

THE VALUE OF CONNECTED ENERGY



CONSOLIDATED
DIRECTORS' REPORT
2014

Note: Free translation from the original in Spanish. In the event of discrepancy, the Spanish-language version prevails.

1. COMPANY POSITION

1.1. Organisational structure

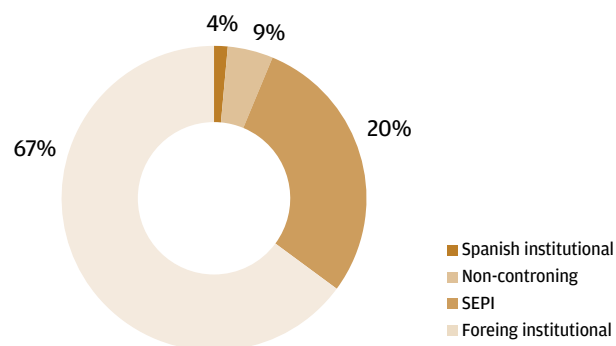
>> Corporate bodies

The board of directors and the shareholders are responsible for governing and managing the Group and its Parent, Red Eléctrica Corporación, S.A. (hereinafter REC).

The shareholders' general meeting is governed by the articles of association and the general meeting regulations, in accordance with the Spanish Companies Act. The ownership structure at the date of the 2014 shareholders' general meeting was as follows:

OWNERSHIP STRUCTURE

Shareholders' General Meeting 2014



The board of directors has formed two permanent committees: the Audit Committee and the Corporate Responsibility and Governance Committee, which are regulated by the articles of association and the regulations of the board of directors, as well as by all applicable corporate governance legislation.

The composition and powers of the board of directors and the various committees are as follows:

BOARD OF DIRECTORS

>> 63.63% independent members >> 45.45% women >> Coordinating independent director

Powers

- > Approval of the general strategies and policies of both the Company and the Group.
- > Group risk control.
- > Effective supervision of the management team.
- > Annual assessment of the quality and efficiency of the Board and functioning of its Committees.

CORPORATE RESPONSIBILITY AND GOVERNANCE COMMITTEE

>> 75% independent members
>> 75% women
>> Chairperson: Independent Director

Powers relating to:

- > Appointment and removal of directors.
- > Board and senior management remuneration policy.
- > Compliance with director duties.
- > Management of the Board assessment process.
- > Information, supervision and proposals in relation to Corporate Governance and Responsibility.
- > Preparation of the gender diversity report that is submitted to the Board for approval.

AUDIT COMMITTEE

>> 75% independent members
>> 50% women
>> Chairperson: Independent Director

Powers relating to:

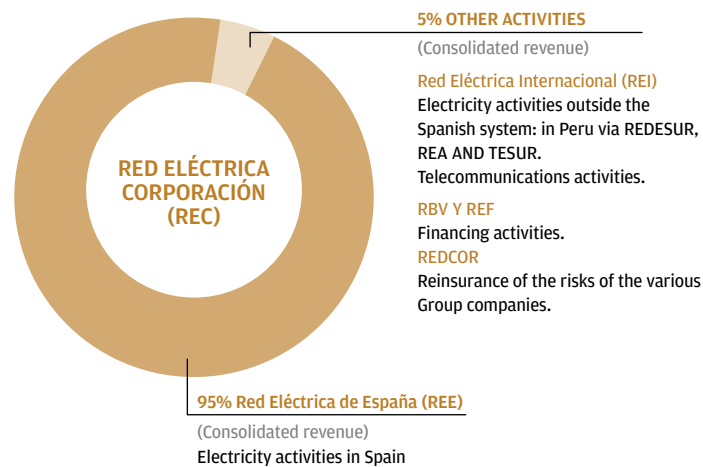
- > Supervision of the process to prepare the Company's financial and economic information.
- > Supervision of internal control and risk management systems.
- > External auditor independence.
- > Compliance with legal provisions and internal regulations.
- > Powers regarding shareholder relations.

In May 2013, with the authorisation of the shareholders' general meeting, the board of directors introduced the position of Coordinating Independent Director. Broad powers are attached to this office, to counterbalance those attributed to the Chairman of the Board and chief executive, and they entail specific responsibilities and dedication in addition to those of ordinary director. The main task of the Coordinating Independent Director is to organise the common positions of independent directors and act as a liaison between holders of such positions and the Chairman of the Board, the Board itself and its committees.

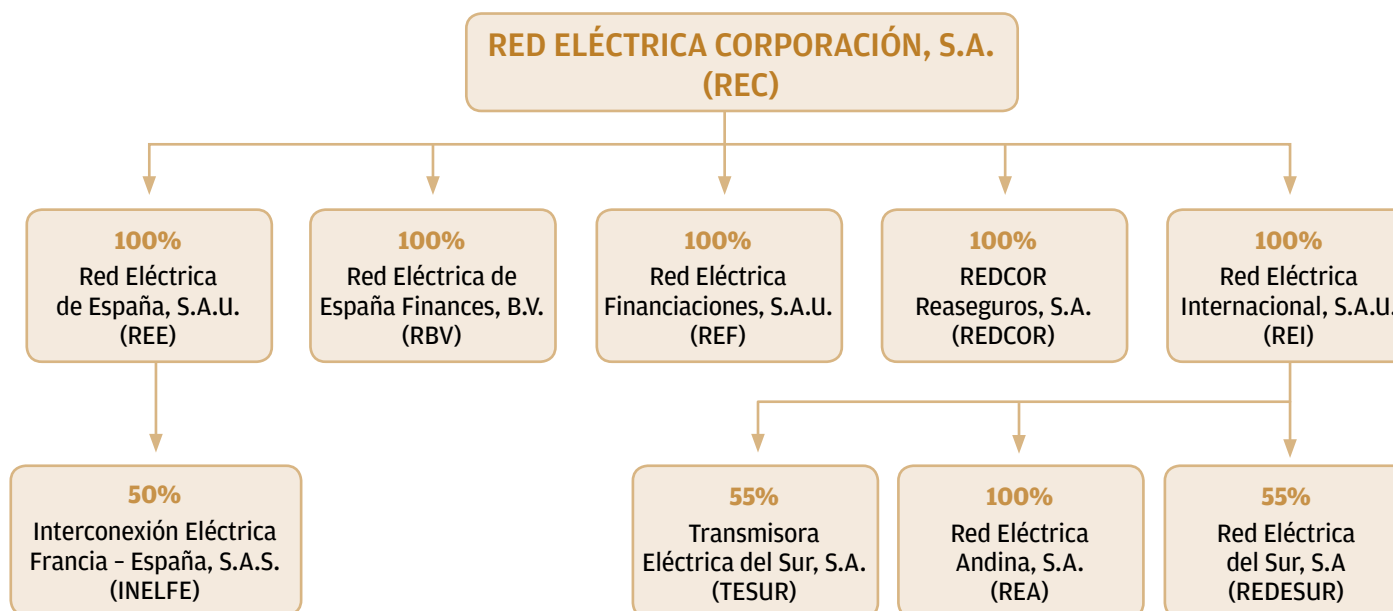
The Corporate Governance Report, which is attached hereto, contains detailed information regarding the composition and operation of the governing bodies of the Group and the Parent.

