REPORT SUBMITTED BY THE BOARD OF DIRECTORS OF IBERDROLA, S.A. REGARDING THE PROPOSED REDUCTION IN SHARE CAPITAL BY MEANS OF THE RETIREMENT OF SHARES OF IBERDROLA, S.A. INCLUDED IN ITEM NUMBER FOURTEEN ON THE AGENDA FOR THE GENERAL SHAREHOLDERS’ MEETING CALLED TO BE HELD ON 31 MARCH AND 1 APRIL 2017, ON FIRST AND SECOND CALL, RESPECTIVELY.

1. Purpose of the Report

This report has been prepared by the Board of Directors of IBERDROLA, S.A. (“Iberdrola” or the “Company”) pursuant to the provisions of sections 286 and 318 of the Companies Act (Ley de Sociedades de Capital), in order to provide a rationale for the proposed reduction in share capital by means of the retirement of own shares (the “Reduction in Capital”) submitted to the shareholders for approval at the General Shareholders’ Meeting under item number fourteen on the agenda.

Pursuant to such sections, the Board of Directors must prepare a report setting forth the rationale for the proposal being submitted to the shareholders at the General Shareholders’ Meeting, to the extent that the approval of the Reduction in Capital necessarily entails the amendment of the article of the By-Laws setting the share capital.

2. Rationale for the Proposal

Pursuant to the provisions of the Shareholder Remuneration Policy, the Company maintains a strategy for growth in shareholder remuneration in line with the increase in results, with a pay-out of between 65% and 75% of net profits attributed to the Company in its consolidated annual accounts, implementing successive editions of the “Iberdrola Flexible Dividend” system, which is carried out through the implementation of increases in capital by means of scrip issues.

The issue of new shares as a result of said increases in capital by means of scrip issues is offset with reductions in capital – such as the one now proposed, and such as the Company has implemented each year since 2013 – to maintain the number of outstanding shares of the Company at approximately 6,240 million.

This avoids dilution of the shareholders and contributes to maintaining the profit per share of the Company, all of which benefits the shareholders.

Therefore, the Board of Directors has resolved to propose to the shareholders at the General Shareholders’ Meeting a reduction in capital that offsets the effects of the increases in share capital by means of scrip issues approved by the shareholders at the General Shareholders’ Meeting held on 8 April 2016 under sections A and B of item six on the agenda and which were implemented in July 2016 and January 2017, respectively. If said proposal is ultimately approved, it is provided that the Company’s own shares in treasury will be retired, with a corresponding reduction in share capital by an amount equal to the nominal value of such shares, and that the number of outstanding shares will be established at the target figure of 6,240 million.

A portion of the own shares will come from a share Buy-Back Programme approved by the Board of Directors at its meeting of 21 February 2017 under the provisions of (a) Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and Commission Delegated Regulation (EU) No 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures and (b) in reliance on the authorisation granted by the shareholders at the General Shareholders’ Meeting held on 28 March 2014 under item nine on the agenda. This initiative is intended to favour the liquidity of the shares, apart from the benefits of the Reduction in Capital already discussed.

3. Main Terms and Conditions of the Reduction in Capital

It is proposed to reduce the share capital by the amount resulting from the sum of:

(i) 141,715,734.75 euros, through the retirement of 188,954,313 treasury shares, each with a nominal value of seventy-five euro cents, representing 2.925% of the share capital and acquired under the authorisation granted by the shareholders at the General Shareholders’ Meeting held on 28 March 2014 under item nine on the agenda and within the limits established by section 146 and related provisions and section 509 of the Companies Act (the “Existing Treasury Shares”); and

(ii) the aggregate nominal value, up to the maximum amount of 23,276,765.25 euros, of the own shares of the Company, each with a nominal value of seventy-five euro cents, up to a maximum of 31,035,687 own shares (representing a maximum of 0.48% of the share capital), that are acquired for their retirement under the buy-back programme approved by the Board of Directors today, 21 February 2017, under the provisions of...
Consequently, the maximum amount of the Reduction in Capital would be 164,992,500.00 euros, through the retirement of a maximum of 219,990,000 own shares, each with a nominal value of seventy-five euro cents, representing not more than 3.41% of the share capital at the time the resolution is approved. If the resolution regarding the Reduction in Capital covered by this report is adopted, the final amount of the reduction would be set by the Board of Directors of the Company depending upon the final number of shares acquired from the shareholders within the framework of the Buy-back Programme.

