



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 ELEVEN ON THE AGENDA FOR THE GENERAL SHAREHOLDERS' MEETING CALLED TO BE HELD ON 28 AND 29 MARCH 2014, 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. (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 shares of Iberdrola, S.A. (the “**Reduction in Capital**”) and the amendment of article 5 of the *By-Laws* as a result, submitted to the shareholders for approval at the General Shareholders’ Meeting under item eleven on the agenda.

As provided in the aforementioned sections, the Board of Directors must prepare a report setting forth the rationale for the proposal submitted to the shareholders at the General Shareholders’ Meeting to the extent that the Reduction in Capital necessarily entails the amendment of article 5 of the *By-Laws*, regarding share capital.

2. Rationale for the Proposal

The Board of Directors of the Company, by resolution adopted at its meeting of 22 October 2013, amended the Company’s *Dividend Policy* in order to, among other things, contemplate the possibility that issuances of shares in the capital increases used to implement the “Iberdrola Flexible Dividend” system are offset by capital reductions such as those proposed, as already occurred during financial year 2013, so that the number of the Company’s shares in circulation, which is used to calculate the profit per share, tends to be approximately 6,240 million.

This avoids dilution caused to shareholders from the repeated issuance of new shares, contributing to the maintenance of the profit per share of the Company, all of which benefits the shareholders.

Therefore, the Board of Directors has resolved to propose the Capital Reduction to the shareholders at the General Shareholders’ Meeting to offset the increase in share capital by means of scrip issue approved by the shareholders at the General Shareholders’ Meeting held on 22 March 2013 under item B on the Agenda, such that the Company’s treasury shares are retired if said proposal is ultimately approved, with a corresponding reduction in share capital by an amount equal to the nominal value of such shares, and the number of shares in circulation would be established at the target figure of 6,240 million.

Moreover, the Board of Directors resolved today to approve a share buy-back programme under the provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 and in reliance on the authorisation granted by the shareholders at the General Shareholders' Meeting held on 26 March 2010 under item eight on the agenda, which shall also be retired within the framework of the Capital Reduction. Thus, the purpose of this initiative is to favour the liquidity of the shares as well as the abovementioned benefits of reducing both capital and treasury shares.

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) 68,478,978.00 euros, through the retirement of 91,305,304 treasury shares, each with a nominal value of 0.75 euro, representing 1.433% of the share capital and acquired under the authorisation granted by the shareholders at the General Shareholders' Meeting held on 26 March 2010 under item eight 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 31,621,272.00 euros, of the Company's own shares, each with a nominal value of 0.75 euro, with a maximum of 42,161,696 shares (representing not more than 0.662% of the share capital), that are acquired for their retirement under the buy-back programme approved by the Board of Directors today, 18 February 2014, under the provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 (the "**Buy-back Programme**").

Consequently, the maximum amount of the reduction would be 100,100,250.00 euros, through the retirement of a maximum of 133,467,000 shares of Iberdrola, S.A., each with a nominal value of 0.75 euro, representing not more than 2.094% of the share capital at the time the resolution is approved, if at all. 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, article 5 of the Company's *By-Laws* would be amended such that it reflects the new amount of share capital and the new number of outstanding shares (after the number of shares of Iberdrola, S.A. 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 18 February 2014 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 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 delisting 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 ELEVEN ON THE AGENDA

Approval of a reduction in share capital by means of the retirement of 91,305,304 treasury shares of Iberdrola, representing 1.433% of the share capital, and acquisition of a maximum of 42,161,696 shares of the Company, representing 0.662% of the share capital, through a buy-back programme for the retirement thereof. Delegation of powers to the Board of Directors, with the express power of substitution, including, among others, the powers to amend article 5 of the By-Laws and to apply for the delisting of the retired shares and for the removal thereof from the book-entry registers.

RESOLUTION

1. Reduction in Share Capital by means of the Retirement of both Treasury Shares and Shares of the Company acquired through a Buy-back Programme for the Retirement thereof

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

(i) 68,478,978.00 euros, through the retirement of 91,305,304 treasury shares, each with a nominal value of 0.75 euro, acquired under the authorisation granted by the shareholders at the General Shareholders' Meeting held on 26 March 2010 under item eight 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 31,621,272.00 euros, of the shares of the Company, each with a nominal value of 0.75 euro, that are acquired for their retirement under the buy-back programme approved by the Board of Directors on 18 February 2013 under the provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003 and expiring on or before 31 May 2014 (the "**Buy-back Programme**").

Consequently, the maximum amount of the capital reduction (the "**Capital Reduction**") will be 100,100,250.00 euros, through the retirement of a maximum of 133,467,000 shares of Iberdrola, S.A., each with a nominal value of 0.75 euro, representing not more than 2.094% of the share capital at the time this resolution is approved.

In accordance with the provisions below, the final amount of the reduction 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 18 February 2014, the Company may acquire a maximum number of 42,161,696 shares of the Company with a nominal value of 0.75 euro each and representing 0.662% of the share capital of the Company on the date of approval of this resolution, which number is within legal limits, for retirement thereof and by way of implementation of the Buy-back Programme directed to all of the shareholders.

As provided in the aforementioned resolution of the Board of Directors, the shares will be acquired on such terms as to price and volume as are established in article 5 of Commission Regulation (EC) No 2273/2003 of 22 December 2003.

In accordance with the foregoing, pursuant to section 340.3 of the Companies Act, if the Company fails to acquire the maximum number of 42,161,696 shares of the Company, each with a nominal value of 0.75 euro, 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 under 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 Commission Regulation (EC) No 2273/2003 of 22 December 2003, 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 shares acquired under the Buy-back Programme must be retired by the Company within one month following the expiration of such programme. Therefore, 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 because the Company itself is the holder of the shares to be retired at the time of the reduction, 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.

Consequently, in accordance with the provisions of such section, creditors 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

It is hereby resolved 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 and the effectiveness period, as well as the acts, statements, and formalities heretofore carried out in connection with the public communication of the Buy-back Programme.

5. Delegation of Powers

It is hereby resolved to authorise the Board of Directors, with express powers of substitution, 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. Specifically, and merely by way of illustration, the following powers are delegated to the Board of Directors, with express powers of substitution:

(a) 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 Commission Regulation (EC) No 2273/2003 of 22 December 2003.

(b) 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) 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) 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 by the shareholders at this General Shareholders' Meeting.

(e) Amend article 5 of the By-Laws of the Company, regarding share capital, in order to adjust it to the result of the Reduction in Capital.

(f) 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.

(g) 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 embodying 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) Perform all acts that may be necessary or appropriate to implement and formalise the Reduction in Capital before any public or private, Spanish or foreign 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 preceding resolutions.

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

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Bilbao, 18 February 2014