>> Composition of the RED ELÉCTRICA Group

The RED ELÉCTRICA Group's principal activity is electricity transmission and system operation in Spain via Red Eléctrica de España S.A.U. (REE), which generates 95% of the consolidated revenues and 94% of the Group's total assets (96% and 98%, respectively, in 2013). Other activities together account for the remaining 5% of revenues and 6% of total assets (4% and 2%, respectively, in 2013). It was therefore not considered relevant to provide information by segment of activity or geographic area. The Group is present in five countries (Spain, Peru, the Netherlands, Luxembourg and France).



There have been no changes to the consolidated group in 2014 and, at 31 December 2014, the composition of the Group was as follows (for more information on the activities of each company, see Appendix I to the notes to the consolidated annual accounts):



1.2 Activities and business performance

The Group carries out the aforementioned activities in Spain and abroad, most notably electricity transmission in Spain and Peru and rendering telecommunications services to third parties.

>> **Role of transmission agent and system operator for the Spanish electricity system**

The mission of Red Eléctrica de España, as transmission agent and system operator for the Spanish electricity system, is that of ensuring that the Spanish electricity system functions correctly and guaranteeing the continuity and security of the electricity supply at all times. To this end, it oversees and coordinates the generation and transmission system and manages the development of the transmission grid. The Company seeks to fulfil its mission while adhering to the principles of neutrality, transparency, independence and economic efficiency, so as to offer a secure, efficient and high quality electricity service to society as a whole.

In 2014, 600 km of new lines and 95 new substation bays came into service, and transformation capacity was increased by 3,250 MVA, with a total investment in the transmission grid of Euros 493 million.

The most significant initiatives in terms of development and renewal of the transmission grid, by major works or axes, were as follows:

>> **Bescanó-La Farga-Santa-Llogaia axis:** this axis aims to reinforce the mesh of the 400 kV grid in Catalonia, allow for continuity in the new interconnection with France and support the supply to the high-speed train line between Barcelona and the French border. The axis has a 164 km line, 25 substation bays and 2 transformers. In 2014 the Bescanó-La Farga-Santa Llogaia line and the Santa Llogaia 400/220 kV conventional substation were brought into service.

>> **Almaraz-Guillena axis:** this axis aims to connect the Almaraz, San Serván, Brovales and Guillena substations, providing a north-south link with a region that has a generation shortfall, as well as supporting the expansion of the interconnection with Portugal and the region's distribution grid, allowing for the evacuation of newly generated renewable energy. In 2014, the Brovales-Guillena and Mérida-San Serván lines and the Almaraz ET substation were brought into service.

>> **San Martín axis:** this axis aims to facilitate the evacuation of energy produced by the Es Murterar thermal power station, which has 20 bays, a 12 km line and 2 transformers. In 2014, the San Martín, E/S San Martín and SE Alcudia substations were brought into service and construction of the San Martín de Alcudia line commenced.

>> **Aragón-Levante line:** this line was created to connect the Aragón, Fuentetodos, Muniesa, Mezquita and Morella substations, enabling wind power generated by the new facility in the Maestrazgo region to be evacuated to Castellón. In 2014, authorisation was obtained for the Mezquita-Morella line and construction of the Morella substation commenced.

Actions to reinforce international and inter-island interconnections included the following:

>> **Interconnection with Portugal:** the Puebla de Guzmán-Portuguese border line that came into service in 2014 has increased the interconnection capacity between Spain and Portugal and brought greater operating security.

>> Interconnection with France: this new line extends between the two transformers located in Santa Llogaia (Spain) and Baixas (France) and came into service in December 2014. This infrastructure has doubled the current capacity for electricity exchange between these two countries bringing it to 2,800 MW, while heightening the security of the two electricity systems and opening the door for integration of a greater volume of renewable energy.

This project is being carried out in conjunction with Réseau de Transport d'Électricité (RTE) through the French company INELFE, in which the Spanish and French transmission system operators each have a 50% stake, and has been classified as a priority by the European Union. Its characteristics make this project a technical challenge of the highest degree.

In 2014, both transmission system operators - REE and RTE - conducted studies for a new west-side interconnection that would increase the exchange capacity to European Union recommended levels.

>> Inter-island interconnections: the main goal of the Mallorca-Ibiza interconnection is to put an end to the present isolation of Ibiza in electricity terms, as well as to enable system cost savings and encourage competition in energy generation on the islands. Although this is the main project, other inter-island interconnection projects are also underway to connect Mallorca-Menorca, Ibiza-Formentera and Lanzarote-Fuerteventura.

In 2014 the entry into service of the Vilanova-Valldigna-Gandía (31.3 km) and the Costa de la Luz-Onuba (25.7 km) lines, amongst others, is also noteworthy, as well as various 400 kV and 220 kV substations. Initiatives conducted at several facilities under construction, including the Boimente-Peso line, should also be highlighted.

In 2014 implementation of the MAR (network asset enhancement) Plan in non-mainland systems gathered momentum, with a considerable volume of maintenance and renovation works being carried out on the transmission grid. As a result, 53% of bays have already been integrated in the Balearic Island electricity system and 50% in the Canary Island system.

The most notable events in 2014 were as follows:

>> Mainland energy demand amounted to 243,395 GWh, down 1.2% on 2013. Having corrected for the effect of working patterns and temperatures, demand attributable primarily to the economic activity has brought the rate of decline down to 0.2%, a notably lower drop than the prior year's 2.2%.

>> Maximum instantaneous power was recorded on Wednesday 4 February at 8.18 pm, at a rate of 38,948 MW. This is down 3.3% on the maximum for the prior year. Peak demand in terms of time was also posted on 4 February (between 8 and 9 pm) at 38,666 MWh.

