



INDEPENDENT
AUDITORS'
REPORT



CONSOLIDATED
STATEMENT OF
FINANCIAL POSITION



CONSOLIDATED
ANNUAL ACCOUNTS



CONSOLIDATED
DIRECTORS'
REPORT



CONSOLIDATED DIRECTORS' REPORT



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1 Company position

1.1. ORGANISATIONAL STRUCTURE

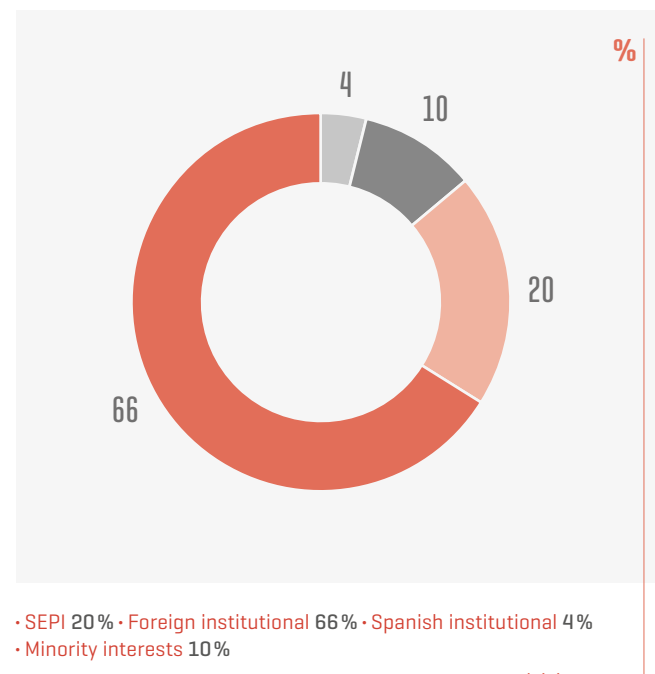
Corporate bodies

The board of directors and the shareholders are responsible for governing and managing the Red Eléctrica 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 2017 shareholders' ordinary general meeting was as follows:

Ownership structure

[FIGURES FROM THE GENERAL SHAREHOLDERS MEETING OF 2017]



The board of directors has formed two permanent committees: the Audit Committee and the Appointments and Remuneration 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.



At 31 December 2017, REC's board of directors comprised 12 members.

The general shareholders' meeting of 31 March 2017 approved the re-election of María José García Beato as an independent director, and agreed the ratification and appointment of Arsenio Fernández de Mesa and Díaz del Río as independent directors, and the appointment of Alberto Francisco Carbajo Josa as an independent director.

At its meeting of 25 April 2017, the board of directors appointed Arsenio Fernández de Mesa as an independent director, and Díaz del Río as a member of the Audit Committee, to cover the vacancy left by the proprietary director Santiago Lanzuela Marina, and it also appointed the proprietary directors Alberto Francisco Carbajo Josa and Santiago Lanzuela Marina as members of the Appointments and Remuneration Committee, in order to cover the two vacancies on said Committee.

In a meeting held on 31 October 2017, the board of directors appointed Mercedes Real Rodrigálvarez i) as a proprietary director of REC, in representation of Sociedad Estatal de Participaciones Industriales (SEPI), until the next General Shareholders' Meeting, so as to cover the vacancy on the board following the resignation of José Ángel Partearroyo Martín, and ii) as a member of the Appointments and Remuneration Committee; the board also appointed José Luis Feito Higuera to the Appointments and Remuneration Committee; it appointed Socorro Fernández Larrea to the Audit Committee, to cover the vacancy left by José Luis Feito Higuera; and it re-elected Antonio Gómez Ciria, independent director, as a member of the Audit Committee.

In the meeting held on 20 November 2017, the Audit Committee elected Antonio Gómez Ciria as its chairman.

In its meeting of 27 November 2017, the Appointments and Remuneration Committee appointed José Luis Feito Higuera as its chairman.



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

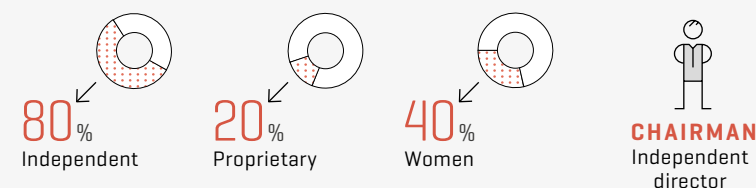
BOARD OF DIRECTORS



Main competences

- Approval of the general policies and strategies of the Company and the Group.
- Risk Monitoring for the Company and the Group.
- Drawing up annual accounts and submitting them to the General Meeting.
- Annual evaluation of the quality and efficiency of the Board and the functioning of its Committees.

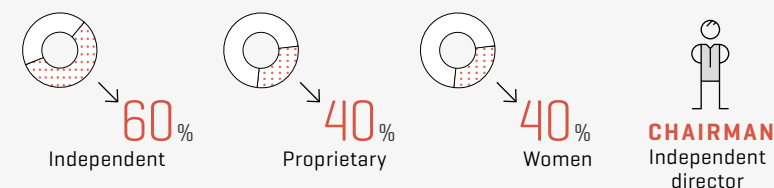
AUDIT COMMITTEE



Powers relating to

- The procedure for preparing the economic and financial information of the Company.
- The effectiveness of the internal monitoring and risk management systems.
- The independency of the external auditor.
- Compliance with legal provisions and internal regulations on the matters within its scope of action.
- The Company shareholders.

APPOINTMENTS AND REMUNERATION COMMITTEE



Powers relating to

- Appointment and removal of directors and some members of senior management.
- The policy of directors' remuneration.
- Directors fulfilment of their duties.
- Directing the process for evaluating the Board and its Committees.
- The annual report on diversity and equality.
- Corporate liability and sustainability.



In response to the commitment undertaken by the company chairman at the general shareholders meeting held in April 2012, and considering international best practice in the field of corporate governance, at the extraordinary meeting held on 17 July 2015, called specifically for that purpose, the board of directors of Red Eléctrica asked shareholders to approve a proposal to separate the positions of chairman of the board of directors and chief executive of the company, and to appoint Juan Lasala Bernad as chief executive officer. The two motions were passed, with votes in favour from 99% of the shareholders, compared to the required quorum of 58%. At its meeting of 28 July 2015, the board of directors appointed the new executive director as chief executive of the company.

For the process of separating powers, a transition period was established which ended when the ordinary general shareholders' meeting of 2016 was held, with the complete separation of duties between the chairman of the board of directors and the chief executive. Since that meeting, the Chairman of the board of directors has only had the responsibilities inherent in that position.

Until the ordinary general shareholders meeting of 2016, the chairman retained his executive functions, focusing on managing, supporting and sponsoring the transfer of executive powers to the new chief executive officer to ensure a rational and orderly transition.

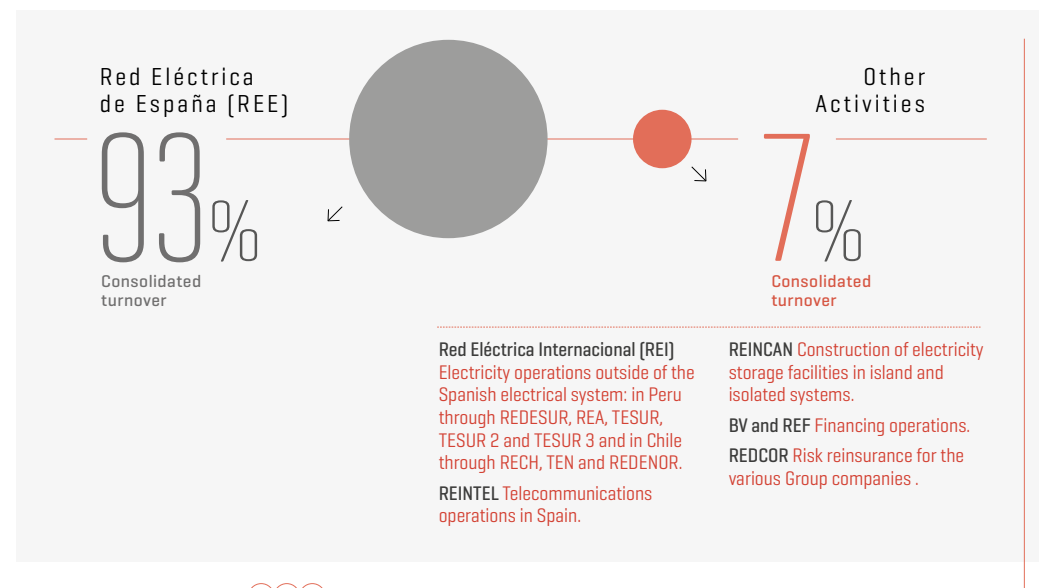
The figure of lead independent director, created in 2013, was maintained, since, based on the responsibilities attributed to the post, it is an efficient corporate governance practice, as acknowledged by shareholders and proxy advisors alike.

