



RED ELÉCTRICA

CORPORACIÓN

Board of Directors

12 June 2015

Report on the process for the splitting of positions of Chairman of the Board of Directors and Chief Executive Officer (CEO) of the company.



Process for splitting of positions of Chairman of the Board of Directors and Chief Executive Officer (CEO) of the company.

The organisation Red Eléctrica currently has an Executive Chairman, Mr. José Folgado Blanco, who holds the position of Chairman of the Board of Directors.

On the motion of its Chairman, The Board of Directors of Red Eléctrica Corporación, S.A. (hereinafter, Red Eléctrica, REC or the company) has undertaken a long period of reflection and has decided proposing to the General Shareholders' Meeting the necessary steps that are necessary to split the positions of Chairman of the Board of Directors and Chief Executive Officer (CEO) of the company. This conclusion was reached after assessing the benefits of this type of organisational model for Red Eléctrica and its shareholders, with a view to improving the company's current corporate governance structure.

In reaching this conclusion, we have analysed the new organisational model involving the splitting of positions and decided that the new model will not only help to maintain the proper balance of powers on the Board of Directors and improve the company's corporate governance structure, but will also facilitate compliance with the targets and strategies set out in the Group's new Strategic Plan, approved by the Board last February, and will contribute to the adequate sustainable development of the various business areas of the Group.

This document is divided into three sections:

- Red Eléctrica's engagement with its shareholders.
- The competences and responsibilities of both positions and
- The process for the splitting of positions of Chairman of the Board and CEO of Red Eléctrica.

1. Red Eléctrica's engagement with its shareholders

The company has been taking steps and implementing new measures within its corporate governance structure since 2012 and believes that the time has now come to define and implement a clear and transparent transition towards a new model involving the splitting of positions. This will improve on past experiences and is furthermore backed by its shareholders.

It should also be noted that, for a number of years, there has been a growing international trend in the area of corporate governance—which has become increasingly widespread, particularly in Europe—recommending that companies listed on the securities markets split the positions of Chairman of the Board of Directors and CEO within their companies, so that these positions are held by different people.

The basic rationale behind this trend is to avoid the risk of excessive concentration of power in the hands of a single person acting as both Chairman of the Board of Directors and CEO of the company, which could prevent or make it difficult for both the Board and the management team to adequately exercise—with the due independ-



ence and objectivity— the oversight and management roles respectively assigned to them.

The accumulation of power in a Chairman/CEO can cause disruptions to the exercise of the various responsibilities of the Board of Directors (led by the Chairman) and of the management team (led by the CEO), which may lead to conflicts of interest that, if not properly resolved, could result in the destruction of shareholder value.

Although the most significant proxy advisors and the most prominent institutional shareholders allow the adoption of transitional counter measures to mitigate the excessive accumulation of power in a sole person, such measures are only justified as a temporary solution that must be accompanied by a commitment to a formal splitting of the two positions within a reasonable time-frame. The initial recommendation on the splitting of positions has become a *de facto* requirement for institutional shareholders, which is gradually being adopted by the majority of listed companies with a significant percentage of foreign capital —as is the case of Red Eléctrica, in which foreign investments represent around 70% of its share capital.

The practice of appointing a lead independent director as a counterbalance to the accumulation of power by the Chairman/CEO has been accepted as a leading practice by the most prominent proxy advisors (*ISS, Glass Lewis, ECGS, etc.*) and by high-profile institutional investors and shareholders. However, they do not consider this to be a sufficient measure and are demanding the formal and real separation of the positions of Chairman and CEO. The majority are including this requirement in their voting policies and permitting the appointment of a lead independent director only on a complementary, subsidiary and temporary basis, provided that the company has signalled its willingness to split the two positions within an appropriate time-frame. In any case, the role should be granted sufficient powers and responsibilities, and should regularly exercise them in practice.

In the action policy that it publishes annually, ISS (headquartered in the US and serving the majority of foreign institutional investors) has considered that a basic requirement for listed companies is the separation of the positions of Chairman and CEO.

Glass Lewis —also headquartered in the US— recommends in its policies the appointment of a lead independent director when the positions of Chairman and CEO in listed companies are not separate, in order to improve the oversight of the CEO and senior management of the company, to avoid potential conflicts of interest with the management team and to achieve better care for the needs and concerns of shareholders. However, this proxy advisor has openly declared that it is a supporter of the separation of the two roles.

ECGS (Proxinvest), a leading French proxy advisor, also defends —with even greater enthusiasm, in line with the prevailing general trend in France— the basic principle of the separation of the positions of Chairman and CEO in listed companies. It supports its position by indicating, among other things, that the Chairman of the Board should not have executive functions because this endangers the general oversight function of the Board and hinders the Board's objective assessment of the performance of the management team, of the Strategic Plan and of the initiatives and actions of the CEO.