>> In 2014 the first auctions for the rendering of the interruptibility service were successfully completed. Specifically, the country's major industrial players competed to be assigned the service in auctions that awarded 3,020 MW of interruptible resources for 2015.

>> The CECRE (Renewable Energy Control Centre), a pioneer and benchmark worldwide in the supervision and control of renewable energies, has enabled energy production from renewable sources to record new all-time highs in 2014, in terms of daily and monthly wind power generation. In 2014, the production of energy from renewable sources represented 43% of total energy generated by the Spanish mainland electricity system.

For another year running, the key role played by wind power, which contributed 20% of annual energy production, positioned this technology as the second-ranking producer amongst the different types of energy available to meet demand, behind only nuclear energy. Furthermore, in January, February and November wind power technology made the largest contribution to total energy production in the Spanish mainland system, generating 29.2%, 27.8% and 25.8%, respectively.

- >> Moreover, in 2014 the system of cross-border balancing energy exchanges was established, enabling the exchange of surplus energy between neighbouring electricity systems using available interconnection capacity. This mechanism fosters competition amongst generation resources, optimises the use of international interconnections and favours the integration of renewable energy. It also represents another step towards the internal electricity market.
- >> Within the Balearic Islands system, the positive effects of the HVDC link-up that connects Mallorca with the mainland electricity system continued to emerge in 2014. This infrastructure substantially improves the quality and security of electricity supply on the islands of Mallorca and Menorca, preventing frequency limits being exceeded and avoiding power outages caused by generation losses. In addition, the electricity transmitted from the mainland covered 27% of the demand in the Balearic Islands, reaching peaks of 35% of hourly consumption. This represented a saving of 23% in the costs of covering the Balearic Islands electricity system and prevented around 340,000 tonnes of CO₂ being emitted into the atmosphere in Balearic Islands territory.
- >> In the Canary Islands electricity system, renewable power generation – wind and photovoltaic – accounted for 8% of the total in 2014, reaching levels of 32% in Tenerife and 35% in La Palma during the year, which are particularly promising levels for small isolated electricity systems.

In mid-2014 the Gorona del Viento hydro-wind plant was brought into service on the island of El Hierro, comprising an upper and a lower reservoir, a wind farm and a turbine pumping system, which operated under test conditions in the second half of the year.

- >> International electricity exchanges resulted in a net export balance, reaching 3,406 GWh in 2014, 49.4% less than in 2013.
- >> Exports amounted to 15,716 GWh (16,936 GWh in 2013) and imports totalled 12,310 GWh (10,204 GWh in 2013).

>> **Telecommunications business**

The telecommunications business focuses on the commercial operation of the surplus fibre optic network and associated infrastructure not used in electricity system operations. Since 20 November 2014, and for a period of 20 years, the Company has held the rights to use and manage the operation of ADIF's fibre optic network and other related items that are not used for railway services. At present, the Company is positioned as a neutral supplier of telecommunications infrastructure, its main customers being telecommunications operators and other private firms. It has a fibre optic network in excess of 32,000 Km rolled out over the electricity transmission grid and the railway network.

>> **International business**

The Group's international business is mainly carried out through its subsidiaries REDESUR, TESUR and REA, which manage transmission infrastructure in Peru.

In 2014, REDESUR's management excellence and its commitment to satisfying stakeholders allowed it to offer a transmission service with maximum availability, while improving financial results and supporting development in its operating environment.

The management process of REDESUR in 2014 included the full consolidation of its results for the year as a whole in Red Eléctrica Group following REI's purchase (in a joint transaction with its consortium partner AC Capitales) of the investments in Cobra Peru and Abengoa Peru in May 2013, whereby REI's stake increased from 33.75% to 55% of REDESUR's capital.

For REDESUR, consolidation of the Integrated Management System (IMS) has allowed the company to continue delivering excellent operating standards, with an availability factor for the grid of 99.87% in 2014 and an average of 99.75% for the past five years.

In 2014, TESUR's construction period for the 220 kV transmission line between Tintaya and Socabaya in the south of Peru drew to a close. The concession for this line was awarded to the subsidiary TESUR in 2010. The facilities were brought into service satisfactorily, meeting the deadlines undertaken with the Peruvian State and Regulator. TESUR has therefore now commenced its 30-year operation period for this concession.

The project entailed the construction of a dual-circuit 205 km 220 kV line and also includes the extension of the Socabaya substation (220 kV), the extension of the existing Tintaya substation (138 kV) and the construction of the new Tintaya substation (220 kV).

REA has continued to render facilities maintenance services to REDESUR. In 2014, REA was involved in the supervision of the TESUR facilities and helped to bring these into service, and collaborated in the implementation of the special projects undertaken by REDESUR. The company also carried out maintenance work on its facilities and supervised work for other clients, consolidating its position in southern Peru as a leading provider of such services.

2. BUSINESS PERFORMANCE

2.1 Key financial indicators

Revenue for 2014 amounted to Euros 1,846.7 million, up by 5.0%. This increase is due to the revenues from the new transmission facilities which started operating in 2013 and the rise in revenues from system operation services rendered, in accordance with the 2014 Tolls Order. From 20 November 2014 revenues associated with the rights to use and operate ADIF's fibre optic network have been included.

EBITDA amounted to Euros 1,385.4 million, up 6.4% on the prior year. EBITDA was favourably affected by the trend in operating expenses:

- >> Costs of supplies and other operating expenses fell by 2.8% on 2013.
- >> Personnel expenses rose by 4.5%. The Group's average headcount at 31 December 2014 was 1,737 employees, 1.1% higher than in the prior year. The year-end headcount was 1,742 employees.

The net finance cost was Euros 95.7 million, and includes the Euros 52.3 million compensation for the nationalisation of TDE. Finance costs amounted to Euros 160.2 million, Euros 23.4 million less than in the prior year. This improvement is primarily a result of the lower average interest rate on debt, which was 3.49% in 2014, 35 basis points less year-on-year. In addition, the average balance of gross financial debt was Euros 5,047 million, Euros 127 million less than the average for 2013.

As a result, profit before tax was Euros 853.5 million, 16.4% higher than in the previous year. Profit for the year was Euros 717.8 million, up 35.7% year-on-year. In addition to the above effects, profit for the year also reflected Euros 106.1 million less of tax expense, in accordance with the new Corporate Income Tax Law 27/2014. This amount, which does not entail lower income tax payments in 2014, is a result of a decrease in deferred tax liabilities as a consequence of the reduction in the tax rate from 30% to 28% in 2015 and to 25% from 2016.