The Annual Corporate Governance Report, which is attached hereto, contains detailed information regarding the composition and operation of the governing bodies of 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. (hereinafter, REE), which generates 93% of consolidated revenues and represents 88% of the Group's total assets [92% and 92%, respectively, in 2016]. Other activities account for the remaining 7% of revenue and 12% of total assets [8% and 8%, respectively, in 2016]. The Group is present in six countries: Spain, Peru, Chile, the Netherlands, Luxembourg and France.

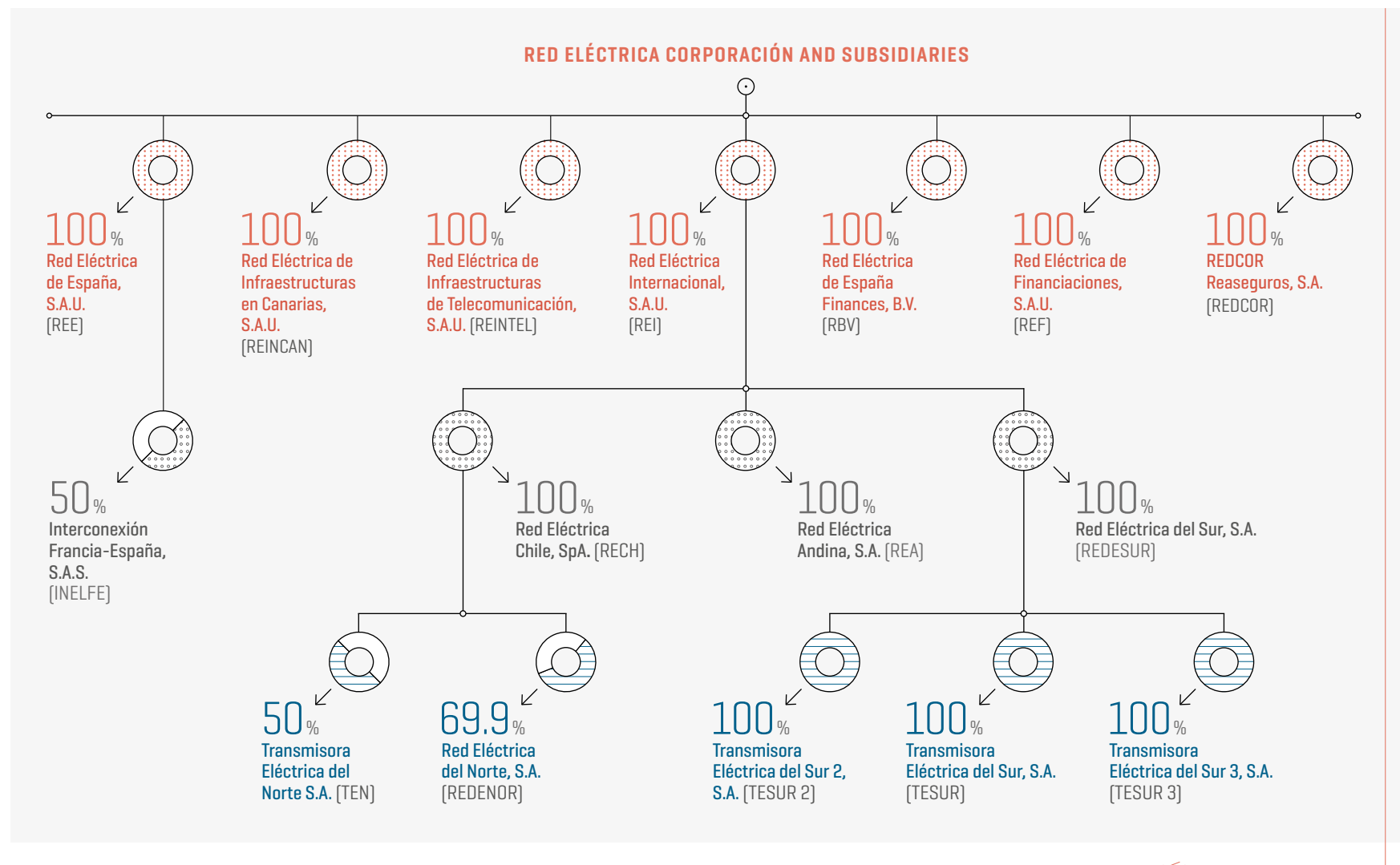
Red Eléctrica Corporación [REC]





In 2017, there were changes in the consolidated Group, as described in note 2g to the consolidated annual financial statements. At 31 December 2017, the composition of the

Group was as follows [for more information on the activity of each company, see Appendix I of 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, Peru and Chile, and rendering telecommunications services to third parties.

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

The mission of REE, as carrier and operator of the Spanish electricity system, is to guarantee at all times the safety and continuity of the electricity supply and manage the transmission of high voltage energy. To this end, it oversees and coordinates the generation and transmission system and manages the development of the transmission network. 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.

Approval of the 2015-2020 Plan injected the necessary certainty so as to execute the Investment Plan which the Company is implementing and will continue to execute in the next few years.

2017 is the second year in which the remuneration for the transmission activity has been set pursuant to the new remuneration model approved in 2013.

Investments in new facilities in the transmission network in 2017 totalled Euros 411.8 million and were basically to address technical restrictions, extend the network mesh, execute specific projects for international interconnections and inter-island underwater connections, and to ensure supply security and network.

This year, around 150 kilometres of transmission network entered into service, bringing REE's total transmission network to approximately 43,800 kilometres at the end of the year. Meanwhile, transformation capacity was increased by 1,210 MVA, bringing the nationwide total up to 86,654 MVA.

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

- Lanzarote - Fuerteventura axis: this axis is aimed at carrying out the necessary actions to build the grid mesh on both islands, enabling power to be harnessed and strengthening the connection between the two islands. In 2017, the first facilities of this axis came on stream, and these will be completed, with the rest of installations, in the coming years.
- Olmedo - Zamora axis: this axis is aimed at providing power to the Olmedo - Orense section of the Madrid - Galicia high-speed railway. The Tábara substation entered into service in 2017 and the Arbillera substation is scheduled to follow suit in 2018.
- Gerona Norte: this axis is linked to the interconnection with France which entered into service in 2014. Works continued on this axis in 2017, and it is expected to be completed in 2018.



- > Venta de Baños - Burgos - Vitoria: these facilities relate to the need to provide power to the Burgos - Vitoria high-speed railway link. In 2017, some of the facilities entered into service, and work will be ongoing in the next few years.
- > Campanario - Ayora - Cofrentes: aimed at building the grid mesh to consolidate mutual support between the regions of Castilla La Mancha and Valencia, and to strengthen the provision of power to the Madrid - Levante high-speed railway. Part of this axis is already in service. In 2017, new facilities came on stream, and work is scheduled to continue in the next few years.
- > Arkale phase-shifting transformer: this consisted of installing a 550 MVA machine in the 220 kV interconnection line between the substation of Arkale (Guipuzcoa) and Argia (France), to act as a power limiter enabling part of the power to be routed through a less congested route. This will be key to increasing the interchange capacity with Europe and ensuring supply security.
- > Western interconnection with France: triggered by the need to continue increasing the interconnection capacity with France, to achieve the European energy goals that will enable access to sustainable, competitive and safe energy, in 2017, the preliminary studies continued on the laying of underwater cables in continuous current in the Gulf of Biscay.

Moreover, in 2017, the key events in regard to the operation of the electricity grid system were as follows:

- > Mainland energy demand closed the year at 252,752 GWh, up 1.1% on 2016. Adjusting for labour and seasonal factors, attributable demand, mainly to economic activity, points to a growth rate of 1.6%, in contrast to the previous year, when it was 0%.
- > Maximum instantaneous power was recorded on Wednesday 18 January at 19:50 hours, at a rate of 41,381 MW, i.e. 2.2% higher than the previous year's maximum and 9.0% lower than the record of 45,450 MW posted on 17 December 2007. Peak demand in terms of time was also posted on 18 January [between 20:00 and 21:00 hours] at 41,015 MWh, 8.6% below the all-time high obtained in 2007.
- > Installed capacity on the mainland has fallen compared to the prior year, ending 2017 at 99,311 MW, which is 573 MW [0.6%] less than at December 2016. The biggest variation was seen in nuclear output, where power slid 455 MW as a result of the closure of the Santa María de Garoña plant. The capacity of other technologies either did not vary or changed only insignificantly.
- > The auctions for the rendering of the interruptibility service in 2017 were successfully conducted between 1 January and 31 May 2018. Specifically, the country's electricity-intensive industry competed for the allocation of interruptibility in auctions resulting in the adjudication of 2,600 MW of interruptible resources.