Proxy advisors and investors, regardless of their favourable stance regarding splitting the two positions, argue that this splitting requirement should be analysed case by case, within each company, in case it is possible to maintain, in certain circumstances, a single combined Chairman/CEO role. For this reason, the principle of the



splitting of positions has not been included imperatively and unanimously in all the voting policies and recommendations of such companies (including the Code of Good Governance of Listed Companies (CBGSC), recently approved in Spain in February 2015, which in its principle No. 16 refers to a "*lack of uniformity in international practice and a lack of an empirical basis for formulating an exhaustive recommendation*" regarding the separation of positions). However, in the case of Red Eléctrica, proxy advisors and institutional shareholders have adopted a common position, resulting from the many meetings that have regularly been held with them, discussed below.

In March 2012, on the occasion of the re-election as director of the current executive Chairman, Mr. José Folgado Blanco (which the Board of Directors proposed to the Annual General Meeting of Shareholders in April 2012), in view of the position and the overwhelming consensus of the foreign institutional shareholders and the unanimous position of the leading *proxy advisors* demanding the splitting of the positions of Chairman and CEO, the Board released a document entitled "*Statement on Key Issues of Red Eléctrica Corporación (REC). A Corporate Governance Approach*" (hereinafter referred to as the Statement). The aim of this document was to support and provide justification for the proposed re-election as director —with executive powers— of Mr. Folgado Blanco at the said AGM. To secure the strongest endorsement by the shareholders at the AGM, in the said document the company agreed to take certain measures to counterbalance the powers and competences of the combined position of Chairman/CEO, to pave the way towards the final separation of such positions at the time when the new organisational model had been sufficiently analysed and was mature enough to be effectively implemented, and to seek an orderly, organised and well-planned succession, which would eliminate the potential risks and disadvantages associated with an improvised implementation of the new model.

The main counter measures that Red Eléctrica promised to implement in its governing bodies following the re-election in 2012 of Mr. Folgado Blanco as director, were, *inter alia*, maintaining an adequate level of dialogue and engagement with shareholders, the removal of the executive director from the Appointments and Remuneration Committee, the appointment of a lead independent director, strengthening the independence of the Board and its Committees, reinforcing the oversight and control function of the Board of Directors at the expense of the powers of the Chairman/CEO, the annual self-assessment of the Board with independent external support, the necessary reining in of the remuneration of the Board of Directors, which must be transparent, comparable and appropriate to the performance of their responsibilities, and subject to the approval of the shareholders at the AGM and, furthermore, time limits —beyond the legal term then in force— on the office of the directors, thereby favouring their rotation.

All these practices, together with the need for a Board of Directors with full dedication, which is balanced and diverse in terms of gender, experience and knowledge, and which has a suitable programme for updating its technical knowledge, and also acts according to the principle of transparency and quality of information to the markets, would be sufficient measures to ensure a robust corporate governance system that would aid the Board in the exercise of the general oversight and control function of its managers and, in particular, of the Chairman/CEO, until the formal and final separation of both positions is fully implemented.

Red Eléctrica has strictly complied with all the commitments made in 2012 and has been regularly reporting to all its stakeholders, particularly its shareholders, on the progress and actions taken, by communicating reportable events, its Annual Corporate Governance Reports, and its remuneration policy and the Annual Report on di-



rector remuneration, as well as various road shows and conference calls held with institutional investors and proxy advisors in national and international forums (*International Corporate Governance Network*, among others). This also includes proposals and reports that the Board of Directors has submitted to the Annual General Meeting of Shareholders and the interventions that both the Chairman of the Board and the chairmen of the Appointments and Remuneration Committee have made at successive AGMs.

In this respect, and as a true reflection of the various counter measures taken by the company since 2012, we should note that:

- Without prejudice to his appointment as Executive Chairman and Chairman of the Board in 2012, Mr. Folgado Blanco was never appointed as a member of the Appointments and Remuneration Committee.
- The position of lead independent director was created by the Annual General Meeting of Shareholders of the company held in April 2013, and Ms. Carmen Gomez de Barreda Tous Monsalve was appointed as lead independent director in May 2013.
- The Board of Directors is currently composed of a significant majority of independent directors (64%) acting as a counterbalance on the Board.
- The procedure for selecting and appointing directors has been strengthened in recent years in order to improve gender diversity, experience and expertise in the composition of the current Board.
- Within its Regulations, the Board of Directors has voluntarily delegated to itself certain responsibilities that cannot be exercised either by the Executive Chairman or by the Board Committees.
- The Board also exercises immediate effective control over the ordinary, extraordinary or urgent actions carried out by the Executive Chairman, at each regular session.
- The Board Committees, currently comprising 75% of the independent directors, have been granted broad functions in the Bylaws and the Regulations of the Board of Directors.
- For a number of years, the Board has submitted to an annual self-assessment, with advice from independent external professionals, and publishes the preliminary findings of these procedures in its Annual Corporate Governance Reports.
- Since 2010, Red Eléctrica has voluntarily submitted the annual report on directors' remuneration—and since 2007, the annual remuneration of the Board of Directors—to the approval of the Annual General Meeting of Shareholders as separate and independent points of the Agenda of the AGM, including therein the highest degree of information and information on comparable companies.
- Several years earlier, the company voluntarily limited the mandate of its directors to four years, when the law had set a limit of six years.