If the impact on profit of the compensation received for the nationalisation of TDE, the reduction in tax rates stipulated in Corporate Income Tax Law 27/2014 and the contract with ADIF at year end are eliminated, profit for the year would have risen by 5.4%.

Investments in 2014 amounted to Euros 957.6 million and included Euros 492.6 million to develop the transmission network in Spain and the impact of the agreement signed to acquire the rights to use and operate ADIF's fibre optic network, in an amount of Euros 433.7 million

The dividends paid at 31 December 2014 amounted to Euros 343.8 million, 7.8% more than in 2013.

As a result, in 2014 the RED ELÉCTRICA Group's net financial debt rose by Euros 867.4 million compared to the prior year, up to Euros 5,408.5 million at 31 December.

In terms of debt structure, 79% bears interest at a fixed rate and the remaining 21% has a floating rate.

The RED ELÉCTRICA Group's equity stood at Euros 2,552.5 million, up 14.7% on the 2013 year end. This growth was primarily a result of the profits for the year, reduced by the corresponding distribution of dividends.

FINANCIAL INDICATORS

(millions of Euros)

	2013	2014	Δ%
Revenue	1,758.3	1,846.7	5.0%
(EBITDA)	1,301.9	1,385.4	6.4%
(EBIT)	898.7	949.2	5.6%
Net profit	529.1	717.8	35.7%
ROE (PAT/Equity)	23.8%	28.1%	18.2%
Cash flows from operating activities	1,191.9	512.0	-57.0%
Distribution of dividends	319.0	343.8	7.8%
Equity	2,224.6	2,552.5	14.7%
Gearing	67.1%	67.9%	1.2%
Investments	596.0	957.6	60.7%
Total assets	9,419.9	10,558.0	12.1%
Debt service coverage ratio (Net debt/EBITDA)	3.49	3.90	12.0%

2.2 Environmental issues and personnel

2.2.1 ENVIRONMENTAL ISSUES

The RED ELÉCTRICA Group carries out its activities in accordance with strict environmental criteria incorporated into and enforced through the Company's environmental policy.

The commitment to the environment originates from Group management, which defines the environmental policy (reviewed and approved in 2014 by the Steering Committee) and implements measures to comply with environmental requirements. The Company Chairman, who has ultimate responsibility for environmental issues, has appointed the General Manager of Transmission as the specific representative of the Environmental Management System, which is ISO 14001 certified.

The involvement of all of the organisational units and the commitment of all of the Group's employees are essential to the implementation of this system. A specific environmental department therefore exists within the Group's organisational structure to provide technical support.

The main environmental challenges facing the RED ELÉCTRICA Group are as follows:

- >> Ensuring that facilities are compatible with the environment, selecting layouts and locations to minimise environmental impact. Its application of preventative and corrective measures and strict environmental criteria in all stages of activity means that the potential impact on the environment is immaterial.
- >> Ensuring the protection and conservation of biodiversity, to which end the Group has implemented a specific strategy covering the following areas of action: protection of fauna and flora (particularly birdlife), fire prevention and development of conservation projects. In 2014, REE received the European Business Award for the Environment (EBAE), in

the special Business and Biodiversity category, for its "Birds and power lines: Mapping of bird flight paths" project (an award that it also received in the Spanish section of these awards).

- >> Contributing to the fight against climate change, which has led the RED ELÉCTRICA Group to define its climate change strategy (reviewed and approved in May 2014) and action plan to reduce emissions. Various measures have been implemented concerning energy savings and energy efficiency, primarily in relation to sustainable transport and reducing electricity consumption.

Ordinary expenses incurred by the RED ELÉCTRICA Group in 2014 in relation to the protection and improvement of the environment amounted to Euros 20 million. In addition, investment in environmental actions totalled approximately Euros 3 million in 2014.

2.2.2 PERSONNEL

All of the actions and projects are informed by the principles of efficiency and quality, equal opportunities, talent management, fair and equitable remuneration, a healthy company, understood to refer to physical, psychological and social wellbeing, dialogue and transparency; all of which underpin the Group's Human Resources Master Plan and corporate policies.

All of the actions and projects included in the plan are aimed at achieving the following objectives:

- >> Creation of stable employment: a highly qualified, motivated and committed team is key to RED ELÉCTRICA fulfilling its responsibilities and responding to the energy-related challenges of the coming years.

A Mobility Model has been set in place at Red Eléctrica de España, boosting the abilities of its people by enhancing their multidisciplinary skills and employability, as well as development of the leadership

model, thereby catering to the company's short- and mid-term needs. Furthermore, the signing of the 10th Collective Bargaining Agreement represents another step towards stable, quality employment, introducing measures such as increased efficiency and striking a better work/life balance, key to attracting and retaining talent at the Group. In fact, Red Eléctrica de España placed 22nd in the international Merco Personas index, which selects the 100 best companies to work for in the country, assessing the quality of their labour policies, their internal reputation and the brand as an employee, and was named the leading company in the energy sector in the 2014 ranking of the top 100 best companies to work for.

- >> Remuneration: we work with a global remuneration and incentives package that attracts and motivates people. Fair, internally equitable and externally competitive, it recognises and respects diversity and encourages professional development and the desire to excel.
- >> Talent Management: design of the "Global Talent Management Model", helping to bring the training and development systems into line with one another, as well as managing know-how within the Group in the mid- to long-term, thus enabling the Group to hold on to its position as a national and international benchmark. 2014 saw the consolidation of RED ELÉCTRICA's Corporate Academy (ECRE) for the management of in-company business training, drawing on in-house instructors and experts from across the various company units.

The RED ELÉCTRICA Group aims to recognise potential, both in technical positions and departmental heads, launching international and cross-departmental mobility projects. To this end, Talent Panels were set up as an instrument to enable validation and consensus.

A multidisciplinary working group was assembled in 2014 with a view to launching and developing a global knowledge management model.

The project will yield a host of benefits, such as cost-cutting by preventing the loss of key expertise, improving business results via the capacity to extrapolate and manage the know-how associated with the company's best practices, and boosting employee morale.

Working in tandem with the education sector, 110 recent graduates were able to perform work experience at the company, thanks to the PRACTICA+2014 scholarship program.

