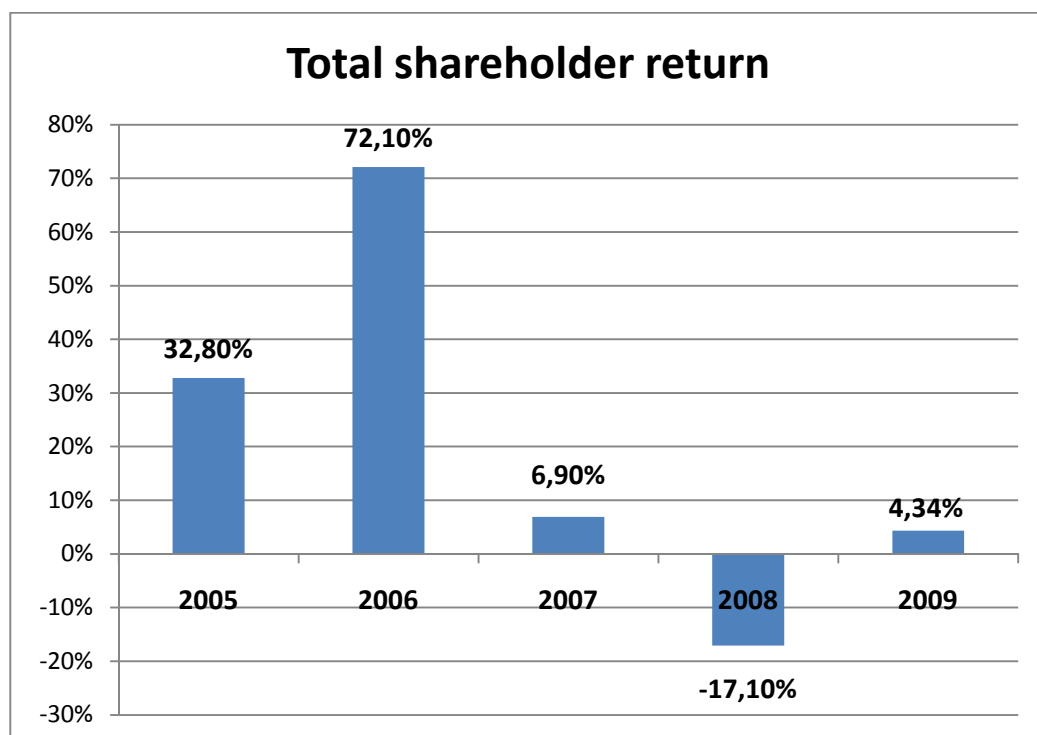
Share performance was strongly impacted by the takeover bids for the company and eventually closed the year up 1.5%. In the last 3 years, total annual return for Endesa's shareholders has averaged 37.3%.

The total returns for Endesa shareholders were negative for the first time since 2002. Nevertheless, the company's shareholders were able to partly offset the stock market losses incurred during the year thanks to the dividend of Euro 1.53 per share, equivalent to a return of 4.21%. The meant the total return for the year

fell by 17.1%. Extending our analysis to the four years during which successive takeover bids were launched for the company, the total average annual return for Endesa shareholders was 23.7%.

The total return for Endesa's shareholders in 2009 was enhanced by the payment of the aforementioned historic dividend. Following the dividend paid in March, the share price hit a low of Euro 13.96 on 30 March and from there gained ground to close the year at Euro 23.945, down 16.28% on 2008. However, this stock market loss was offset by the dividend yield of Euro 20.62%, putting the total shareholder return in 2009 at a positive 4.34%.

In the last five years, the total annual return for Endesa shareholders has averaged 19.79%.



P/E Index

Trading volumes of share

2.4 The Choice of Endesa

In Europe

In Latin America

2.4.1. Analysis per country

Capacity installed

The companies in which ENDESA has interests in Latin America had total installed capacity of 15,853 MW at the close of 2009. Their aggregate output in the year was 62,767 GWh — a 3.4% advance on the previous year's level — with sales of 63,745 GWh, i.e. 1.5% more than in 2008, to a total of 12.9 million clients.

Energy demand

Price of energy

2.4.2 Analysis per type of energy

Gas

Coal

Hydroelectric

Biomasses

Wind

2.4.3 Future Strategy of Enel-Endesa

2.4.4 Sustainability

2 Key and success Factors of the acquisition

3.1 Goodwill and badwill

3.1.1 What was good and what could be better

Cultural Critical success factors

Organizational culture differences is ranked as one of the most significant challenges. In fact, when reflecting on the reported top 10 critical success factors (CSFs) for M&A deals, it is interesting to note that each one can be undermined by the cultural attributes of an organization or by highly differentiated cultures. For example, an organization that typically does not place a great deal of value on communicating, and communicates infrequently or ineffectively, will be less inclined to take the time to clearly articulate and share the real context of the deal beyond what goes to the market or the press (CSF #1). The same organization is unlikely to communicate governance issues well (CSF #6) or be able to successfully win the hearts and minds of stakeholder groups through engaging communications (CSF #7). Without a culture of open and regular communication, the organization is less able to connect well with employee groups to gain their buy-in and support for what is required for success in the newly combined organization (CSF #8). In this way, one cultural attribute can have a significant impact on several elements that drive deal success.

Another example is an organization that has a strong hierarchical or “command-and-control” approach to getting work done. Such an organization is likely to find it difficult to accept or appreciate ideas from “outsiders” – that is, the organization being acquired (CSF #9) – or to think about an organization that has a predominately collaborative culture; it will have a difficult time making tough decisions with the speed required to quickly create value (CSF #10).