As a result of this, the history of the company, in terms of dialogue and engagement with its shareholders and proxy advisors, has been publicly recognised by institutional investors and proxy advisors themselves.

In line with its experience in corporate governance, since 2012 Red Eléctrica has also continued to analyse the process for the splitting of positions, in order to meet the target of splitting the positions of Chairman/CEO and achieve an orderly succession at the appropriate time. Worth noting in this regard is the section on "prospects for corporate governance" appearing at the end of the voluntary part of the Annual Corporate Governance Reports approved by the Board since 2013, as well as the inter-



vention of the Chairman of the Company and the chairmen of the Appointments and Remuneration Committee at the most recent Annual General Meetings. Furthermore, the recently approved—in November 2014— Corporate Governance Policy of the company also confirms this, as do certain recent appearances by the CEO, Mr. Folgado Blanco, before the media.

The demands of shareholders and proxy advisors have recently been joined by those of high-profile international organisations and institutions such as *RobecoSam Dow Jones Sustainability World Index* (DJSI), which each year assess the corporate social responsibility (CSR) practices adopted by large international groups and industrial corporations and by listed companies, penalising in their corporate governance ratings and rankings those companies that have not proceeded to effectively split the positions of Chairman/CEO, as is the case with Red Eléctrica.

In Spain there is a movement among the IBEX 35 companies that is increasingly favourable to the separation of the two positions, as shown in the latest report published by the Spanish National Securities Market Commission (CNMV) on the "Annual Corporate Governance Reports of the IBEX 35 companies" for the year 2013, which shows that around 35% of these have implemented such a separation; although in 2014, the CNMV has not yet updated its report, it is public knowledge that this percentage is increasing.

As indicated above, Red Eléctrica currently has an "executive Chairman" Chairman/CEO, Mr. Folgado Blanco; and a lead independent director, Ms. Gomez de Barreda. The mandate of the current executive Chairman will end in April 2016.

2. Competences and responsibilities of both positions

2.1 Responsibilities of the Chairman of the Board of Directors

The Chairman of the Board of Directors has as essential functions:

- To direct and promote the general oversight function assigned to the Board of Directors.
- To lead and promote the adoption by the Board of Directors of the Strategic Plan of the company and of the Group, as well as the adequate oversight of its implementation.
- To direct and coordinate the adoption by the Board of Directors of the risk control and management system of the company and of the Group, and the necessary oversight of its implementation and proper operation.
- To lead the Board's actions regarding proposals for the appointment and removal of senior executives, and to direct and promote the oversight of their management by the Board itself.

Article 529 *sexies* of Act 31/2014 of 3 December, modifying the Corporate Enterprises Act to improve Corporate Governance (the LSC, according to its Spanish acronym), has regulated the powers of the Chairman of the Board for the first time, which it highlights as the chief director responsible for the effective functioning of the Board. In addition to



the functions stipulated in the legislation, the Bylaws and the Regulations of the Board, the LSC assigns to the Chairman responsibility for:

- Calling and presiding over the meetings of the Board, setting the Agenda of the meeting and directing the discussions and deliberations.
- Presiding over the General Meeting of Shareholders.
- Ensuring that the directors are provided with adequate information in advance in order for them be able to deliberate on the items on the Agenda.
- Stimulating debate and the active participation of the directors during the meetings, safeguarding their right to freely take positions.

Additionally, the new Spanish *Code of Good Governance of Listed Companies (CBGSC)*, in its recommendation No. 16, extends the competences of the Chairman of the Board to the following:

- Preparing and submitting to the Board a schedule of dates and issues to be discussed.
- Organising and coordinating regular assessments of the Board and, where applicable, the CEO.
- Directing the Board and being responsible for its effective operation.
- Ensuring that there is sufficient opportunity for discussion of strategic matters.
- Agreeing and reviewing the refresher programmes of the Board.

The Bylaws of the company regulate the role of Chairman of the Board, in particular Articles 20, 21 and 25, and confer to this role the duty of permanently representing the Board of Directors, as well as calling, presiding over and voting on the issues of the Board once he/she is satisfied that they have been sufficiently debated, and ensuring that the resolutions of the Board are met.