- >> Diversity and equality: commitment to diversity and equality is intrinsic to the RED ELÉCTRICA Group's culture, and is enshrined within the company's code of ethics and internal policies. The goal is to foster a working environment in which all employees, regardless of gender, age or ability, can access and develop their professional career.
- >> Promoting integration: the RED ELÉCTRICA Group has designed a Management Model and a Global Disability Plan with a view to raising awareness among employees, going beyond its statutory obligations and integrating disability within the company's various processes and disabled persons within its workforce, taking part in job forums targeting this segment and initiatives seeking to integrate university students within the business world.
- >> Gender equality and equal opportunities: the Group has had an Equality Plan in place since 2009, bringing together initiatives aimed at promoting a level playing field for men and women in the areas of employment (recruitment, promotion and hiring), training and development, remuneration and awareness-raising activities.
- >> Work/life balance: developments in recent years in the work/life balance model have enabled the RED ELÉCTRICA Group to enhance its HR management strategy.

The challenge lies in being able to assess, on a case-by-case basis, the dual demands placed on people (work-personal life) in order to manage the work/life balance more flexibly, based on a mutual commitment between the company and its people, with a view to enhancing wellbeing and quality of life.

>> Health and safety: 2014 saw the design of the healthy company model that sets out the general principles and guidelines to promote and safeguard the health, safety and wellbeing of employees, with the drawing up of an action plan for the next three years. The RED ELÉCTRICA Group aims to cut down on occupational accidents and ensure continuous, ongoing improvement to levels of health and safety among its employees and the employees of suppliers collaborating or working at the Group's facilities.

The challenge lies in fostering and developing a healthy working environment and, by extension, a better quality of life.

>> Dialogue and transparency: the RED ELÉCTRICA Group is working on initiatives to promote a transparent, collaborative culture, encouraging two-way communication, facilitating the exchange of information and giving voice to the various segments.

>> Social dialogue: the RED ELÉCTRICA Group safeguards its employees' rights to trade union membership, association and collective bargaining within the framework of the labour legislation in force and the collective bargaining agreement. Collective bargaining is also a guiding HR principle.

Variations in average and final headcount in 2013 and 2014 were as follows:

	2013	2014	Δ%
Average headcount	1,718	1,737	1.1%
% Male	77.4%	77.1%	-0.3%
% Female	22.6%	22.9%	1.2%
Year end headcount	1,745	1,742	-0.2%

3. LIQUIDITY AND CAPITAL

The RED ELÉCTRICA Group has a liquidity policy to ensure payment obligations are met, by diversifying how financing requirements are covered and when debt matures.

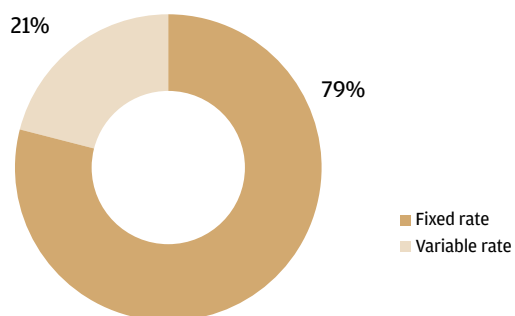
The Group's liquidity position is essentially based on robust cash flow generation, primarily through regulated activities. Coupled with appropriate management of collection and payment periods and current financial capacity through short and long-term credit facilities, this allows the Group to prudently manage its liquidity risk.

The undrawn balance on credit facilities at 31 December 2014 amounts to Euros 985.6 million.

The average maturity of the debt drawn down at the end of the year is 5 years.

The Group's traditional financial strategy has aimed to reflect the nature of its business, at all times adhering to legislation in force. Transmission and operation of the electricity system are very capital-intensive activities, wherein investments mature over long periods. In addition, the remuneration of these assets is for 40-year periods at rates linked to Spanish long-term government debt. Therefore, our financial debt is primarily long-term and fixed rate.

STRUCTURE OF FINANCIAL DEBT: FIXED vs. VARIABLE



The RED ELÉCTRICA Group's capital structure policy ensures a financial structure that optimises the cost of capital through a sound financial position, which balances the generation of value for shareholders with competitive costs of financing. Capital is periodically monitored through the gearing ratio, which in 2014 stood at 67.9%, compared to 67.1% in 2013. This ratio is calculated as net financial debt divided by equity plus net financial debt.

To maintain and adjust the capital structure, the Company can adjust the amount of dividends payable to shareholders, reimburse capital or issue shares.

4. RISK MANAGEMENT

Since 2002, the RED ELÉCTRICA Group has had a Risk Management System in place, which aims to ensure that any risks that might affect the Group's strategies and objectives are systematically identified, analysed, assessed, managed and controlled, according to uniform criteria and within the established risk levels, in order to facilitate compliance with the strategies and objectives of the RED ELÉCTRICA Group.

The Risk Management System is fully inclusive as all of the Group's units are involved, together with its various governing bodies, in accordance with the guidelines set out in the Comprehensive Risk Management and Control Policy and Procedures, in turn based on the Enterprise Risk Management Integrated Framework outlined in the Committee of Sponsoring Organizations (COSO II) report.

As already mentioned, the RED ELÉCTRICA Group's principal activity comprises regulated business in Spain and Peru.

The fact that the activities are regulated affects revenue and the conditions under which the principal activities must be carried out. In view of this, it is important to note that regulatory risks could arise from the possibility of changes to the legal framework applicable to the activity, which could affect both revenue and costs either directly or by establishing new requirements.

There are also operational risks related to possible process inadequacy or failure, which could have a social and economic impact. The financial risks are described in note 15 to the accompanying consolidated annual accounts.

The Group has analysed the risks to which it is exposed and produced a risk map identifying each risk, classifying them by level (high, medium or low) according to their probability and the impact they would have

if they were to materialise. According to the risk policy, any risk that exceeds tolerance levels must be automatically addressed with specific actions to make the risk manageable and ensure the costs incurred are in proportion to the prevented risk.

The Internal Audit and Risk Control Department, part of the Department of Regulation and Global Risk Control, reviews the progress and impact of the previously established risk management plans in conjunction with the organisational units on a half-yearly basis for high-level risks and annually for other risks.