In addition, if the aforementioned resolution regarding the Reduction in Capital is approved, the article of the By-Laws setting the share capital would be amended such that it reflects the new amount of share capital and the new number of outstanding shares (after the number of own shares proposed to be retired has been deducted).

The Reduction in Capital would not entail a return of contributions because the Company itself is the holder of the retired shares and it would be carried out with a charge to unrestricted reserves by funding a retired capital reserve in an amount equal to the nominal value of the retired shares; such reserve could only be used by complying with the same requirements as those applicable to a reduction in share capital, as provided by section 335 c) of the Companies Act.

Therefore, in order to make the implementation as simple as possible, and under the provisions of section 335 c) of the Companies Act, creditors would not be entitled to assert the right of objection contemplated by section 334 of the Companies Act.

It is also proposed that the shareholders at the General Shareholders’ Meeting ratify the acts performed to date by the Board of Directors in connection with the Buy-back Programme approved on 21 February 2017 and that they authorise the Board of Directors to implement the Reduction in Capital resolution (with the express power of substitution, under the provisions of section 249.2 of the Companies Act) within a period not to exceed one month following the expiration of the Buy-back Programme, with authority to establish any terms that are not expressly set forth in the resolution approving the reduction or that are a consequence thereof and to approve the resolutions, publish the announcements, take the steps, and execute the public or private documents that may be required or appropriate for the successful implementation of the Reduction in Capital.

Specifically, it is proposed to authorise the Board of Directors to take the steps and carry out the formalities required to cause the exclusion from trading of the retired shares from the Spanish Stock Exchanges and the removal thereof from the book-entry registers once the resolution regarding the Reduction in Capital has been implemented.

4. Proposed Resolution Submitted to the Shareholders at the General Shareholders’ Meeting

The proposed resolution submitted to the shareholders for approval at the General Shareholders’ Meeting reads as follows:

**ITEM NUMBER FOURTEEN ON THE AGENDA**

*Approval of a reduction in share capital by means of the retirement of 219,990,000 own shares (3.41% of the share capital). Delegation of powers for the implementation thereof.*

**RESOLUTION**

1. **Reduction in Capital by means of the Retirement of both Currently Existing Treasury Shares and Own Shares of the Company Acquired through a Buy-back Programme for the Retirement thereof**

To reduce the share capital of IBERDROLA, S.A. (the “Company”) by the amount resulting from the sum of:

i. 141,715,734.75 euros, through the retirement of 188,954,313 currently existing treasury shares, each with a nominal value of seventy-five euro cents, acquired under the authorisation granted by the shareholders at the General Shareholders’ Meeting held on 28 March 2014 under item nine on the agenda and within the limits established by section 146 and related provisions and section 509 of the Companies Act (the “Existing Treasury Shares”); and
ii. the aggregate nominal value, up to the maximum amount of 23,276,765.25 euros, of the own shares of the Company, each with a nominal value of seventy-five euro cents, up to a maximum of 31,035,687 own shares, that are acquired for their retirement under the buy-back programme in effect until no later than 31 May 2017 approved by the Board of Directors on 21 February 2017 under the provisions of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and Commission Delegated Regulation (EU) No 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures (the “Buy-back Programme”).

Consequently, the maximum amount of the reduction in capital (the “Reduction in Capital”) will be 164,992,500.00 euros, through the retirement of a maximum of 219,990,000 own shares, each with a nominal value of seventy-five euro cents, representing not more than 3.41% of the share capital at the time this resolution is approved.

In accordance with the provisions below, the final amount of the Reduction in Capital will be set by the Board of Directors of the Company depending upon the final number of shares acquired from the shareholders within the framework of the Buy-back Programme.

2. Procedure for Acquisition of the Shares that Will Be Retired under the Buy-back Programme

Without prejudice to the Existing Treasury Shares, and in accordance with the resolution approved by the Board of Directors at its meeting of 21 February 2017, the Company may acquire a maximum number of 31,035,687 own shares by way of implementation of the Buy-back Programme for all of the shareholders and for their retirement, each of such own shares having a nominal value of seventy-five euro cents and representing a maximum of 0.48% of the share capital of the Company on the date of approval of this resolution, which number is within the legal limit and the limit provided for in the authorisation for the acquisition of own shares granted by the shareholders at the General Shareholders’ Meeting held on 28 March 2014 under item nine on the agenda.

As provided in the aforementioned resolution of the Board of Directors, the own shares will be acquired subject to such terms as to price and volume as are established in article 5 of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and in Commission Delegated Regulation (EU) No 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures.