In Article 9, the Regulations of the Board of Directors of the Company contemplate certain functions of the Chairman of the Board that reflect those that were recently incorporated within the LSC, although the said Regulations are being revised and updated to adapt them to the reform of Act 31/2014 (LSC), the new CBGSC, the new international corporate governance practices that could be incorporated thereto and the changes in its organisation and operation arising from the separation of the positions of Chairman of the Board and CEO.

Finally, we should indicate that the current Regulations of the General Meeting of Shareholders of the company also establish in Article 12, the responsibility of the Chairman of the Board to preside over the General Meeting, in anticipation of the new legal provision introduced with the recent reform of the LSC.



2.2 Responsibilities of the Chief Executive Officer (CEO)

It is up to the CEO the responsibilities that are specified in the bylaws or those that have been delegated by the Board of Directors

In corporate practice, as the most senior executive of the company, the CEO is primarily responsible for the following:

- The guidance, coordination and promotion of the management of the business areas of the company and of the Group.
- The leadership, promotion and direction of the correct implementation and compliance with the Strategic Plan of the company and of the Group.
- The efficient implementation of the risk control system approved by the Board of Directors of the company and the Group, and monitoring that it functions correctly.
- Reporting and regular information to the Board of Directors on the degree of implementation and compliance with the Strategic Plan, the operation of the implemented risk management system and the degree of progress in the management of the business areas of the Group, enabling the Board to exercise its general oversight and control thereof appropriately and effectively.

The current legislation, the corporate rules of the company and the new Spanish *Code of Good Governance of Listed Companies (CBGSC)*, maintain almost complete silence regarding this matter.

In effect, neither the Corporate Enterprises Act (article 249 and 529 *septies*), nor the Bylaws of the company (articles 22 and 25), nor the Regulations of the Board, currently establish the competences and responsibilities that should or may be assigned to the CEO thereof, as they focus more on issues relating to the appointment procedure, the possible splitting of the positions of Chairman of the Board and CEO, the appointment of the lead independent director and the possibility of the coexistence of several executive directors.

However, the LSC *does* establish a range of non-assignable powers of the Board of Directors (arts. 249 *bis* and 529 *ter*) and the Regulations of the Board of the company do the same (article 5).

The Bylaws (article 25) of the company state that the power to represent the company, in court or out of it, may lie—in addition to the Board and its Chairman—with the executive directors.

The *Code of Good Governance of Listed Companies (CBGSC)*, on the other hand, does not add any new developments regarding the responsibilities of the CEO when performing the functions of Chairman of the Board (recommendation No. 33) or when addressing the issue of the possible splitting of the Chairman/CEO (No. 16) and the position of the lead independent director.

Both the Bylaws (article 22) of the company and the Regulation of the Companies Registry (article 149), merely require that when appointing one or more executive directors



the Board of Directors draw up a detailed list of the delegated powers or state that it has delegated all the powers that may be delegated by law and by the Bylaws; and if there are several executive directors, it must indicate which powers may be exercised jointly and severally and which jointly or, as the case may be, whether all the delegated powers should be exercised in a certain way. For its part, the Corporate Enterprises Act (article 249) also allows the possibility of the Board to appoint one or more executive directors. To do so the Board must establish the content, limits and arrangements for this delegation.

On 26 April 2012, the Board of Directors delegated to the current executive Chairman of the company, Mr. Folgado Blanco, all the powers of the Board that may be delegated by law and according to the Bylaws.

The ongoing process to revise and update the Regulations of the Board—for their adaptation to the reform of Act 31/2014 (LSC), the new CBGSC and other international corporate governance practices— must include the core responsibilities and competences of the CEO, as the case may be.

3. Process for splitting of the positions of Chairman of the Board and Chief Executive Officer (CEO) of Red Eléctrica.

It is considered necessary to address at this point the Process for splitting of positions of Chairman of the Board and Chief Executive Officer (CEO) of the company, under the terms contemplated herein, which details the procedure necessary to comply with the commitment given to the shareholders to split these roles, for the reasons set out below.

Firstly, we have already tackled the main regulatory uncertainties in the electricity sector in Spain that existed in 2013 and 2014, affecting the main activities of the company and in particular the remuneration of its main activities; as a result, the Board of Directors approved in February 2015 a new Strategic Plan for the Group within a time-frame ranging from 2014 to 2019, which represents a clear and sustained increase in unregulated activities. It therefore seems highly appropriate that the promotion and implementation of the new Plan be addressed, from the start, with a well-planned and sustainable solid organisational structure, as regards the organisation of the company and the Group—and particularly its senior executives— allowing proper alignment between the interests of the company and its shareholders.