- > In 2017, renewable energy's percentage contribution to total energy generation in the electricity system shrank to 33.8% (40.8% in 2016).
- > Electricity exchanges through the mainland-Balearic Islands link resulted in a net balance of exports to the islands of 1,179 GWh [-5.7% compared with 2016], covering 19.5% of their demand.
- > Annual demand for electric power across all non-mainland systems ended in 2017 with a variation of 2.6% compared with the previous year. By grid, demand increased by 3.5% in the Balearics, by 2.1% in the Canaries and by 1.2% in Melilla, while it decreased by 3.5% in Ceuta.
- > International electricity exchanges resulted in a net import balance for the second consecutive year after a long period of exporting since 2004, and totalled 9,160 GWh in 2017.

In accordance with Law 17/2013, REE has been commissioned to develop the Pump-Storage Hydroelectric Plants in the Canary Islands, so as to guarantee supply, system security and the integration of non-manageable renewable energies.

In July 2016, the Project Reform and the extension of the Environmental Impact Study at the Soria-Chira plant in Gran Canaria commenced. The Public Disclosure process commenced in October and ended in December 2016. In May 2017, the Company renewed the concession for reservoir and basin of the Chira Dam for hydro-electric purposes. In September 2017, the Environmental Assessment began and in the November issue of the Official Journal of the European Union (OJEU) they advertised the need to recruit the services of an Engineer – Architect to prepare the project in detail, manage the works and provide technical assistance for the Reform.

With respect to the potential reversible pump in Tenerife, in 2017 the preliminary studies were conducted. More than 60 implementation alternatives were identified depending on the terrain, of which, having analysed the minimum power and energy requirements, those that are technically feasible were selected. In a second, more detailed study, these options were analysed based on economic, technical, environmental and social parameters. This work allowed the preferred locations to be chosen. Next year, the basic projects for the two top options are expected to be completed, so that the best can be chosen and the next measures implemented.



Telecommunications business

The Red Eléctrica Group's telecommunications business primarily operates in Spain, doing so through the subsidiary Red Eléctrica Infraestructuras de Telecomunicación, S.A.U. [hereinafter REINTEL].

REINTEL is the Red Eléctrica Group company responsible for operating telecommunications networks and rendering telecommunications services to third parties.

REINTEL is a neutral provider of telecommunications infrastructure. Its principal activity is leasing dark fibre and associated infrastructure. REINTEL operates a fibre network of more than 33,000 km deployed above the electric transmission grid and railway network, guaranteeing transparent access and equal conditions to its clients and players within the telecommunications sector.

No significant events were recorded in 2017 that could influence the performance of the business.

REINTEL won a 20-year concession for the rights to use and operate the fibre optic network not used for the railway business and other associated elements, owned by high-speed rail provider Adif - Alta Velocidad.

International business

The Group's international business is implemented through its subsidiary Red Eléctrica Internacional, S.A.U. [hereinafter, REI], which holds a direct 100% interest in the capital of Peruvian companies REA and REDESUR after acquiring, in January 2017, a 45% stake in the capital of REDESUR from Peruvian investment fund AC Capitaes. In turn, REDESUR

owns 100% of TESUR, TESUR 2 and TESUR 3. Furthermore, REI holds interests in the Chilean company RECH (100%) and, through it, a 69.9% stake in REDENOR and 50% of Transportadora Eléctrica del Norte, S.A [hereinafter, TEN].

In 2017, the management excellence of REDESUR and TESUR [the companies that manage transmission infrastructure in Peru] allowed them to offer a transmission service with maximum availability, while supporting development in their operating environment.

For REDESUR, consolidation of the Integrated Management System (IMS) has allowed the company to continue delivering excellent operating standards, with a network availability factor of 99.85% in 2017, above the average for the last five years [99.82%].

TESUR, meanwhile, is currently in the initial stages of operating the concession for the facilities, following its entry into commercial service in mid-2014. The availability factor for TESUR's network was 99.85% in 2017.

REA renders maintenance services for the REDESUR and TESUR facilities. Moreover, in 2017, REA carried out all the work to develop and implement the special projects undertaken by REDESUR, pending at TESUR's facilities, as well as the management services for the construction projects of TESUR 2 and TESUR 3.

REA also carries out facilities maintenance and supervises works for other clients, consolidating its position in southern Peru as a leading provider of such services.



The new projects awarded to TESUR 2 and TESUR 3 are at the construction stage, and are in different phases of completion.

The design and construction activities adjudicated to the facilities of TESUR 2 and TESUR 3 under concession are still in process. The projects have an earmarked investment of USD 110 million. The work will be completed and they will enter into operation in the next few years.

The main activity of RECH, a company incorporated by REI in November 2015, is to acquire, hold, administer and manage the Group's shareholdings in Chile. REI owns 100% of the company's share capital, which amounted to USD 110 million. RECH also holds 50% of TEN, and the other 50% is owned by Chilean company Engie Energía Chile, a subsidiary of the ENGIE Group. It also owns a 69.9% stake in REDENOR.

At the end of 2017, the 500 kV power line began operating commercially, 600 km in length and connecting the Central Interconnected System [SIC in Spanish] with the Greater North Interconnected System [SING], developed by the Group company TEN.

In June 2017, the Red Eléctrica Chile-Cobra Instalaciones y Servicios consortium [69.9%- and 30.1%-owned, respectively] was awarded one of the projects included in the Plan to Expand Chile's Backbone system, involving more than 258 km power lines in the SING. This project amounts approximately to USD 55 million.

In November, the Group, through its subsidiary REDESUR, won the concession of a new project in Peru. The Group will be responsible for the design, construction, financing, operation and maintenance, for a period of 30 years plus the construction period, of 128 km of 220 kV lines in the south of the country. The benchmark value of the investment amounts to USD 55 million.

These adjudications signal a new step forward in the Group's internationalisation strategy, after commencing its activity in Chile in 2016 and having strengthened its position in both Chile and Peru thanks to the latest adjudications. With the addition of those assets to the Group's portfolio, the company will manage more than 1,300 km of transmission network in Peru and nearly 1,500 km in Chile, obtaining a preferential position for the future interconnection between Chile and Peru.



2 Business performance

2.1. KEY FINANCIAL INDICATORS

Revenue for 2017 amounted to Euros 1,941.2 million, compared with Euros 1,932.3 million in the previous year. This figure includes the remuneration from the Transmission business in Spain, including the facilities entering into service in 2016. Furthermore, it includes the revenues associated with the provision of telecommunications services, which amounted to Euros 86.5 million, regulated revenues relating to the system operation, which amounted to Euros 56.0 million, and the revenues deriving from the foreign transmission activity, which amounted to Euros 19.6 million.

Gross Operating Profit (EBITDA) ⁽¹⁾ amounted to Euros 1,519.5 million, climbing 2.3% year-on-year.

With regard to operating expenses:

> **Supplies and other operating expenses** increased by 1.8% compared with the previous year, due mainly to the inclusion of this item of the investment made in construction projects in Peru, in application of IFRIC 12, and expenses associated with accidents. If both of these effects are removed, this item would have decreased by 1.8% compared to the level of expense in 2016, evidencing the Group's efforts to improve efficiency.

> **Personnel expenses** increased by 2.4% compared to the previous year. More than half of this increase was due to the difference in wages and salaries, as a result of the larger workforce. The remainder is a result of the rise in employee benefits and similar expenses.

The **headcount** was 1,815 at 31 December 2017, while the average workforce was 1,801 employees, up 2.0% on 2016.

Net Operating Profit (EBIT) ⁽²⁾ totalled Euros 1,031.4 million, i.e. 2.8% higher than in the previous year.

Net finance costs were Euros -142.6 million, compared with Euros -151.3 million in the previous year. This improvement was due mainly to lower interest on the back of decreased finance expenses managed.

Lastly, **Profit for the year** totalled Euros 669.8 million, up 5.2% on the previous year. The effective tax rate was 24.8%, in line with the 25% defined in the Corporate Income Tax Act 27/2014.

⁽¹⁾ The gross operating profit or EBITDA is calculated as the sum of the net turnover plus the work carried out by the company on its fixed assets and other operating income, less expenses for personnel, supplies and other operating costs.

⁽²⁾ The net operating profit or EBIT is calculated as the EBITDA plus the allocation of grants for non-financial assets and the gains or losses or impairment on disposals of fixed assets less provisions for amortization/depreciation.



The **Investment** carried out by the Group in 2017 amounted to Euros 510.2 million, down 20.7 % on the previous year's figure, which included Euros 199.8 million relating to the 50 % stake in Chilean company TEN ⁽³⁾. Investment in developing the national transmission network amounted to Euros 411.8 million, a 3.3 % increase on 2016.

Dividends paid against the previous year's profit totalled Euros 463.2 million, equivalent to Euros 0.8587 per share, an increase of 7 % on the previous year as envisaged in the 2014-20 Strategic Plan.

