

**TITLE I:**  
LEGAL FRAMEWORK  
APPLICABLE TO  
RED ELÉCTRICA

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## **ANNUAL CORPORATE GOVERNANCE REPORT OF RED ELÉCTRICA CORPORACIÓN, S.A. 2014<sup>(1)</sup> FINANCIAL YEAR**

### **CHAPTER I.- EXTERNAL FRAMEWORK**

In accordance with the requirements of applicable legislation (initially under Article 116 of the Securities Market Act (the “LMV”), introduced by Act 26/2003, known as the Transparency Act, and the Regulations of the Board of Directors (Article 46)), the Board of Directors of RED ELÉCTRICA CORPORACIÓN, S.A. (hereinafter, Red Eléctrica or the Company) has been complying, in its capacity as a listed company, with the obligation to prepare and approve an Annual Corporate Governance Report (ACGR), which must be notified to the CNMV as a material event and published on the Company’s website, and which is attached as an Annex to the Company’s annual management report.

The amendment to the regulatory framework in this area, approved in 2011, reaffirmed the obligation of companies both to approve an annual ACGR (Article 61.bis of the Securities Market Act, introduced by the fifth final provision of Act 2/2011, of 4 March, on Sustainable Economy (LES)) and to incorporate the ACGR into the Management Report, in a separate section (Article 538 of the Capital Companies Act (LSC), approved by Royal Legislative Decree 1/2010, of 2 July, as amended by Act 25/2011, of 1 August).

Act 31/2014, of 3 December, amending the Capital Companies Act, to improve Corporate Governance, has included new Article 540 into the Capital Companies Act, establishing the minimum content of the Annual Corporate Government Report; this was previously established

in Article 61.bis) of the Securities Market Act, which was expressly repealed as a result of the latest reform. As a novelty, its content will include information on any measures adopted to ensure that the Board of Directors includes a number of female members that is able to guarantee a balance between men and women, as well as any measures agreed upon by the Appointments Committee. Furthermore, a reference is made to fiscal risks in risk control systems.

New Article 540 of the Capital Companies Act provides that the content and structure of the Corporate Governance Report will be determined by the Ministry of Economy and Competitiveness, or by the Spanish Securities Market Commission, if expressly authorised.

Act 31/2014 of 3 December came into force on 24 December 2014, which is why it has not been the object of implementing regulations until now. Consequently, during the 2014 financial year the ACGR model approved in Ministerial Order ECC/461/2013, of 20 March, and CNMV Circular 5/2013, of 12 June, remains applicable, given that both rules were still in force at the date this Report was approved. Thus, these rules are the basis of the Official Annex attached to this ACGR, which has been completed according to this standard form.

The legal framework affecting various Corporate Governance aspects of Spanish joint stock companies has undergone relevant changes over the last year, particularly as a result of the entry into force of Act 31/2014, of 3 December, amending the Capital Companies Act to

<sup>(1)</sup> Unless another date is expressly indicated in this Report, its content will be presumed effective at 31 December 2014.

improve corporate governance. This Act has entailed a review of the Company's basic corporate rules, in order to adapt to the new law, to take place in 2015.

The main novelties in corporate governance matters introduced by Act 31/2014, of 3 December, for joint stock companies, are described below:

**>> 1. Regarding the competences of the General Meeting and its involvement in management matters:**

- > For joint stock companies it is now possible for the General Meeting to get involved in management matters, instructing the management body or presenting for authorisation the latter's adoption of decisions or resolutions in certain matters.
- > The General Meeting is entrusted with a new exclusive competence, consisting of decision-making in relation to the acquisition, disposal or contribution of essential assets.
- > In listed companies the General Meeting will also be reserved any matters related to the transfer to dependent entities of essential activities, until then carried out by the company, even if they are still totally controlled by the latter ("subsidiarization").
- > An asset/activity will be presumed essential if the transaction exceeds 25% of the asset value included in the latest approved balance sheet.