In accordance with the foregoing, pursuant to section 340.3 of the Companies Act, if the Company fails to acquire the maximum number of 31,035,687 own shares, each with a nominal value of seventy-five euro cents, under the Buy-back Programme, it will be understood that the share capital is reduced by the sum of (i) the amount corresponding to the Existing Treasury Shares, and (ii) the amount corresponding to the shares effectively acquired within the framework of the Buy-back Programme.

Consequently, the shares will be acquired upon the terms set forth in sections 144.a) and 338 through 342 of the Companies Act, to the extent applicable, in section 12.2 of Royal Decree 1066/2007 of 27 July, and in Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and in Commission Delegated Regulation (EU) No 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures, without the need for a takeover bid for the shares of the Company planned to be retired.

3. Procedure for the Reduction and Reserves with a Charge to Which It Is Carried Out

Pursuant to the provisions of section 342 of the Companies Act, the Reduction in Capital must be implemented within one month following the expiration of the Buy-back Programme.

The Reduction in Capital does not entail a return of contributions to the shareholders because the Company itself is the holder of the shares being retired, and it will be carried out with a charge to unrestricted reserves by funding a retired capital reserve in an amount equal to the nominal value of the retired shares; such reserve may only be used by complying with the same requirements as those applicable to a reduction in share capital, as provided by section 335 c) of the Companies Act.

Therefore, in accordance with the provisions of such section, creditors of the Company will not be entitled to assert the right of objection contemplated by section 334 of the Companies Act in connection with the Reduction in Capital.

4. Ratification of Resolutions of the Board of Directors

To ratify the resolutions of the Board of Directors regarding the approval of the Buy-back Programme and the establishment of the terms and conditions thereof, including the determination of the maximum number of shares to be
acquired within the framework and the effective period thereof, as well as to ratify the acts, statements, and formalities carried out through the date hereof in connection with the public communication of the Buy-back Programme.

5. Delegation of Powers

To delegate to the Board of Directors, with express powers of substitution, the powers necessary to implement this resolution within a period not to exceed one month following the expiration of the Buy-back Programme, with authority to establish any terms that are not expressly set forth in this resolution or that are a consequence hereof. In particular, and by way of example only, the following powers are delegated to the Board of Directors, with express powers of substitution:

(a) To modify the maximum number of shares that may be bought back by the Company, within the limits set in this resolution and by law, as well as any other terms and conditions of the Buy-back Programme, all in accordance with the provisions of Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse and in Commission Delegated Regulation (EU) No 2016/1052 of 8 March 2016 supplementing Regulation (EU) No 596/2014 of the European Parliament and of the Council with regard to regulatory technical standards for the conditions applicable to buy-back programmes and stabilisation measures.

(b) To perform any acts, make any statements, or take any steps that may be required in connection with the public communication of the Buy-back Programme and with the formalities, if any, that must be carried out at Spanish regulatory agencies and Stock Exchanges; negotiate, agree to, and sign all contracts, agreements, commitments, or instructions that may be necessary or appropriate for the successful completion of the Buy-back Programme.

(c) To cause all announcements required by law to be published, acquire the shares under the Buy-back Programme, and, within one month following the expiration of the Buy-back Programme, retire the shares in accordance with the terms approved herein.

(d) To declare the approved Reduction in Capital to be completed and implemented, establishing, for such purpose, the final number of shares that must be retired and, as a result, the amount by which the share capital of the Company must be reduced in accordance with the rules specified in this resolution.

(e) To set the final amount of the Reduction in Capital based on the provisions of this resolution and establish any other terms that may be required to implement it, all in accordance with the terms and conditions set forth above.

(f) To amend the article of the By-Laws setting the share capital such that it reflects the amount of share capital and the number of outstanding shares resulting from the implementation of the Reduction in Capital.

(g) To take such steps and carry out such formalities as may be required and submit such documents as may be necessary to the competent bodies such that, once the shares of the Company have been retired and the notarial instrument for the Reduction in Capital has been executed and registered with the Commercial Registry, the retired shares are delisted from the Bilbao, Madrid, Barcelona, and Valencia Stock Exchanges, through the Automated Quotation System (Continuous Market), and they are removed from the corresponding book-entry registers.

(h) To perform all acts that may be necessary or appropriate to implement and formalise the Reduction in Capital before any Spanish or foreign public or private entities and agencies, including acts for purposes of representation, supplementation, or correction of defects or omissions that might prevent or hinder the full effectiveness of the foregoing resolutions.

Pursuant to the provisions of section 249.2 of the Companies Act, the Board of Directors is expressly authorised to further delegate the powers referred to in this resolution.”

In Bilbao, on 21 February 2017.