At the end of 2017, 100 % of the Group's financial debt is non-current. In terms of interest, 89 % is fixed-rate and the remaining 11 % is floating-rate.

In 2017, the average cost of the Group's financial debt was 2.78 %, compared to 2.94 % in the prior year. The average balance of gross debt was Euros 5,346.5 million, compared with Euros 5,462.1 million in the previous year.

Finally, the Group's **Net profit** amounted to Euros 3,093.4 million, i.e. 5.9 % higher than at 2016 year-end. This growth was due mainly to profit in the period less dividends paid.

This growth is primarily due to profit for the period

[MILLIONS OF EUROS]

| | 2016 | 2017 | Δ% |
|---|----------|----------|---------|
| Revenue | 1,932.3 | 1,941.2 | 0.5% |
| EBITDA | 1,486.0 | 1,519.5 | 2.3% |
| EBIT | 1,003.3 | 1,031.4 | 2.8% |
| Net profit | 636.9 | 669.8 | 5.2% |
| ROE (post-tax profit/Equity) | 21.8 % | 21.7 % | -0.5 % |
| Cash flows from operating activities | 1,007.1 | 1,153.3 | 14.5 % |
| Dividend policy | 432.8 | 463.2 | 7.0 % |
| Equity | 2,920.5 | 3,093.4 | 5.9 % |
| Gearing | 62.9 % | 60.8 % | -3.4 % |
| Investments | 643.1 | 510.2 | -20.7 % |
| Total assets | 10,550.4 | 10,917.9 | 3.5 % |
| Debt service coverage ratio (Net debt / EBITDA) | 3.33 | 3.15 | -5.3 % |

[3] Company that is consolidated in the Group's financial statements by the equity method.





3

Personnel

In 2017, the Group updated and rolled out the human resources plan, linked to the Company's strategic plan. This plan establishes actions and projects to foster a quality working environment, based on personal and professional development, diversity and equality, commitment and a healthy social climate.

In 2017 several key actions were carried out, such as organisational review, publication of the new functions manual, completion of the Campus project of the RE Group and unfolding the new internal mobility plan; opting for employment and career development.

A stable, committed and highly-qualified team

At the end of 2017, the Group's workforce comprised 1,815 professionals, a 2.4% increase on 2016. The commitment to employment stability is reflected in the high percentage [almost 100%] of employees on permanent contracts and the fostering of internal promotions [100% of appointments to senior management positions were covered through internal promotion].

Average headcounts in 2016 and 2017 were as follows:

MILLIONS OF EUROS

| | 2016 | 2017 | Δ% |
|-------------------|-------|-------|-------|
| Average headcount | 1,765 | 1,801 | 2.0% |
| % men | 76.6% | 76.0% | -0.6% |
| % women | 23.4% | 24.0% | 2.6% |

Diversity and integration

For the Group, it is essential to foster a quality working environment, based on ethical behaviour, respect, diversity and equality. To realise the Company's commitment to these principles, various initiatives are in place aimed at guaranteeing a workplace free of discrimination that promotes diversity and overcomes gender, age and disability barriers.

Regarding the percentage of women in the workforce at the end of the year was 24.2%. While women accounted for 23.8% of management at 31 December.

Regarding disability, in 2017, the Company attained a 2.6% equivalent employment rate of people with disabilities. Of this percentage, 0.8% correspond to employees on the payroll.



Talent management

The global talent management model is aimed at attracting, uncovering, developing, training, transforming and retaining talent and pooling knowledge, through a systemic approach of the various action lines: employment, training, development, knowledge management and leadership, and performance assessment.

In 2017, the Campus Red Eléctrica project, the Group's corporate university, was culminated, and the facilities located in Parque Tecnológico de Madrid (PTM), in Tres Cantos, were launched, equipped with modern infrastructure, cutting-edge technology and innovative methodology.

In 2017, more than 100 hours of training per employee were provided and the average investment was Euros 4,4 thousands.

All employees are assessed continuously in terms of skills, commitment and contribution. In 2017, the current model was analysed and reviewed, with the involvement of various transversal internal working groups, with a view to nurturing a culture of development and recognition.

In 2017, an internal mobility plan integrated into the Talent Management Model was put in place, including a tool to which 100 % of employees have access to share their experience and interests with respect to the areas of development and mobility—Linkred.

Also during 2017, the age management model was put into operation with the aim of stimulating inter-generational knowledge management and optimising the skills of our professionals.

Dialogue and transparency

In 2017, work was carried out to design the action plans resulting from the internal survey conducted in 2016.

In addition, a new climate survey was carried out using methods and an approach focused on analysing 'Sustainable Commitment' which includes individual wellbeing (physical, interpersonal and emotional) in the workplace as an essential aspect, rational and emotional commitment, and organisational support. Participation was 86 %, with a satisfaction score of 8.9 out of 10.

Health and safety

The prevention plan associated with the results of the psychosocial risk assessment conducted in 2016 was launched in 2017. Initiated with a specific communication plan and actions to develop competencies, leadership, team cohesion, integration plans, with a direct impact on emotional/ psychosocial welfare.

With regard to risk prevention, the continuous monitoring of the higher risk work and activities through safety inspection programmes is key. In this regard, in 2017 more than 13,000 safety inspections were conducted at facilities.



To raise awareness amongst employees with regard to occupational risk prevention, in 2017 REE provided more than 15,000 hours of health and safety training. Specific training on electricity-related risk made up approximately 40% of these hours.

This last year, there was an improvement in the main accident indicators. Accident frequency and seriousness fell by 29.6% and 44.4%, respectively, to rates of 1.71 [frequency] and 0.05 [seriousness].

Work-life balance

The more than 60 work-life balance measures, actions and initiatives implemented by the Group and applied evenly throughout its workforce regardless of their contract type, are among the fundamental threads of the management model.

Periodically, an assessment is made of both the management model and the measures implemented through the surveys, in which people's knowledge and use of and degree of satisfaction with the entire work-life balance management system are measured. The 2017 survey, with participation of over 60%, yielded highly satisfactory results, attaining an average score of 7 out of 10, which is considered a strong score on the scale used. The survey will enable new needs and aspects for improvement to be identified.

4 Liquidity and capital

The RED ELÉCTRICA Group's liquidity policy has been designed 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.

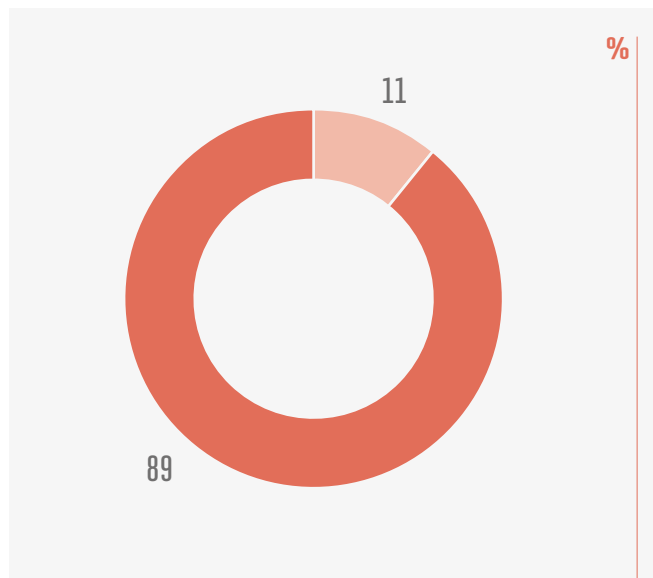
The undrawn balance on credit facilities at 31 December 2017 amounts to Euros 1,658 million.

The average maturity of the debt drawn down at the end of the year is 5.3 years.

The Group's financial strategy has aimed to reflect the nature of its businesses, at all times adhering to legislation in force. The activities conducted by the Group are very capital-intensive, wherein investments mature over long periods. In addition, these assets are remunerated over long periods of time, meaning that financial debt is primarily long-term and fixed-rate.



Structure of financial debt: Fixed vs. variable



• Fixed rate 89% • Variable rate 11%

The 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 2016 stood at 62.9%, compared to 60.8% in 2017. 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 number of dividends payable to shareholders, reimburse capital or issue shares.

5

Risk management

The Group has implemented a Comprehensive Risk Management System, which aims to ensure that any risks that might affect its 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 Group. The Comprehensive Risk Management Policy was approved by the board of directors. This Comprehensive Risk Management System, the Policy and the General Procedure are based on the COSO II [Committee of Sponsoring Organizations of the Treadway Commission] Enterprise Risk Management Integrated Framework.

The main risks to which the Group is exposed, and which might affect the achieving its objectives, are regulatory risks—inasmuch as the Group's main businesses are regulated—operating risks, mainly from the activities for the electric grid system service, and financial and environmental risks.