Secondly, as already mentioned above, the deadline for completion of the term of the current executive Chairman will end in less than a year—in April 2016—and it would appear appropriate to take the necessary steps for splitting of the positions of the Chairman and CEO in an orderly manner, to ensure the continuity and stability of the various business areas of the Red Eléctrica Group.

Thirdly, it should be noted that inasmuch as the internal process of analysing the transfer of executive powers and the separation of roles is at an advanced stage, it is felt that the



current timing is right to make a concrete proposal for its formal approval and the implementation of the relevant procedure.

Moreover, the exercise of competences and functions separately, which entails greater independence and objectivity in their performance, will strengthen the management of the Group's businesses in order to meet the challenges contemplated in the new Strategic Plan, based —*inter alia*— on the principles of excellence, efficiency and sustainability.

The increased demands that may arise with the new model of separation of functions, such as the need for coordination and possible organisational adjustments, will be resolved in the transition period of the process detailed below.

The extraordinary importance for the company and for the Red Eléctrica Group of the proposal for the real separation of the positions of Chairman of the Board of Directors and CEO, together with the fact that such proposal originates from the shareholders, fully justifies such decisions being submitted directly to the company's shareholders, who shall be called to attend an Extraordinary General Meeting of Shareholders for this purpose in the near future, thereby endowing the process with the necessary shareholder backing.

3.1 Position separation process

Based on the existing situation at Red Eléctrica, we expect a transitional period of between 6 and 9 months in duration, culminating in the 2016 Annual General Meeting of Shareholders, with the full separation of functions between the Chairman of the Board and the CEO. From the date of the aforementioned 2016 General Meeting, the Chairman of the Board will exclusively hold the responsibilities of that office.

Since there are currently no vacancies on the Board of Directors, this will require that the Extraordinary General Meeting called for this purpose by the Board to validate the process, approve the increase in the current number of directors by one —from eleven (11) to twelve (12) members.

Subsequently, the said General Meeting must decide on the appointment of the new CEO as a member of the Board.

Until the 2016 Annual General Meeting of Shareholders, the current Executive Chairman, Mr. Folgado Blanco, will retain all of his current executive faculties and his role as Chairman of the Board of Directors, with the responsibilities and functions inherent to this position.

In his capacity as Chairman of the Board, in addition to the powers established in the Corporate Enterprises Act (article 529 sexies), in the Bylaws (articles 20, 21 and 25) and in Regulations of the Board (article 9), he shall hold the following basic powers:



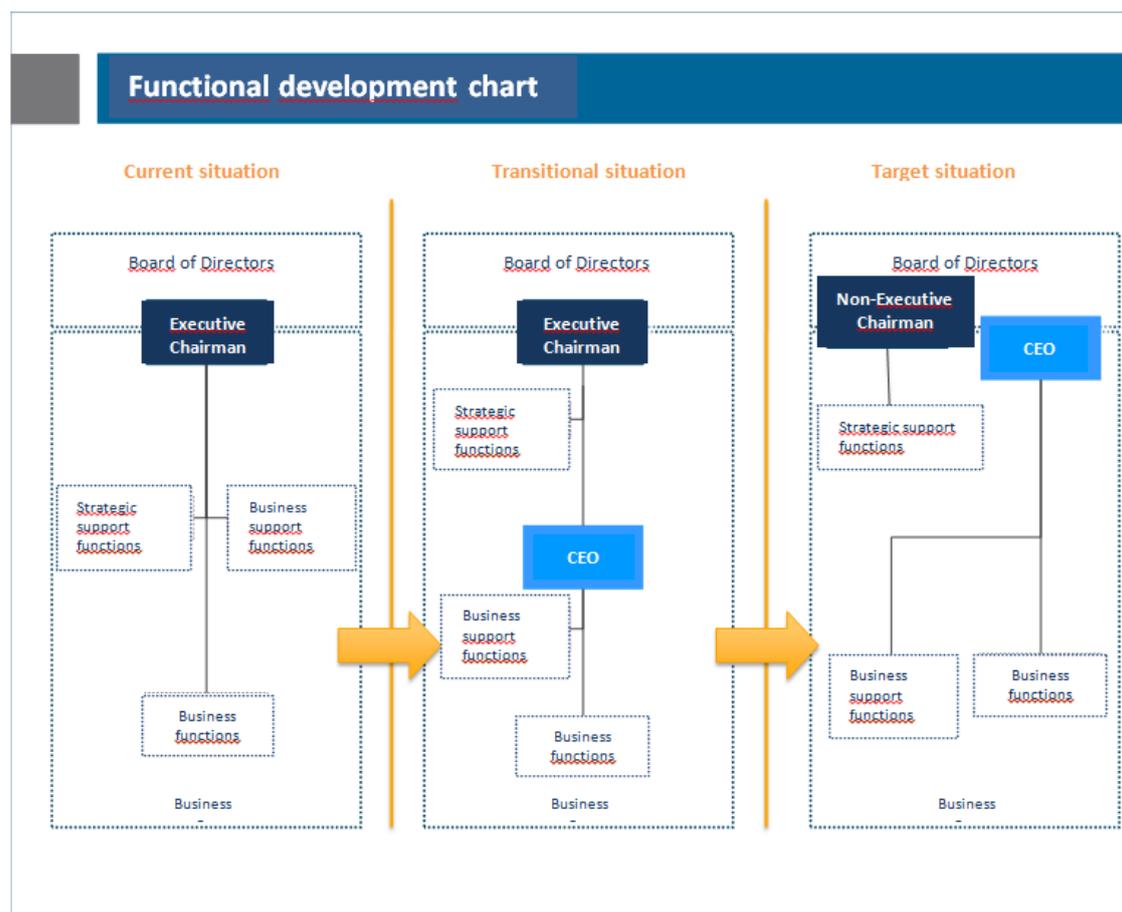
- To direct and promote the general oversight function assigned to the Board of Directors.
- To lead and promote the adoption by the Board of Directors of the Strategic Plan of the company and of the Group, as well as the adequate oversight of its implementation.
- To direct and coordinate the adoption by the Board of Directors of the risk control and management system of the company and of the Group, and the necessary oversight of its implementation and proper operation.
- To lead the Board's actions regarding proposals for the appointment and removal of senior executives, and to direct and promote the oversight of their management by the Board itself.