5. SIGNIFICANT EVENTS OCCURRING AFTER THE REPORTING PERIOD

On 23 January 2015 the Company entered into an agreement with UNELCO for the transfer of the Chira-Soria 200 MW reversible hydroelectric power plant project in Gran Canaria. This agreement complies with the provisions of Ministry of Industry, Energy and Tourism Order IET 728/2014 (see note 3 to the accompanying consolidated annual accounts).

On 12 February 2015, Red Eléctrica Internacional S.A.U., in consortium with AC Capitaes, was awarded the concession of the 115km/220kV Azángaro-Juliaca-Puno line and associated substations in Peru. This project involves the design, construction, operation and maintenance of the line for 30 years and the expected investment is USD 70 million.

No other significant circumstances have arisen after 31 December 2014.

6. OUTLOOK

As the Parent of the RED ELÉCTRICA Group, REC will work to ensure that, through their activities, the Group companies contribute to fulfilment of the objectives laid down in the Group's Strategic Plan.

To this end, Group companies will be encouraged to develop both their regulated businesses and their unregulated businesses, in Spain and abroad, in accordance with the above principles and focusing on the efficiency required by current conditions.

Implementation of the strategy, based on excellence, innovation and personal development, will allow the Group to maintain its current leadership in terms of the reliability and security of the electricity grids it operates and the excellent standards in other activities.

REC remains committed to maximising value for its shareholders, offering an attractive dividend yield and contributing to a re-rating of its shares through efficient business management, analysing alternative means of generating value for shareholders.

The Group will therefore continue to seek the generation of long-term value, creating lasting, competitive advantages and improving our corporate reputation, whilst focusing on providing optimum service to society – the differentiating feature of the Company's management.

The performance of the RED ELÉCTRICA Group's regulated activities in Spain is primarily based on the following lines of action:

- >> Market integration and the sustainability of the electricity system, which justify maintaining the level of investment in the transmission grid in coming years, in accordance with the new remuneration framework.

The investment plan will focus on bolstering the process of reinforcing the structure and mesh of the grid and developing interconnections, especially in non-mainland systems.

- >> A goal of efficiency, maintaining the RED ELÉCTRICA Group's position as an international benchmark.

Accordingly, the Group will review its main operating processes, promoting streamlined and flexible organisation that optimises the Company's profitability and the efficiency of the electricity grid in the mainland and non-mainland systems.

- >> Implementation of new regulated activities, such as storage of energy in the island systems as a tool to guarantee the security of the Spanish electricity system.

The RED ELÉCTRICA Group will apply a financial policy adapted to the new remuneration model for the transmission activity in Spain, ensuring that financial debt is diversified and its liquidity position can comfortably cover upcoming maturities, aiming for a financial structure that is as flexible as possible.

7. RESEARCH, DEVELOPMENT AND INNOVATION (R&D&I)

In 2014 the Innovation and Technological Development Plan for 2012-2016 was updated for adaptation to the current technological environment and the new strategic and financial outlook, and progress has been made towards achieving its objectives. Throughout 2015 work on a new edition of the Plan will be ongoing, with the purpose of establishing the technological strategy for 2016-2020, in line with the new Strategic Plan of the RED ELÉCTRICA Group.

Furthermore, a new computer system was launched to manage the technical progress of the R&D&i projects, enabling the active participation of employees and promoting the development of new ideas and technology.

In the international sphere RED ELÉCTRICA made efforts to prepare the "2015-2017 Implementation Plan", which includes the technological initiatives that must be undertaken in the next three years as part of the ENTSO-E R&D&i plan; and also collaborated on a joint roadmap for energy technology as part of the European Union SET-Plan "Towards an integrated Roadmap: Research & innovation challenges and needs of the EU Energy system". A new ENTSO-E Monitoring report has also been drawn up, focused on analysing how TSOs are using the results obtained from the European R&D&i projects completed in recent years.

The European BEST PATHS (BEyond the State-of-the-art Technologies for re-Powering Ac corridors & multi-Terminal HVDC Systems) project started in October, financed by the European Union's Seventh Framework Programme for research. REE coordinates this project, which comprises five large-scale demonstrations with a total budget of Euros 62.8 million (including EU financing of Euros 35.5 million), involving 39 different partners, including universities, technological centres, industrial companies, electricity companies and European TSOs. This project is a continuation of TWENTIES, completed in 2013.

In addition, 2014 saw the completion of the European GRID+ project (which supported EEGI – European Electricity Grid Initiative – in the coordinated design of a joint R&D&i roadmap between TSOs and DSOs); and a new project is forecast to begin at the start of 2015 to extend the support given to the European Commission in the GRID+ project. Lastly, RED ELÉCTRICA has continued to work on e-HIGHWAY 2050 (optimum planning of the long-term pan-European transmission system – 2050).

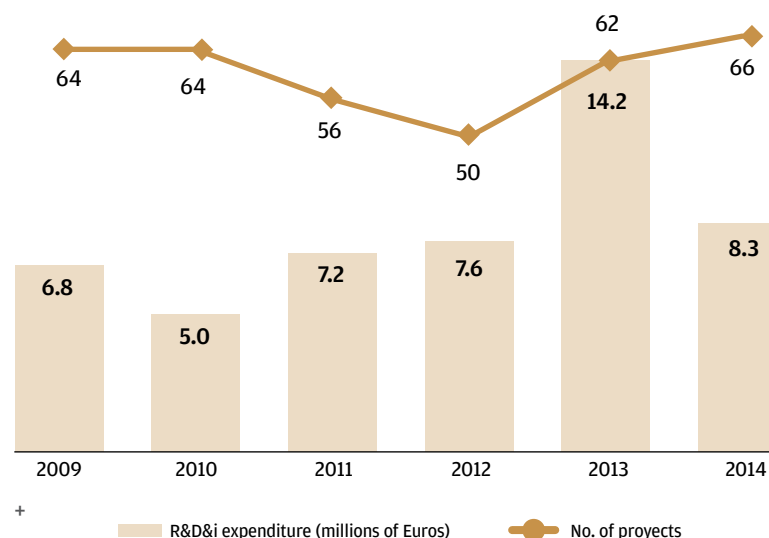
Of the projects linked to national innovation programmes, work has continued on projects associated with the INNPACTO programme: ESP-Líder (SSSC device to redirect current flows, in Torres del Segre) and PRICE (Joint Smart Grid Project in the Henares Corridor), promoting residential demand management, led by Iberdrola and Gas Natural Fenosa, and recipient of the European Electricity Grid Initiative Core Label in recognition of the project's alignment with the criteria and objectives laid down in the European Electricity Grid Initiative.