The Integrated Risk Management Policy also includes financial risk, detailed in note 15 of the Consolidated Annual Financial Statements.



6

Average payment periods to suppliers. 'Reporting requirement', third additional provision of law 15/2010 of 5 July 2010

In accordance with the Spanish Accounting and Auditing Institute (ICAC) resolution of 29 January 2016 regarding the information that must be disclosed in the notes to annual accounts on average payment periods to suppliers in commercial transactions, the average supplier payment period in the case of Spanish Group companies was 47.2 days at the 2017 year end.

The disclosures required by this Resolution are outlined in note 19 to the Group's consolidated financial statements for 2017.

7

Significant events occurring after the reporting period

No significant events have occurred between the reporting date and the date on which these consolidated annual accounts were authorised for issue.

8

Outlook

The Group will keep working towards achieving the objectives laid out in the Strategic Plan. To this end, it will continue in its role of Spanish TSO, while also reinforcing its efficiency criteria so as to adapt to the new, more stringent regulatory and remuneration environment, and placing greater emphasis on widening its business base as an alternative means of growth.

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 systems it operates and the excellent standards in other activities.

The Group will uphold its commitment to maximise value for its shareholders, offering an attractive return in the form of dividends and generating value through efficient management of its activities, analysing alternatives for expanding its business base, maintaining a robust capital structure and working to guarantee supply with a maximum level of quality.

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 Group's management.



Outlook for regulated activities in Spain

Regulated activities primarily observe the following lines of action:

- Market integration and the sustainability of the electricity system, which justify maintaining the level of investment in the transmission network 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, both internationally and, especially, in non-mainland systems.
- A goal of efficiency, enabling the Group to maintain its position as an international benchmark. Accordingly, the Company has reviewed its main operating processes, promoting a streamlined and flexible organisation that optimises the Company's returns and the efficiency of the mainland and non-mainland electricity systems.
- Implementation of new regulated activities, such as storage of energy in the island systems as a tool to guarantee the security of the non-mainland and isolated electricity systems.

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

Outlook for telecommunication activities

The telecommunications activities carried out by REINTEL, as telecommunications infrastructure supplier, will focus on the backbone fibre network market, specifically the lease of dark fibre optic infrastructure associated with agents in the telecommunications sector. To this end, REINTEL will continue to implement its commercial plan and undertake the investments requested by customers, in order to generate greater revenues.

Furthermore, REINTEL will continue to make progress on interconnecting rail and electrical fibre networks with the aim of offering new solutions to its customers, such as new redundant sources and access points, whilst continuing to uphold the high standard of service quality offered to its customers.

Outlook for the international business

The Group will continue to focus on strengthening its performance in the countries where it operates, specifically in Peru and Chile.

Furthermore, as a means of broadening the business base, the Company will seek to execute projects or acquisitions which, fulfilling a series of geographic, strategic and financial criteria, boost the Company's international presence.



9

Innovation

In 2017, work continued to implement and roll out the new Innovation Strategy to leverage innovation as a driver for growth, cultural change and sustainability within the Group. This initiative aims to bring innovation to all corners of the business activity, focusing primarily on four key angles: In the international arena, innovation activity undertaken as part of ENTSO-E projects is particularly noteworthy.

One of the milestones was the second edition of the innovation awards, whose aim is to detect potentially interesting ideas and foster a culture of innovation. 28 proposals were submitted this time around, and the winning idea was ANTILUS — an unmanned vessel to inspect and monitor undersea power lines.

At the end of 2017, in cooperation with InnoEnergy, the GRID2030 programme was launched, a European initiative to uncover potentially disruptive ideas for the Group and finance their transition to solutions closer to being incorporated into the Group's activities. The deadline for presenting proposals for this first edition is February 2018.

Abroad, we highlight the dedication to the Research, Development and Innovation Committee of ENTSO-E, the European Association of transmission system operators, and its working groups. We also highlight that the collaboration with the European Technology & Innovation Platform (ETIP) for electricity networks is ongoing as part of the EU's SET Plan. REE sits on the steering committee as a representative of the European TSOs.

With regard to projects financed by European programmes, in 2017 work is ongoing in BEST PATHS (*Beyond the State-of-the-art Technologies for re-Powering Ac corridors & multi-Terminal HVDC Systems*), coordinated by REE and involving 39 partners, including universities, technological centres, industry, electric utilities and TSOs; and in MIGRATE, in which REE is a partner leading a working package aimed at improving the understanding of the electric power grid system with a high level of penetration of power electronics devices (generators, loads, HVDC, FACTS...). The OSMOSE project was also approved and will commence shortly. This project will research the scope (mainly based on storage) to improve the electric grid system's operation and the integration of renewables.

As regards projects implemented under domestic innovation programmes, work continues on AMCOS-Stability FACTS to design a prototype to improve the stability of frequency and voltage in small isolated systems.

Throughout 2017, work was ongoing on our own RDi projects, including the CECOVEL and ALMACENA projects.

The CECOVEL (Electric Vehicle Control Centre – Centro de Control del Vehículo Eléctrico) project is a Group initiative to support electric mobility in the current scenario of energy transition. In operation since 2017, CECOVEL monitors



demand for energy to recharge electric vehicles, raising the visibility of these new consumers of electricity. This is a collaboration involving the main charging station managers in Spain which currently monitors more than 900 charging stations. The project received an enerTIC Award in 2017, in the Smart Vehicle category.

The ALMACENA project has enabled a more in-depth investigation into new storage technologies in the sphere of integrating renewables and improving system operating services thanks to an electrochemical storage unit installed in Carmona [Seville]. In 2017, research was ongoing into operation and maintenance, compiling information to feed into the models developed. Similarly, optimisation models were developed to determine the best possible functioning of the storage equipment in isolated electric grid systems, devising a methodology to estimate the size of the storage equipment in such systems and the construction of the model to optimise the annual operating costs of that equipment in isolated systems.

Geared towards environmental conservation, including the development and validation of a ground-breaking technique, the first in the world, to recover underwater meadows formed by *Posidonia Oceanica* seagrass – a highly-protected aquatic plant native to the Mediterranean – using laboratory-germinated seeds and bundles originating from natural fragmentation. Notably, the RGI [*Renewables Grid Initiative*], an association of various TSOs and environmental NGOs in the European Union, aimed at fostering renewable energy, granted this project the '*Good Practice of the year 2017*' award.

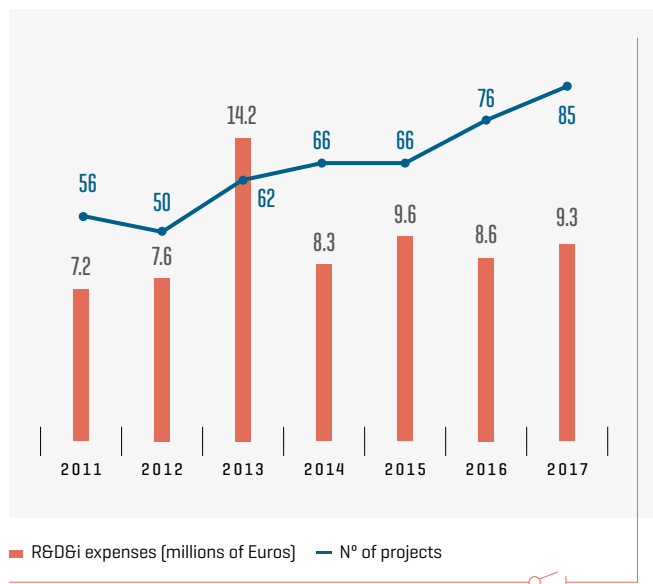
The VEGETA project was also successfully completed. This was an algorithm methodology to globally optimise the entire cycle of vegetation treatment under power lines with the aim of achieving efficient and socially responsible forestry management.

Overall, the Group worked on 85 innovation projects in 2017, at a total cost of Euros 9.3 million.

It is important to say that in 2017 a significant number of projects in the construction, operation and maintenance of electric power transmission facilities were completed, as well as in the environmental sphere.



Evolution of the R&D+i expense and number of projects



10 Own shares

In order to provide investors with adequate levels of liquidity the Company acquired 1,781,515 shares with a total par value of Euros 0.9 million and a cash value of Euros 32.4 million in 2017. A total of 2,134,154 shares were sold, with an overall par value of Euros 1.1 million and a cash value of Euros 39.9 million.

At 31 December 2017, the Company held 1,613,693 own shares, representing 0.30% of its share capital. These shares had a par value of Euros 0.50 each, and an overall par value of Euros 0.8 million and an acquisition price of Euros 18.45 [see note 11 to the annual financial statements] and their market value totalled Euros 29.8 million.

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 official secondary markets, together with those already held by the Parent and its subsidiaries, must not exceed 10% of the share capital. The Group subsidiaries do not hold own shares or shares in the Parent.

