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 NINE ON THE AGENDA FOR THE GENERAL SHAREHOLDERS’ MEETING CALLED TO BE HELD ON 13 AND 14 APRIL 2018, ON FIRST AND SECOND CALL, RESPECTIVELY

1. Object 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 nine 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 such 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, which until now it has been implementing through successive editions of the "Iberdrola Flexible Dividend" system, which is carried out through the implementation of increases in capital by means of scrip issues. Subject to approval by the shareholders at the General Shareholders’ Meeting, the system will be called "Iberdrola Flexible Remuneration" as from this year and will include certain improvements that have been described in the Report of the Board of Directors of Iberdrola, S.A. regarding the proposed implementation of two increases in capital by means of scrip issues in order to implement the "Iberdrola Flexible Remuneration" system included in items number seven and eight of the agenda for the General Shareholders’ Meeting called to be held on 13 and 14 April 2018, on first and second call, respectively.

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 those that the Company has implemented each year since 2013– in order 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 31 March 2017 under items number twelve and thirteen on the agenda and which were implemented in July 2017 and January 2018, 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 are held in treasury as at 19 February 2018, while the rest of the shares to be retired will be acquired as a result of the settlement of the derivatives acquired by the Company prior to 20 February 2018, as well as within the framework of a share buy-back programme approved by the Board of Directors at its meeting of 20 February 2018 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 on market abuse 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, and, if approved, the authorisation replacing it approved by the shareholders at the General Shareholders’ Meeting called for 13 and 14 April 2018 on first and second call, respectively.
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) 74,272,523.25 euros, through the retirement of 99,030,031 currently existing own shares in treasury as at 19 February 2018, 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 74,507,976.75 euros, of the own shares of the Company, each with a nominal value of seventy-five euro cents, up to a limit of 99,343,969 own shares (the “Overall Limit”), that are acquired for their retirement both through the settlement, no later than 15 June 2018, of the derivatives acquired by the Company prior to 20 February 2018 as well as under the programme for the buy-back of up to 99,343,969 own shares that will be in effect until no later than 15 June 2018, approved by the Board of Directors today, 20 February 2018, 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 of 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 on market abuse 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 would be 148,780,500 euros, through the retirement of a maximum of 198,374,000 own shares, each with a nominal value of seventy-five euro cents, representing not more than 3.08% 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 Company’s Board of Directors (with express power of substitution) depending upon the final number of shares acquired both by virtue of the settlement of the derivatives acquired by the Company prior to 20 February 2018 and within the framework of the Buy-back Programme, provided they do not exceed said Overall Limit. Otherwise, there will be a retirement of all of the shares acquired pursuant to the Buy-back Programme as well as of the number of shares acquired as a result of the settlement of the derivatives acquired by the Company prior to 20 February 2018 equal to the difference between the Overall Limit and the shares acquired in implementation of the Buy-back Programme, and the remaining treasury shares will not be retired.

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 20 February 2018 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 NINE ON THE AGENDA**

Approval of a reduction in share capital by means of the retirement of a maximum of 198,374,000 own shares (3.08% of the share capital).

**RESOLUTION**

1. **Reduction in Capital by means of the Retirement of Both Currently Existing Own Shares in Treasury and of Own Shares to Be Acquired through the Settlement of Derivatives Acquired prior to the Formulation of this Proposed Resolution 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. 74,272,523.25 euros, through the retirement of 99,030,031 currently existing own shares in treasury as at 19 February 2018, 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 74,507,976.75 euros, of the own shares of the Company, each with a nominal value of seventy-five euro cents, up to a limit of 99,343,969 own shares (the “Overall Limit”), that are acquired for their retirement both through the settlement, no later than 15 June 2018, of the derivatives acquired by the Company prior to 20 February 2018 as well as under the programme for the buy-back of up to 99,343,969 own shares that will be in effect until no later than 15 June 2018, approved by the Board of Directors on 20 February 2018 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 of 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 on market abuse 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”) shall be 148,780,500 euros, through the retirement of a maximum of 198,374,000 own shares, each with a nominal value of seventy-five euro cents, representing not more than 3.08% of the share capital at the time this resolution is approved.

As set out below, the final amount of the Reduction in Capital will be set by the Company’s Board of Directors (with express power of substitution) depending upon the final number of shares acquired as a result of both the settlement of the derivatives acquired by the Company prior to 20 February 2018 and within the framework of the Buy-back Programme, provided they do not exceed the Overall Limit. Otherwise, there will be a retirement of all of the shares acquired pursuant to the Buy-back Programme as well as of the number of shares acquired as a result of the settlement of the derivatives acquired by the Company prior to 20 February 2018 equal to the difference between the Overall Limit and the shares acquired in implementation of the Buy-back Programme, and the remaining treasury shares will not be retired.

2. **Procedure for the 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 20 February 2018, the Company may acquire a maximum number of 99,343,969 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 1.543 % 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, and if approved, in the authorisation in replacement thereof approved by the shareholders at this General Shareholders’ Meeting under item number twelve on the agenda.

As provided in the aforementioned resolution of the Board of Directors, the own shares shall 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 on market abuse 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 99,343,969 own shares, each with a nominal value of seventy-five euro cents, both through the settlement, no later than 15 June 2018, of the derivatives acquired by the Company prior to 20 February 2018 as well as under the Buy-back Programme, it shall 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 sum of the shares effectively acquired pursuant to the settlement, no later than 15 June 2018, of the derivatives acquired by the Company prior to 20 February 2018 and within the framework of the Buy-back Programme.

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 shall 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 power 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 power 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 on market abuse 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 of “Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A. Unipersonal” (IBERCLEAR).

(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.”

Bilbao, 20 February 2018.