



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 TEN ON THE AGENDA FOR THE GENERAL SHAREHOLDERS' MEETING CALLED TO BE HELD ON 27 AND 28 MARCH 2015, 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 of Iberdrola, S.A. (the “**Reduction in Capital**”) submitted to the shareholders for approval at the General Shareholders’ Meeting under item ten 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* governing share capital.

2. Rationale for the Proposal

Pursuant to the provisions of the *Shareholder Remuneration Policy*, on 19 February 2014 the Company announced its intention to maintain shareholder remuneration at a minimum of 0.27 euro per share, and to continue 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.

In addition, the Company stated its commitment to maintain the number of outstanding shares of the Company at approximately 6,240 million, offsetting the issuance of new shares that such increases in share capital by means of scrip issues entail with reductions in capital such as the one now proposed, and as implemented in financial years 2013 and 2014.

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 28 March 2014 under sections A and B of item six on the Agenda. 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



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share capital by an amount equal to the nominal value of such shares, and the number of shares in circulation is 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 17 February 2015 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 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) 101,826,370.50 euros, through the retirement of 135,768,494 treasury shares, each with a nominal value of 0.75 euro, representing 2.125% of 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 9,535,879.50 euros, of the own shares of the Company, each with a nominal value of 0.75 euro, up to a maximum of 12,714,506 own shares (representing a maximum of 0.199% of the share capital), that are acquired for their retirement under the buy-back programme approved by the Board of Directors today, 17 February 2015, 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 in Capital would be 111,362,250.00 euros, through the retirement of a maximum of 148,483,000 own shares, each with a nominal value of 0.75 euro, representing not more than 2.324% 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* governing 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 17 February 2015 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 TEN ON THE AGENDA

Approval of a reduction in share capital by means of the retirement of 148,483,000 own shares representing 2.324% of the share capital of IBERDROLA, S.A. Delegation of powers to the Board of Directors, with express power of substitution, including, among others, the powers to amend the article of the By-Laws governing share capital and to apply for the removal from trading 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 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) 101,826,370.5 euros, through the retirement of 135,768,494 currently existing 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 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 9,535,879.5 euros, of the own shares of the Company, each with a nominal value of 0.75 euro, up to a maximum of 12,714,506 own shares, that are acquired for their retirement under the buy-back programme approved by the Board of Directors on 17 February 2015 under the provisions of Commission Regulation (EC) No 2273/2003 of 22 December 2003, and in effect, at the latest, through 31 May 2015 (the “**Buy-back Programme**”).

Consequently, the maximum amount of the reduction in capital (the “**Reduction in Capital**”) would be 111,362,250.00 euros, through the retirement of a maximum of 148,483,000 own shares, each with a nominal value of 0.75 euro, representing not more than 2.324% of the share capital at the time the 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 17 February 2015, the Company may acquire a maximum number of 12,714,506 own shares, each with a nominal value of 0.75 euro and representing a maximum of 0.199% 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 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 12,714,506 own shares, 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 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 and the effectiveness period, 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 Commission Regulation (EC) No 2273/2003 of 22 December 2003.

(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 governing share capital such that it reflects the new 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 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) To 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 foregoing 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, 17 February 2015