11 Other relevant information

11.1. STOCK MARKET PERFORMANCE AND SHAREHOLDER RETURNS

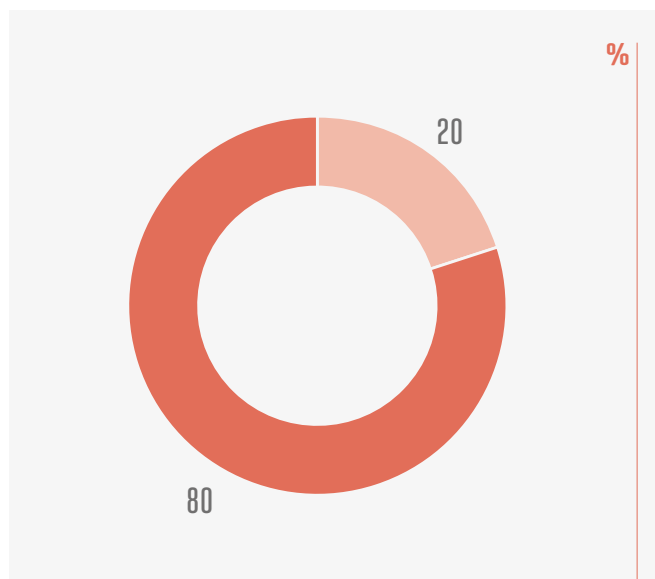
All of the shares in REC, the Group's listed company, are quoted on the four Spanish stock exchanges and are traded through the Spanish automated quotation system. REC also forms part of the IBEX 35 index, of which it represented 1.9% at the end of 2017.



At 31 December 2017, the share capital of REC amounted to Euros 270.5 million and was represented by 541,080,000 shares with a par value of Euros 0.50 each, subscribed and fully paid.

During the year REC's free float was 80%.

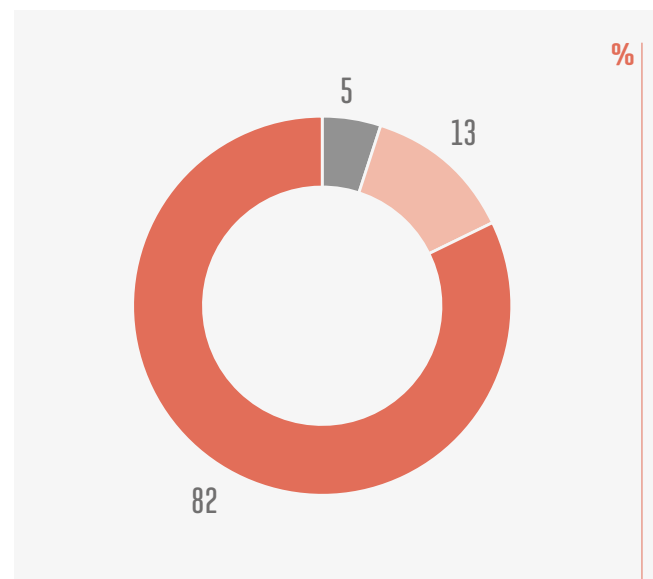
Shareholder structure



• Free-float 80% • Strategic investors 20%

At the date of the last shareholders' meeting – 31 March 2017 – the free float comprised 432,864,000 shares, of which an estimated 13% is held by non-controlling shareholders, 5% by Spanish institutional investors and 82% by foreign institutional investors, primarily in the United Kingdom and the United States.

Distribution of the free-float



• Foreign institutions 82% • Spanish institutional 5% • Minority interests 13%



With regard to share performance, 2017 was a good year. Wall Street surprised investors with another robust performance, with its main indices logging gains in some cases in excess of 20 %, and setting an impressive array of records in the year [almost 70 records in the Dow Jones]. Moreover, the US tax reform approved at the end of 2017 was another driver of healthy growth in the New York Stock Exchange.

Bourses elsewhere in the world logged a more moderate performance. In Europe, however, in 2017 we have also seen Germany's DAX and the UK's FTSE beat their previous records. Nevertheless, the revaluations in the main European equity markets were more modest, with Milan and Frankfurt the outperformers, both logging gains of more than 12 %.

Shares in REC gained 4.4% in 2017, outperforming most regulated European energy companies. The company's efforts to improve efficiency, its shareholders' remuneration policy and its diversification strategy were applauded by the markets, in what was a tough context for companies like ours.

The market capitalisation of the Company at the end of 2017 was Euros 10,124 million.

In total, 596 million shares were traded in 2017, which is 1.1 times the Company's share capital. In cash terms, Euros 10,958 million was traded, down 25 % on the Euros 13,432 million traded in the prior year.

11.2. DIVIDEND POLICY

The dividends paid in 2017 amounted to Euros 463.2 million, 7 % more than in 2016.

The dividend against 2017 results, proposed by the Board of Directors and pending approval at the General Shareholders' Meeting, is Euros 0.9188 per share, an increase of 7% on the previous year.

Based on the projections and estimates contained in the Group's 2014-2019 Strategic Plan, the dividend could grow at a rate of approximately 7%. 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. This forecast is subject to fulfilment of the Plan.

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

11.3. CREDIT RATING

On 4 July 2017, the rating agency Standard & Poor's issued a new report on Red Eléctrica, maintaining its rating and outlook. Following this announcement, the Company and its subsidiary REE maintain long-term ratings of A- and short-term ratings of A-2, with a stable outlook.



On 18 September 2017, the rating agency Fitch Ratings granted the Company a long-term rating of 'A', with a stable outlook. Following this announcement, REC and REE maintain long-term ratings of 'A' and short-term ratings of 'F1', with a stable outlook.

11.4. EXCELLENCE

In 1999, the Company adopted the EFQM (*European Foundation for Quality Management*) model as a tool for ongoing improvement in its management and results, and since 2001 it has commissioned external assessments every two years in order to identify areas for improvement, which are articulated through excellence plans, and to achieve progress in management excellence. In 2017, as a result of this external assessment, the Company renewed its Recognised for Excellence 500+ certification, with a RADAR score of more than 700 points, consolidating its position among leading companies in Spain and Europe.

Since 2000, the Company has also had a certified quality system encompassing all the organisation's processes. In 2017, this system was adapted to the latest version of international standard UNE-EN-ISO9001 and it received certification through an external audit which, since 2012, has been conducted integrally on all the certified corporate management systems.

The excellence and quality management system is in turn based on a process management approach. In 2017, the process manual was reviewed to ensure it is fully aligned with the Company's functions manual. This year a project to improve "the voice of external customers" was implemented, to speed up the process of compiling and processing information on customer satisfaction, as well as facilitating the introduction of improvements as a result of analysing the requirements and expectations of external customers.

12 Statement of non-financial Information, in accordance With Royal Decree-Law 18/2017, of 24 november, Whereby Directive 2014/95/Eu from the European Parliament and the Council is Transposed Into Spanish Law

12.1. DESCRIPTION OF THE GROUP'S BUSINESS MODEL AND MAIN SUSTAINABILITY EVENTS

In 2002, the Group defined its Corporate Social Responsibility Policy and implemented a system enabling the adequate management of the economic, social and environmental impacts of its activity on its stakeholders.



As a key line of action for the Group, the 2014-2019 Strategic Plan lays down a management process based on corporate responsibility best practice. In implementing this strategy, the Group acts in a responsible, ethical and committed manner vis-à-vis its stakeholders and society in general.

In 2016, the Group decided to further enhance its management by designing the **Group's 2030 Sustainability Commitment**, approved by the board of directors' Appointments and Remuneration Committee on 24 May 2017. The Commitment defines four sustainability priorities, identified as the drivers for responding to the challenges facing the Group and for materialising existing opportunities.

- > **Decarbonisation of the economy.** The Group undertakes to be a proactive agent in the energy transition towards an emissions-free model, based on the electrification of the economy and the efficient integration of renewable energies through a robust and better-connected network and the development and operation of energy storage systems.
- > **Responsible value chain.** The Group undertakes to extend its responsibility commitment to all the links of the value chain, from its employees to its suppliers and customers, by forging alliances and underpinned by the model of good governance and integrity.
- > **Contribution to the development of the surrounding community.** The Group undertakes to contribute to economic, environmental and social progress in the surrounding area, by providing an essential service in a secure and efficient way, fostering environmental

conservation, enhancing people's quality of life and social welfare and involving communities in the development of our activities so as to generate mutual rewards that are tangible to that community.

- > **Anticipation and action for change.** The Group undertakes to foster a corporate culture of innovation and flexibility that enables it to identify growth opportunities and tackle future challenges, by staying ahead of—and adapting to—global trends and to the regulatory environment emerging from the new energy model.