As regards his executive functions, the current Executive Chairman will focus on directing, guiding and properly supervising the transfer of powers, as well as the effective exercise of the executive responsibilities by the new CEO, so that both take place in a rational and orderly manner during this phase.

The current Executive Chairman will keep the necessary competences to ensure, during the transition period, that the organic whole of Red Eléctrica de España, S.A.U., which exercises the functions of electric system operator, has the operational autonomy of the functions that require it, in accordance with legislation in force. During this period, functions that because of their nature might be located directly under the CEO will be studied.

The CEO shall, in turn, assume the functions of his office, which shall be directed by the Chairman of the Board, who shall retain executive power for this leading purpose throughout the transitional stage. In this sense, during the transitional process, the Chairman shall direct the Management Committee and share with the CEO the oversight and management of the members thereof.

The functional evolution described above is summarised in the following table.



The powers of the CEO are focused on:

- The guidance, coordination and promotion of the management of the business areas of the company and of the Group.
- The leadership, promotion and direction of the correct implementation and compliance with the Strategic Plan of the company and of the Group.
- The efficient implementation of the risk control system approved by the Board of Directors of the company and the Group, and monitoring that it functions correctly.
- Reporting and regular information to the Board of Directors on the degree of implementation and compliance with the Strategic Plan, the operation of the implemented risk management system and the degree of progress in the management of the business areas of the Group, enabling the Board to exercise its general oversight and control thereof appropriately and effectively.

To carry out the formal delegation of powers to the new executive director (CEO), after the Extraordinary General Meeting of Shareholders, the Board of Directors shall approve



the delegation of powers and executive responsibilities, with the scope necessary for the effective management of the business lines of the company, thereby commencing the process to ensure stability in the transition to the new organisational model.

The formal transfer of executive responsibilities to the new CEO shall be completed at the time when the current Executive Chairman loses his condition as executive director at the Annual General Meeting of Shareholders to be held in 2016.

The Board of Directors shall inform the Extraordinary General Meeting of Shareholders that the formal and final splitting of the positions of Chairman and CEO shall take place after the conclusion of the Annual General Meeting of Shareholders in 2016.

The Board of Directors shall adopt the necessary resolutions after the Annual General Meeting of Shareholders to be held in 2016, for the new distribution of responsibilities and functions between the two positions as explained above.

3.2 Legal regime applicable to the process

The process for splitting of the positions of Chairman of the Board of Directors and Chief Executive Officer (CEO) of the company, is currently fully covered under the Bylaws and the Regulations of the Board in force, since such corporate regulations were modified in 2013 to provide wide coverage to the various alternatives that, in terms of the splitting of positions, could be pursued in the future.

Among the amendments to the Regulations of the Board of Directors on 13 March 2013, specific provisions were introduced to allow the personal separation of the positions of Chairman and CEO of the Board of Directors (articles 12.1 and 15.3).

In addition, applicable to this process are the Regulations of Board relating to the Chairman of the Board (article 9), the executive directors (article 7.2.a), and the appointment of directors (Article 16.1)

The Annual General Meeting of Shareholders held on 18 April 2013 amended the Bylaws (articles 22 and 25) by introducing counter measures similar to those introduced to the Regulations of the Board, in the event that the Chairman of the Board was also the CEO of the company (regulation of the position of lead independent director), and other measures to enable the personal separation of both positions. This means that the appointment of a new executive director, the temporary coexistence of two executive directors and the separation of the positions of Chairman and CEO, also have the necessary legal backing in the Bylaws.