Notable events in the national sphere included the installation and start-up of a flywheel in Mácher (Lanzarote) to stabilise the frequency of the Lanzarote-Fuerteventura electricity system; and the exploitation of results from the battery installed in Carmona (Seville), as part of the ALMACENA project, with the collaboration of EPRI (Electric Power Research Institute), for the international benchmarking of the installed equipment. Both pieces of equipment completed the testing successfully and are available for the system operator. These assets mark a major milestone in the Group's objective to demonstrate useful innovative technology to improve aspects such as energy efficiency, the integration of renewable energy and system stability.

Also throughout 2014 work continued on the research undertaken to support the PERFILA project, which seeks to improve the profiling methodology, based on a consumer panel equipped with smart meters.

During the year many other projects were completed, such as the new functionalities of SAIR (Automatic Grid Inspection System), the upgrade of demand coverage calculation tools, software for the simulation of induced voltages on the shielding of buried cables, the methodology for controlled transformer energisation manoeuvres, and the study on the possible impact of geomagnetic solar storms on the Spanish electricity system.

In 2014 RED ELÉCTRICA's R&D&i efforts amounted to Euros 8.3 million, with 66 projects entailing more than 39 thousand hours of work by Group personnel, equivalent to more than 23 full-time staff. Although markedly less than in the prior year (Euros 14.2 million), when major equipment that had been worked on for years was brought into service, this investment consolidates a growing trend since 2009, namely the commitment to technological innovation and development, as shown in the chart below.



8. OWN SHARES

In order to provide investors with adequate levels of liquidity the Company acquired 1,697,105 shares with a total par value of Euros 3.4 million and a cash value of Euros 107.3 million in 2014. A total of 1,588,278 shares were sold, with an overall par value of Euros 3.2 million and a cash value of Euros 101.9 million.

At 31 December 2014 the Company held 147,203 own shares, representing 0.11% of its share capital. These shares had an overall par value of Euros 294 thousand (see note 11 to the accompanying consolidated annual accounts) and a market value of Euros 10,777 thousand.

The Parent has complied with the requirements of article 509 of the Spanish Companies Act, which provides that the par value of acquired shares listed on secondary markets, together with those already held by the Parent and its subsidiaries must not exceed 10% of the share capital. The Company's subsidiaries do not hold own shares or shares in the Parent.

9. OTHER RELEVANT INFORMATION

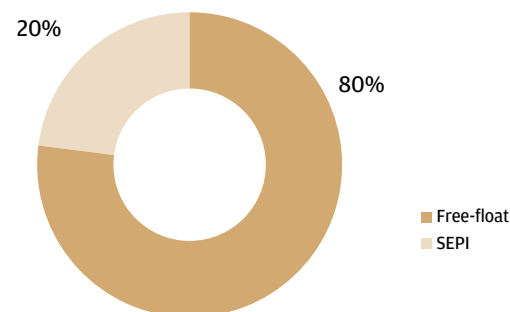
9.1 Stock market performance and shareholder returns

All of the shares in Red Eléctrica Corporación (REC), the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 2.07% at the end of 2014.

At 31 December 2014, the share capital of REC amounted to Euros 270,540 thousand and was represented by 135,270,000 shares with a par value of Euros 2 each, subscribed and fully paid. During 2014 there were no changes that affected the number of outstanding shares or their par value.

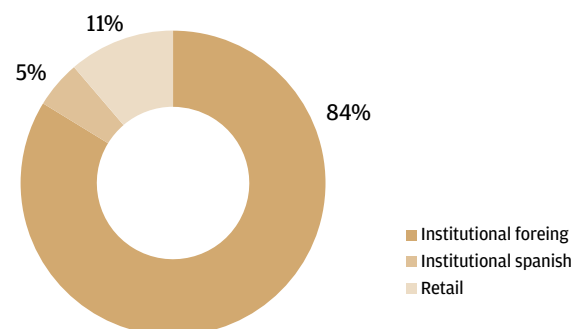
In 2014 Red Eléctrica's free float was 80%.

OWNERSHIP STRUCTURE



At the date of the last shareholders' meeting – 9 May 2014 – the free float comprised an estimated 108,216,000 shares, of which 11% is held by non-controlling shareholders, 5% by Spanish institutional investors and 84% by foreign institutional investors, primarily in the United States and the United Kingdom.

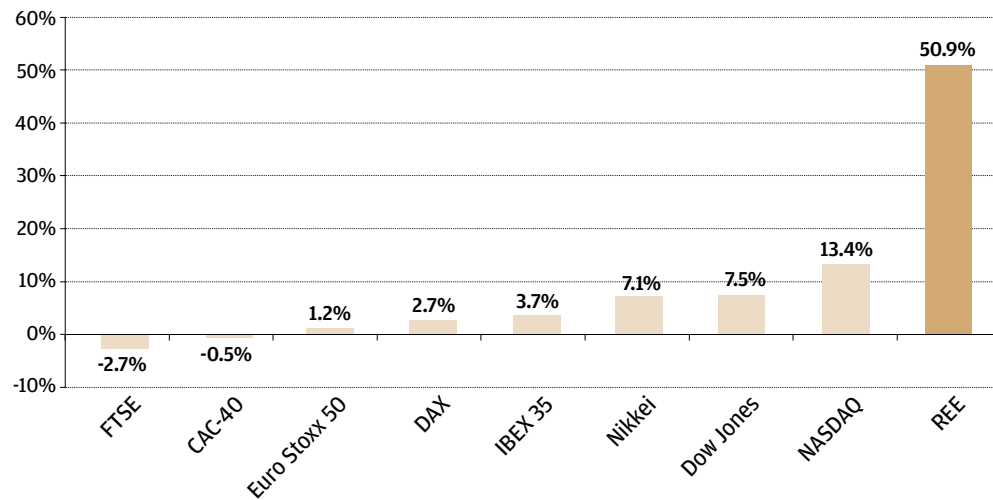
DISTRIBUTION OF THE FREE-FLOAT



In stock market performance, US markets have continued to rise, reflecting the good times in the country's economy, and indexes such as the Standard & Poor's 500 and the Dow Jones have again broken above the all-time highs set in the prior year, with gains of approximately 10%. The Nikkei climbed by 7%, primarily as a result of new fiscal measures to boost the Japanese economy.

However, in European stock markets doubts about the recovery led to major indexes closing at similar levels to the prior year. The same was true for developing countries, where stagnating exports and falling raw material prices have had a knock-on effect on stock markets.