The Group belongs to the most reputable sustainability indices, in recognition of its excellent track record in this connection, and its firm commitment to transparency in its reporting to third parties. In 2017, the Group was recognised as a global leader in the Electric Utilities sector and the Utilities super-sector, which encompasses the sectors of electricity, gas and water, by the Dow Jones Sustainability Index [DJSI]. The Company is also listed in the FTSE4Good, Climate Disclosure Project, Euronext Vigeo-Eiris, Ethibel, MSCI and ECPI.

12.2. PROTECTION AND CONSERVATION OF THE ENVIRONMENT

The Group's commitment to the environment originates from Company management, and is based on the environmental policy (reviewed and approved in October 2014) and implemented by means of an Environmental Management System that is certified under ISO 14001 and EMAS regulations. 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.



The main environmental challenges facing the Company are as follows:

► **Ensuring that facilities are compatible with the environment**, selecting layouts and locations to minimise environmental impact. 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.

► **Ensure the protection and conservation of biodiversity.**

The Group has a specific commitment to the management of biodiversity (reviewed in 2017) and a multi-year Action Plan including the related goals and specific actions to achieve those goals. We highlight the actions relating to the following areas:

- Protection of birds, the main idea being to minimise the risk of birds colliding with earth wires in power lines. A plan has been devised to use bird-saving devices in sections with the greatest potential impact on birds (more than 700 km of lines) and is scheduled for completion in 2023. In 2017, 45% of critical priority areas were equipped with deterrents.
- Prevention of forest fires, through the proper design and maintenance of fire breakers and the joint efforts of all the administrations with competencies in this area. There are currently 12 fire prevention agreements in place, with a related budget of more than Euros 1.2 million every 5 years *earmarked for cleaning up public land, acquiring fire prevention and fire-fighting equipment, training and awareness.*

► Implementation of conservation projects in partnership with the government, NGOs and other bodies, including those relating to the conservation of birds and those aimed at restoring degraded areas. The latter include the 'REE Marine Wilderness' project to restore *posidonia oceanica* seagrass and the 'Red Eléctrica Forest', with more than 778 hectares restored (from 2009 to 2017) and an investment of Euros 1,843,941.

► Helping to fight climate change, leading the Group to undertake a formal commitment (reviewed in 2017) and implement a Climate Change Action Plan defining the main goals for 2020 and 2030. The plan includes actions relating to the Company's transmission and grid system operating activities and its contribution to European emissions targets. Action lines and tasks are also outlined to reduce the Company's carbon footprint. These include actions aimed at improving the management of SF₆ gas and at energy savings and efficiency, especially linked to sustainable mobility and the reduction of electricity consumption. The plan also tackles the adaptation to climate change as one of the main areas of work in this matter.

Note that, in 2017, the Company's ordinary expenses to protect and improve the environment amounted to Euros 21.6 million and the amount earmarked for environmental aspects linked to investment projects was Euros 3.4 million.



12.3. CONTRIBUTION TO SOCIETY

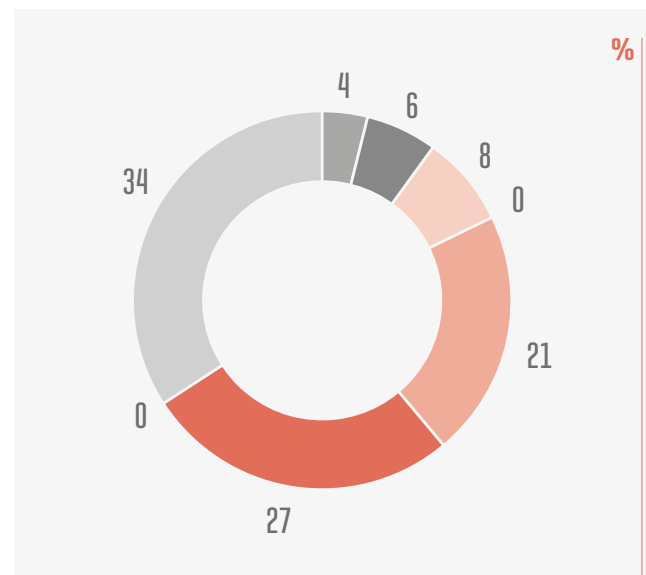
The Group focuses its socio-environmental commitment towards unlocking shared value with society, fostering actions and investments aligned with its business goals which, as they generate value for the Group, also have a positive impact on society, the territory and its inhabitants. Likewise, it contributes to the attainment of various challenges, such as the UN's Sustainable Development Goals or those envisaged as part of the European 2020 energy strategy.

Shared value is created by the Group both in the way it develops and builds infrastructure and in its manner of operating and providing services to the effective systems in which it operates and to its customers. This activity generates opportunities to unlock shared value throughout the life cycle of infrastructure.

In addition, the Group accompanies its projects on the ground with collaboration projects to nurture institutional and social relationships, transparently seeking partnership agreements, disseminating information about the electricity network and fostering involvement in projects and initiatives that boost socio-economic development, and the conservation, protection and valuing of natural heritage in the territories where it operates.

In this regard, in 2017 REE contributed Euros 6.5 million ⁽⁴⁾ to developing or promoting social initiatives.

Acting Area



• Education 27% • Safety 0% • Socio-economic development 34%
 • Environment 21% • Art and Culture 4% • Welfare 6%
 • Humanitarian Aid 0% • Other 8%

⁽⁴⁾ This amount was obtained by applying LBG (London Benchmarking Group) methodology.





In 2017, the Company signed around 100 agreements with public and social entities to cooperate in socio-economic, environmental, educational and cultural development projects, primarily.

More than 50 % of the 480-plus social initiatives undertaken focused on the **socio-economic development of the territory**: construction projects or municipal infrastructure improvements, efforts to nurture cultural wealth in territories, restoration of emblematic and socially significant buildings with an impact on tourism, among others.

With regard to the **dissemination of knowledge**, the Group takes an active role in disseminating and raising awareness about the electricity network as a whole, since a better informed society has greater capacity to develop and maintain a sustainable energy model.

In this connection, in 2017, more than 1,700 people visited REE facilities and control centres, more than 560,000 visitors assisted to the itinerant exhibition 'A Highway behind the Wall Socket' (*'Una autopista detrás del enchufe'*) explaining the electricity supply process from generation to consumption, and more than 8,370 school children took part in activities under the framework of the educational game '**entreREDes**', aimed at teaching kids to be efficient and environmentally-friendly consumers in the future.

15 cooperation agreements were also signed with universities and training centres.

In Spain, training for the State Police and Security Forces was ongoing. In 2017, training on the prevention of forest fires was provided in 10 provinces of 6 regions, involving 1,556 trainees.

Corporate volunteering

Since 2005, promoting corporate volunteering has been a pivotal part of the Group's action, as a result of its firm commitment to improving society, enabling it to channel the solidarity and social concerns of our employees.

In 2017, a new model of corporate volunteering was designed in order to respond to the social and environmental needs and aspects in the general interest in those territories where the Group has a presence, via the employees' voluntary involvement in actions aligned with the Group's Sustainability Commitment.



12.4. RESPECT FOR HUMAN RIGHTS AND COMBATING CORRUPTION AND BRIBERY

Respect for human rights

The Group has an explicit public commitment to respecting and safeguarding human rights in all the territories in which it operates as it conducts its business, with a particular emphasis on vulnerable groups. This commitment is enshrined in the guidelines and conduct outlined in the **Code of Ethics** and the **Corporate Social Responsibility Policy**, and applies throughout the supply chain thanks to the Group's **Code of Conduct for Suppliers**. Lastly, as a member of the Spanish network of the UN Global Compact, REE underpins its commitment to human rights by adhering to the ten principles of the Global Compact.

In order to continue making headway in human rights management and strengthening the Group's commitment in this sphere, in 2017 the Company devised a **human rights management model**, approved by the Sustainability Committee, encompassing all the Group's activities and based on the United Nations' guiding principles for companies and human rights.

The Group's approach is one of ongoing control and improvement by implementing actions to prevent potential breaches of human rights, and to find solutions and address cases in which such breaches have occurred. Consequently, the Group is subject to internal and external audits in connection with human rights and it conducts social audits at its suppliers to ensure the efficiency of the management model.

In 2017, the Group carried out due diligence regarding human rights in connection with all its activities, and found there was a low risk in all the areas analysed, evidencing that the Group implements proper controls.

All the Group's stakeholders can access the Ethical Channel, as a formal response mechanism for queries and complaints in connection with human rights. In addition, the company has the DIGAME (Let's talk) Attention Centre and ASA (Supplier Helpdesk) services, where stakeholders can express their concerns regarding any suspected breach of human rights. In 2017, these channels received a total of three complaints in relation to human rights issues. All of those complaints were resolved.

Ethics and Compliance at the RED ELÉCTRICA Group

Ethics and Compliance are fundamental pillars of the proper course of business at the Group. This means acting with the utmost integrity in discharging the Group's obligations and commitments, and in relations and cooperation with its stakeholders.