In addition, for the issuance of the report and the proposal for the appointment of the new executive director, the new articles of the Corporate Enterprises Act (LSC) would be applicable. These articles refer to the appointment of directors and executive directors in listed companies (articles 529 *decies* to 529 *duodecies* and 529 *quindcies*) and their remuneration (articles 529 *octodecies* and 529 *novodecies*), and were included following



the legal reform approved in December 2014; as well as article 24 of the Bylaws and articles 7, 16, 19, and 21 of the Regulations of the Board of Directors.

The Code of Good Governance of Listed Companies (CBGSC) will also be taken into account in this process, to establish the responsibilities and functions of the Chairman of the Board (principle No. 16 and Recommendation No. 33) and differentiate them from those of the CEO.

The succession plan for the Chairman of the company, approved by the Board of Directors at the meeting held on 27 October 2011, is not, however, applicable to this process of position splitting, since it does not match the situations referred to in the former plan approved in 2011, which did not include the possible splitting of positions or the existence of the role of the lead independent director —this being highly important to the coordination and promotion of the entire process.

Without prejudice to whether or not the current corporate regulations allow implementing the stated position splitting process, we must indicate, as the case may be, the core responsibilities and competences of the CEO during the review of the Regulations of the Board that was commenced with a view to adapting them to the reform of Act 31/2014 (LSC), the new CBGSC and other international corporate governance practices.

In view of the legal regime analysed herein, currently at Red Eléctrica it is possible to formally split the positions of Chairman of the Board and CEO of the company, and even to appoint two executive directors to coexist temporarily, assigning thereto the same delegated powers, as will occur in the process during the transitional period.

Finally, it should be noted that, as stated above, the Board of Directors will be responsible for approving the relevant delegation of powers to the new Executive Director (CEO), once the appointment of the new Executive Director has been approved by the Extraordinary General Meeting of Shareholders. At a meeting held after the Extraordinary General Meeting of Shareholders, the Board of Directors shall approve the contract of the new Executive Director and any relevant amendments, as the case may be, to the contract of the current Executive Chairman, as set out in the legislation in force.

To complete the process, as indicated above, following the 2016 Annual General Meeting of Shareholders, the Board of Directors must adopt the necessary resolutions to annul the powers delegated to the current Executive Chairman. As in the transitional period, the Board must approve the relevant amendments to the contracts of the new and former Executive Director.

3.3 Maintenance of the role of the lead independent director

The Appointments and Remuneration Committee and the Board of Directors feel that the role of the lead independent director (LID), created in 2013, is an effective corporate governance practice —with the responsibilities currently assigned thereto—, as has been recognised by shareholders and proxy advisors, who consider it to be a significant



counterbalance in the structure and composition of the current Board, ensuring a proper balance between the various powers and responsibilities.

This is a role that has recently become mandatory in Spain for listed companies in which the Chairman of the Board of Directors has the status of an executive director (article 529 *septies*), following the reform of the Corporate Enterprises Act (LSC) approved in December 2014. Their competences and responsibilities have been reinforced in the new Code of Good Governance of Listed Companies (CBGSC), which explicitly incorporated certain competences such as those of chairing the Board meetings in the absence of the Chairman, liaising with shareholders and investors and coordinating the Chairman succession plan.

In the annual self-assessment process covering the year 2014 just ended, the Board of Directors of the company expressed a positive opinion regarding the role of the LID, in which it stated that it has contributed to the improved functioning of the Board, and it considers it to be a role that should be strengthened in the coming years.

Regarding the issue of maintaining the role of the lead independent director beyond the 2016 Annual General Meeting of Shareholders, it should be noted that in the event of the re-election as director of Mr. Folgado Blanco by the aforementioned General Meeting, he will be known as an "external director" but may not be considered an independent director for at least five years, since a legal (article 529 *duodecies*, paragraph 4.a LSC) and regulatory (article 7.2c of the Board Regulations) prohibition exists in this sense.

In addition, it should be noted that the percentage of independent directors on the Board—although it will continue to be considered a majority and sufficient— will pass from the current 64% to 58% following the appointment of the new executive director.

Therefore, it is considered that maintaining the role of the LID, even once the process has completed, will help to preserve the checks and balances on the Board of Directors in favour of the independent directors and will be a decision that will be well received by shareholders and proxy advisors, as recently communicated to the company by them.

Moreover, given the experience of some IBEX 35 companies that have already implemented the splitting of these positions, the majority have chosen to keep the role of the lead independent director even after the separation.

Finally, we underline the participation of the current lead independent director in the design, planning and promotion of the current process for splitting of positions.