All this is not to say that one cultural attribute is better or worse than another. What it does suggest, however, is that some behavioral characteristics may be incompatible with what is required for deal success, while others may be well aligned. In any given transaction, the key is to identify and reinforce those critical behavior patterns that have the greatest positive impact on success while discouraging those that will erode value.

Critical success factors (CSFs)	Sample indicators
1. Well-defined, articulated business strategy exists	<ul style="list-style-type: none"> • The reason for the deal are explained • The degree of integration is defined • The context for the deal is understood
2. Clear "product" road map exist	<ul style="list-style-type: none"> • Offering are clearly communicated to market-place • Internal efforts are aligned • A clear branding strategy is in place
3. There is an unyielding focus on customers	<ul style="list-style-type: none"> • Points of contact are clear • Attention and support are uninterrupted • Partnership and channel relationship are maintained
4. Organization is ready on day1	<ul style="list-style-type: none"> • Plans are in place for all functions, businesses and locations • There is an effective transition from planning to execution
5. Synergies are clearly identified	<ul style="list-style-type: none"> • Cost and revenue are included • Clear metrics/target are assigned at the project level • Strong project management is in place
6. Governance is clearly communicated	<ul style="list-style-type: none"> • The board/executive roles are agreed • The organization structures is defined • Line management roles are determined
7. Effective communication to stakeholders exists	<ul style="list-style-type: none"> • Communication takes place early and often • All stakeholders are considered and reached • Messages are clear, honest and consistent
8. There is an unyielding focus on employees and appropriate retention	<ul style="list-style-type: none"> • Key employees are identified and targeted • Employee morale issue are addresses • Incentives are utilized where appropriate

9. Divergent operating principles are addressed	<ul style="list-style-type: none"> • Differences are identified • Proactive steps are taken to bridge gaps • Rules of the road for interaction are defined
10. Organization acts quickly and decisively	<ul style="list-style-type: none"> • Periods of uncertainty are minimized • Planning is completed before close • Synergies are aggressively pursued from day 1

3.2 Comparations with others M&A operations

3.2.1 In the Energy sector

3.2.2 In other sectors

3 Conclusions

Appendix

A. Conditions Imposed by the CNE to E.ON's Offer based on its Function 14 (27th July 2006)

On July 27th, the CNE approved the potential acquisition of Endesa by E.ON subject to compliance of the following 19 conditions:

1. Endesa must be kept as a legal entity for the next 10 years; E.ON will not be merged with Endesa and Endesa will be kept under existing corporate structure
2. Endesa must be kept adequately capitalized with a net debt / EBITDA ratio below 5.25x
3. During the period 2006-2009, Endesa companies that develop regulated activities or own strategic assets will only be allowed to pay dividends if their cash

flows (net income plus amortization) are enough to cover investment commitments, debt servicing and financial expenses. This condition will be re-evaluated in 2010 and may be extended for another 5 years

4. During the period 2006-2009, E.ON must comply with Endesa's investments commitments in transportation and distribution gas networks

5. During the period 2006-2009, E.ON must comply with Endesa's investments commitments in electricity regulated activities and strategic electricity assets such as nuclear plants

6. From 1 January 2010 onwards, E.ON will inform the CNE on its investment plans on regulated gas and electricity activities and strategic gas and electricity assets.

7. E.ON must maintain the useful life of Endesa's ordinary generation plants as is currently scheduled

8. E.ON will have to guarantee gas natural supply to the Spanish market, at least, in the same amount included in the supply plans submitted by Endesa to the CNE

9. E.ON will transfer the management of the nuclear plants in which Endesa is currently a shareholder to the other shareholders. In the nuclear plants, E.ON will sell the nuclear plant Asco 1, wholly owned by Endesa.

10. E.ON must sell the electricity assets in the Balearic and Canary Islands, Ceuta and Melilla

11. E.ON must also sell the national coal plants, Compostilla and Complejo Minero Eléctrico de Teruel and Endesa's stake in Anllares, co-owned with Union Fenosa

12. The sale of the assets mentioned in conditions 9, 10 and 11 will have to be authorized by the CNE

13. Divestitures referred to in conditions 9, 10 and 11 must be completed within a period still to be fixed by the regulator

14. Any acquisition of a stake in excess of 10% in Endesa must be approved by the regulator.
15. E.ON must not prioritize its own interests if that could affect adversely to the gas and electricity supply in Spain
16. Any breach of the conditions set in the present resolution may result in the current CNE authorization being withdrawn, voting rights attached to the Endesa's shares owned by E.ON being suspended and E.ON selling its stake in Endesa within a 12 months period
17. If a third party acquired a stake in excess of 50% in E.ON within the next 10 years, the CNE may force E.ON to sell its stake in Endesa.
18. The CNE may call on the government to intervene to guarantee compliance with the present resolution.
19. All these conditions have essential character.

B. Resolution from the Ministry of Industry against the conditions imposed by the CNE to E.ON's Offer (November 4th)

On November 4th, the Ministry of Industry resolved to cancel i) all the conditions imposed by the CNE to E.ON's offer related to mandatory disposals (conditions 9-13) and ii) condition 19, based on which all the conditions imposed by the CNE qualified as essential and therefore, allowed the Spanish Government i) to revoke the authorisation granted to E.ON for the acquisition of Endesa in the event that any of the them was unfulfilled and to ii) force the sale of any shares of Endesa acquired by E.ON based on such authorisation.

This decision is not completely aligned with the European Commission willing that demands the removal of all the remaining conditions by the Spanish Government.