The Group has a series of corporate rules of conduct establishing the values and standards of behaviour that must be subscribed by all persons in the Group in the performance of their professional activities.



Code of Ethics

The Group's Code of Ethics applies to the Group's directors and employees, and establishes the values and commitments that must govern their behaviour. The latest edition of the Group's Code of Ethics was approved by the Board of Directors on 28 May 2013.

Ethical channel

The Group has an Ethical Channel, available through its corporate website, to convey queries, complaints or suggestions relating to the Code of Ethics. The Group has an 'Ethics Manager' for fielding queries and compiling, analysing and resolving complaints relating to the Code of Ethics. This figure, in direct contact with the Chairman and the board of directors, acts independently, and undertakes to maintain the utmost confidentiality in performing his duties.

In 2017, 26 queries were filed with the Ethics Manager, with a maximum resolution time of 10 days. The queries related to the following patterns of behaviour:

- > Integrity, responsibility and transparency.
- > Respect, dignity and non-discrimination.
- > Responsible monitoring of the supplier management.
- > Restriction of the acceptance of gifts, loans or invitations.
- > Suitable safeguards for the information systems.

In 2017, 7 complaints were received in connection with compliance with the Code of Ethics, 5 of these were resolved in the year and 2 are in the implementation phase of the action plan proposed by the Ethics Manager.

Compliance system

The Group's Compliance System is fully aligned with the best practices in this sphere, so as to support the organisation in fulfilling its obligations and commitments.

The main goals of the compliance system are:

- > To nurture a corporate culture based on ethics and compliance.
- > To attain a global vision of compliance at the organisation.
- > To have a transversal and homogeneous approach to compliance.
- > To strengthen the preventive aspects of compliance.



In accordance with the Group's commitment to responsible and sustainable management, and with best management practices, the organisation has a Compliance Unit within the Risk Control, Compliance and Quality Department (part of Internal Audit and Risk Control) integrating compliance functions with those of risk control and quality management, based on the synergies between these various functions.

Prevention of criminal risks

The Group has a Criminal Risk Prevention Programme aimed at identifying the rules, procedures and tools it has established to prevent non-compliance with criminal legislation applicable to the Group and its staff and adapting it to the current regulatory framework. Thus, the prevention of criminal risks potentially affecting the Group based on its activities and business sectors, in accordance with the Criminal Code, are incorporated in its due control processes.

This Programme, approved by the board of directors, has a control body which supervises its compliance and carries out the specific measures to ensure that it is properly updated and executed. Moreover, it periodically reports to the Audit Committee concerning the actions implemented, improvements proposed, updates introduced, measures agreed and any other aspect deemed relevant in discharging its duties.

As the body in charge of monitoring, supervising and updating the Programme, the Control and Supervisory Body of the Criminal Risk Prevention Programme include periodically reporting to the Audit Committee concerning the actions implemented, the improvements agreed and any other aspect deemed relevant in discharging its duties.

In 2017, the Control and Supervisory Body did not receive any complaints regarding non-compliances in connection with the Criminal Risk Prevention Programme and none of the Group's companies were investigated or found guilty of non-compliances linked to the organisation's criminal risks. Likewise, no complaints were filed in connection with potential cases of corruption, and no Group company was investigated or found guilty by any court in connection with non-compliances linked to corruption cases.

12.5. RESPONSIBLE MANAGEMENT OF THE SUPPLY CHAIN

The globalisation of markets has increased the limits of companies' responsibilities and triggered a change in the sole of suppliers, which have become a pivotal element. In this regard, the Group focuses on broadening its responsibility over the supply chain and is guided by a responsible management model. The Group's management model is based on the principles of non-discrimination, mutual recognition, proportionality, equal treatment and transparency, as well as a framework of legislation and internal Group codes, policies and rules.

In 2017, REE carried out work (including receiving materials and equipment and executing services and projects) through more than one thousand suppliers, for an amount exceeding six hundred million euros.

With regard to the risks and impacts identified in the supply chain, the identification and ranking of risks and impacts on the supply chain by priority have enabled the company to establish adequate controls to minimise them.



In 2017, a supplier sustainability assessment model was devised. This model has 29 questions, grouped into 3 blocks: ethics and labour conditions, environment and workplace health and safety. Based on this knowledge, the aim is to foster sustainable development at suppliers to steadily increase the maturity of the supply chain in terms of sustainability.

In order to verify compliance with the Code of Conduct among the Group's suppliers, audits were conducted at 75 suppliers in 2017. These audits, whose aim is to assess suppliers' compliance with the Code of Conduct, focuses on those supplies with a high potential or real impact on labour conditions and ethical behaviour or suppliers where some kind of ethical incident has been detected.

As a result of the audits, improvements or action plans were agreed at more than 60% of suppliers, the monitoring of which allows their performance and the impact of the improvement implemented to be measured.

12.6. MAIN INDICATORS RELATING TO NON-FINANCIAL DISCLOSURES [SUMMARY TABLE]

Non-financial indicators

| | 2016 | 2017 | Δ% |
|---|---|---|-------|
| Direct emissions of greenhouse gases [scope 1] (tCO ₂ eq.) (5) (8) | 31,500 | 28,765 | -8.7 |
| Direct emissions of greenhouse gases [scope 2] (tCO ₂ eq.) (5) (8) | 848,793 | 956,967 | 12.7 |
| Electricity consumption (MWh) (8) | 15,541 | 15,177 | -2.3 |
| Lines incorporating bird deterrents in critical priority areas (kilometres accumulated at year end) (8) | 218 (29.5% of the total to be equipped with deterrents) | 332 (45% of the total to be equipped with deterrents) | 52.3 |
| Women on the board of directors [%] or figure (6) | 4 (36.4 %) | 4 (33.3 %) | - |
| Women on the payroll Group [final] [%] (6) | 23.5 | 24.2 | 3.0 |
| Women in executive positions Group [final] [%] (6) | 20.1 | 23.8 | 1.8 |
| People with disabilities on the payroll [%] (7) | 0.8 | 0.8 | - |
| Average hours of training per employee (7) | 82 | 108 | 31.7 |
| Investment in training per employee (euros) (7) | 3,431 | 4,398 | 28.2 |
| Accident frequency rate (7) | 2.43 | 1.71 | -29.6 |
| Serious accident rate (7) | 0.09 | 0.05 | -44.4 |
| Social audits to suppliers [number] (7) | 40 | 75 | 87.5 |
| Number of complaints relating to human rights (6) | - | 3 | - |
| Number of cases of corruption (6) | - | - | - |
| Investment in the community [millions of euros] (7) | 6.4 | 6.5 | 1.6 |

[\(5\)](#) The increase in scope 2 emissions is due to the increase in emissions linked to the losses in the transmission network, calculated using the emission factor corresponding to the annual generation mix. The factor calculated for 2017 is considerably higher than in 2016 due mainly to the sharp downturn in hydro-electric generation (associated with low water availability due to weather conditions), which it supplemented with generation from non-renewable sources.

[\(6\)](#) Group.

[\(7\)](#) Spain: REE + REC + REINCAN + REI + REINTEL.

[\(8\)](#) REE.



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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 obligated to publicly update its statements or review the information containing future projections, even where new data is published or new events arise.



DECLARACIÓN DE RESPONSABILIDAD DEL INFORME FINANCIERO ANUAL

Los miembros del Consejo de Administración de RED ELECTRICA CORPORACIÓN, S.A. declaran, hasta donde alcanza su conocimiento, que las cuentas anuales individuales así como las consolidadas correspondientes al ejercicio 2017, formuladas en la sesión de 16 de febrero de 2018, han sido elaboradas con arreglo a los principios de contabilidad aplicables, ofrecen la imagen fiel del patrimonio, de la situación financiera y de los resultados de RED ELÉCTRICA CORPORACIÓN, S.A. y de las empresas comprendidas en la consolidación tomados en su conjunto, y que los informes de gestión, individual y consolidado, incluyen un análisis fiel de la evolución y los resultados empresariales y de la posición de RED ELECTRICA CORPORACIÓN y de las empresas comprendidas en la consolidación tomadas en su conjunto, junto con la descripción de los principales riesgos e incertidumbres a que se enfrentan.

Madrid, 16 de febrero de 2018

José Folgado Blanco
Presidente

Juan Lasala Bernad
Consejero Delegado

Fernando Fernández
Méndez de Andés
Consejero

Carmen Gómez de Barreda
Tous de Monsalve
Consejera

María José García Beato
Consejera

Socorro Fernández Larrea
Consejera

Antonio Gómez Ciria
Consejero

Santiago Lanzuela Marina
Consejero

José Luis Feito Higuera
Consejero

Arsenio Fernández de Mesa y
Díaz del Río
Consejero

Alberto Carbajo Josa
Consejero

Mercedes Real Rodríguez
Consejera