3.4 Remuneration scheme of the positions of the current executive Chairman and the new CEO

The main aspects and items of the remuneration of the new executive director (CEO) will relate to:



- the functional evolution described,
- the principles and criteria set out in the Directors' Remuneration Policy, approved at the last Annual General Meeting of Shareholders of the company held on 15 April 2015
- the best practices and market research of comparable companies, for which an independent external report has been commissioned.

As regards the current **Executive Chairman**, Mr. Folgado Blanco, from the date of the Board of Directors meeting that will follow the Extraordinary General Meeting and until the Annual General Meeting to be held in 2016, he shall receive those items of fixed remuneration to which he is entitled as a result of his executive duties or as a member of the Board—in accordance with the transfer of responsibility that will take place during the transition period.

Additionally, given that during this transitional period the Executive Chairman shall maintain executive functions—as envisaged in the Directors' Remuneration Policy approved at the last Annual General Meeting of Shareholders of the Company held on 15 April 2015 and as the shareholders have recommended—he shall retain a percentage of 50% of the sum he has been receiving as an annual variable item, linked to his executive duties and to the attainment of the targets approved in the aforementioned Policy. In turn, there is no justification for his retaining the multiyear variable item, insofar as his executive duties will be time-limited by the process for splitting of positions.

The Board of Directors, in turn, will raise a proposal to the aforementioned 2016 General Meeting, regarding the remuneration that the Chairman of the Board of Directors of the company should receive from that time.

As regards the remuneration of the new **Chief Executive Officer (CEO)**, within the remuneration framework approved by the Annual General Meeting of Shareholders of the Company held on 15 April 2015, and the established practice of salary moderation and the positioning of the senior executives of Red Eléctrica within the remuneration market (according to the reports available), such remuneration should be located in the vicinity of the 10th percentile of market benchmarks during the transitional period and in the 25th percentile for the final remuneration, taking into account the reports available to the Appointments and Remuneration Committee.

In accordance with the above, we propose establishing the remunerations of the CEO, during the transitional period, considering the following remuneration components, in accordance with the Directors' Remuneration Policy, approved in the last Annual General Meeting of Shareholders of the company, which took place on April 15, 2015.

After analysing in detail the company's performance, the market data and the remuneration conditions within the organization, it has been proposed an annual fixed remuneration (FR) of EUR 235,000. And, in addition: (i) an annual variable remuneration (50% FR) subject to the achievement of the objectives established for the current Executive Chairman for the FY2015, described in the Annual Report on Compensation of Directors approved in the last Annual General Meeting of Shareholders of the company, which



took place on April 15, 2015; (ii) a multiyear variable remuneration (30% FR, annualised target) subject to the achievement of the objectives established in the multiyear variable remuneration of the current Executive Chairman, described in the Annual Report on Compensation of Directors approved in the last Annual General Meeting of Shareholders of the company; and (iii) the fixed annual remuneration for the performance of his duties as director, with the criteria and amounts foreseen in the Annual Report on Compensation of Directors approved in the last Annual General Meeting of Shareholders of the company. The social benefits shall be those corresponding to the remuneration policy approved by the General Meeting, and in line with those social benefits existing for the management team.

The CEO's remuneration, from the Annual General Meeting of Shareholders to be called in 2016 onwards, will be subject to the approval of the General Meeting, in the corresponding Annual Report on Compensation of Directors, in which it shall be included the corresponding breakdown by remuneration items and amounts.

As regards indemnification, exclusivity and non-compete clauses, the provisions of the remuneration policy approved by the General Meeting for the current Executive Chairman will be applicable.

After the Extraordinary General Meeting called for this purpose has been held, in accordance with the provisions of the legislation in force, the Board of Directors will decide on the approval of the relevant contract that will govern the legal relationship between the company and the new CEO, recording, *inter alia*, the main items and aspects of his remuneration. Similarly, the Board of Directors will decide on the approval of the contractual amendments which, if any, it may deem appropriate regarding the Executive Chairman, in order to adapt the contract in the terms agreed.

The Annual Report on Compensation of Directors to be submitted in 2016 for approval by the Annual General Meeting of Shareholders, will provide comprehensive and detailed information on the remuneration items and aspects applicable in 2016 to the new CEO and to the Chairman of the Board of Directors.

In any case, in accordance with existing regulations, the Board of Directors must adopt the necessary resolutions and decisions regarding the appropriate remuneration adjustments, in order to recognise adequate remuneration for the respective responsibilities of both positions held by different people.

4. Board report.

The Board, having examined the report made by the Appointments and Remuneration Committee at the request of the Board, hereby approves this report regarding the Process for splitting of the positions of Chairman of the Board of Directors and Chief Executive Officer (CEO) of the company.