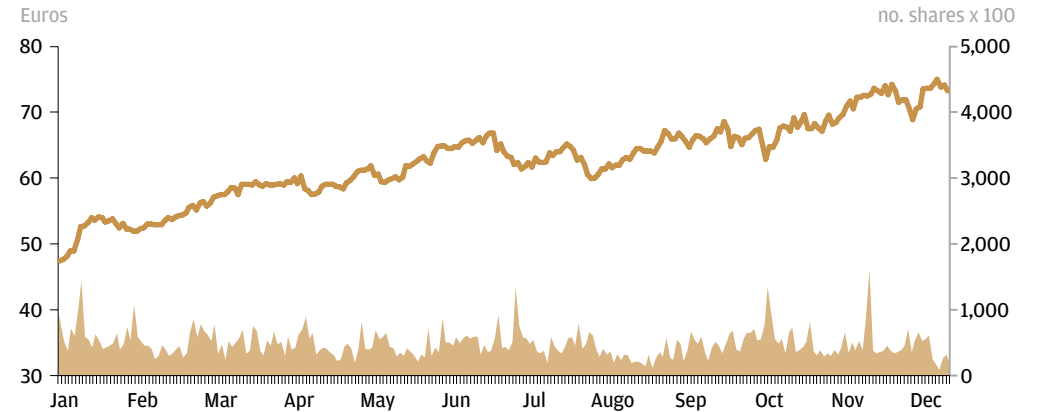
PERFORMANCE OF RED ELÉCTRICA AND MAJOR STOCK MARKET INDEXES - 2014



Red Eléctrica's stock market performance in 2014 could be classed as extraordinary. The company's shares climbed more than 50% over the year, against a backdrop of removal of much of the regulatory uncertainty linked to its core business, teamed with improved country risk, with Spain no longer considered a high-risk investment.

The market capitalisation of the Company at the end of 2014 was Euros 9,903 million.

SHARE PERFORMANCE AND DAILY VOLUME



In total, 241.5 million shares were traded in 2014, which is 1.79 times the Company's share capital. In cash terms, Euros 15,184 million was traded, up on the Euros 13,171 million traded in the prior year.

9.2 Dividend policy

The dividends paid in 2014 amounted to Euros 344 million, 7.8% more than in 2013.

The board of directors has proposed a dividend of Euros 3 per share with a charge to 2014 profit, pending approval by the shareholders at their general meeting, reflecting a year-on-year increase of 18%.

Based on the projections and estimates contained in the Group's Strategic Plan for 2014-2019, the dividend could be around 7% higher. This increase is considered as the average annual rate for the period covered by the Strategic Plan, on the basis of the total dividend approved with a charge to 2014.

The dividend will be paid in two instalments - an interim dividend in January and a supplementary dividend half way through the year following approval of the annual accounts by the shareholders at their general meeting.

9.3 Credit rating

Red Eléctrica has been assigned a long-term credit rating of BBB by Standard & Poor's with a positive outlook, and a short-term rating of A-2.

Fitch's long-term rating for Red Eléctrica is A-, also with a positive outlook, and its short-term rating is F2.

Both rating agencies highlight the Company's predictable and recurrent revenues and strong balance sheet as its fortes.

9.4 Excellence and corporate responsibility

Corporate responsibility is part of the corporate culture of the RED ELÉCTRICA Group, providing a framework for all of its activities, to fulfil its mission as operator and sole transmission agent for the Spanish electricity system. The Group's objective is to consolidate its position as a sustainable, ethical and responsible company, managed in accordance with criteria of excellence and responsibility in its operations.

This focus on sustainable development is reflected at a strategic level, as the pursuit of excellence and responsible business practices constitutes one of the Group's four basic strategies, which is rolled out to operations through management.

The RED ELÉCTRICA Group's performance in terms of corporate responsibility is subject to ongoing analysis and assessment. In 2014, the Group was included in the following sustainability indexes: FTSE4Good, Euronext Vigeo, ESI Excellence Europe, MSCI and Natural Capital Efficiency Leader.

Since 1999, the Group has applied the EFQM Excellence Model (European Foundation for Quality Management), aiming for ongoing improvements to the Company's management and results.

In 2014 the Group retained its European Seal of Excellence 500+, which was renewed in 2013, with a rating of 650 to 700 points, as awarded by Club Excelencia en Gestión (CEG), the official representative in Spain of the European Foundation for Quality Management.

The excellence management system is in turn based on a process management approach. In 2014 the corporate process management methodology was revised and the process manual was updated. During the year, a project was carried out to design, inventory and implement a scorecard for key indicators, aligned with the new process map.

The Group's processes integrate a Corporate Quality Management System based on international standards. Since 2000, a certified system has been in place covering all of the company's processes, which is audited annually. In 2014 all of the certified corporate management systems underwent a third audit (quality, environment, health and safety, corporate responsibility and energy efficiency)

ANNUAL CORPORATE GOVERNANCE REPORT

The Annual Corporate Governance Report forms an integral part of the Directors' Report and can be viewed at the following address:

<http://www.cnmv.es/Portal/consultas/EE/InformacionGobCorp.aspx?nif=A-78003662>

The various sections of this consolidated director's report contain certain prospective information that reflects projections and estimates based on underlying assumptions, statements referring to plans, objectives and expectations associated with future transactions, investments, synergies, products and services, as well as statements concerning results or future dividends, or estimates calculated by the directors and based on assumptions that those directors consider reasonable.

While the Group considers the expectations reflected in those statements to be reasonable, investors and holders of shares in the Parent are advised that the information and statements containing future projections are subject to risks and uncertainties, many of which are difficult to foresee and generally beyond the Group's control. As a result of such risks, actual results and developments could differ substantially from those expressed, implied or forecast in the information and statements containing future projections.

The affirmations and statements containing future projections do not provide any guarantee as to future results and have not been reviewed by auditors outside the Group or by other independent third parties. It is recommended that no decisions be made on the basis of the affirmations and statements containing future projections that refer exclusively to the information available at the date of this report. All of the affirmations and statements containing future projections that are reflected in this report are expressly subject to the warnings given. The affirmations and statements containing future projections included in this document are based on the information available at the date of this directors' report. Except as required by applicable legislation, the Group is not required to publicly update its statements or review the information containing future projections, even where new data is published or new events arise.



*Click on the symbol
and regarding the
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