**>> 2. Regarding the call and operation of the General Meeting:**

- > The percentage capital stock required to exercise minority rights in listed companies is reduced to 3%.
- > In listed companies there is now a right to request that Iberclear provide shareholder identification details, obtained from shareholder associations representing at least 1% of the capital stock, and shareholders representing more than 3%.
- > In listed companies, there is greater prior information made available to the shareholders before a Meeting; limits on the right

of attendance and the right to vote against, held by financial brokers holding shares on account of various parties, are regulated.

- > In general, the rule is to issue a separate vote by matter; the necessary majority to approve resolutions is clarified; joint stock companies are now subject to a shareholder's duty of abstention in a conflict of interest; and some aspects of the right of information are changed.

**>> 3. Regarding the challenge of corporate resolutions:**

- > A balance, between protecting minority shareholders and trying to avoid abuse when challenging resolutions, is pursued.
- > The current system used to bring a challenge is unified and systematized, to enable challengeable resolutions to be identified, the reasons for the challenge, standing to bring a challenge and the timeframe in which to bring this action.
- > The former distinction between null and void and voidable resolutions, disappears.
- > All shareholders must represent a minimum percentage in order to hold standing to challenge resolutions, except for those contrary to the public order.
- > Some particularities are established for listed companies.

**>> 4. Regarding directors' remuneration:**

- > Greater transparency and control over directors' remuneration, reinforcing the role of the General Meeting.
- > The General Meeting will approve the maximum annual remuneration for all non-executive directors, in their position as such.
- > All directors entrusted with executive tasks will sign an agreement with the Company, exhaustively describing their remuneration system for these tasks; said agreement will be approved by a

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**\_TITLE II. MAIN ASPECTS, PRINCIPLES  
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**\_TITLE III. THE YEAR 2014  
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**\_TITLE IV. RED ELÉCTRICA'S  
PERSPECTIVES IN CORPORATE  
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**\_OFFICIAL ANNEX. STANDARD FORM  
ANNEX I, SPANISH STOCK EXCHANGE  
COMMISSION (CNMV)  
CIRCULAR 5/2013, OF 12 JUNE**

- reinforced majority of the Board without the participation of the director in question.
- > All listed companies will approve a directors remuneration policy, including remuneration for non-executive directors, in their position as such, and for performance of executive tasks; the policy will be necessarily approved by the General Shareholders Meeting for a three-year term.
- >> **5.** Regarding directors' duties of conduct (due diligence and loyalty):
- > The "business judgement rule" is enshrined, preventing judges from reviewing directors' strategic and business decisions.
  - > It is distinguished from directors' liability depending on the tasks effectively executed.
  - > Basic manifestations of the duty of loyalty are reformulated and others added, such as the obligation of directors to at all times act impartially, without accepting instructions or links with third parties.
  - > The duty of loyalty makes a difference between basic or material obligations- absolute prohibitions- and certain instrumental obligations covering conflict of interest situations which, on the other hand, may be waived.
- >> **6.** Regarding directors' liability:
- > A director is presumed guilty if the act or omission in question is contrary to the regulations or Company By-laws.
  - > Liability provisions are extended to *de facto* directors, including both unofficial directors or whose office has expired and concealed directors, as well as the individual representative of a legal entity director.
  - > The requirements to bring a corporate responsibility action are made less stringent, by reducing to 3% the capital stock required in listed companies for the minority to hold standing, and the possibility of bringing direct action, without the need for a prior Meeting, if the duty of loyalty is infringed.
- > A statute of limitations is included for corporate and individual liability actions: four years as of the date of exercisable action.
- >> **7.** Regarding the delegation of powers by the Board and powers unable to be delegated:
- > An agreement must be executed between the Company and Board member appointed CEO, or who is entrusted with executive duties, to be approved by a qualified majority of the Board.
  - > The list of non-delegable powers is extended, of the Board of Directors for all companies.
  - > For listed companies there are other additional powers that may not be delegated, in order to preserve the general supervision and control task entrusted to the Board of Directors.
- >> **8.** Regarding the Board of Directors of listed companies (posts and operation):
- > The post of Chairman and Secretary of the Board of Directors is regulated, requiring for their appointment a prior opinion from the Appointments and Remuneration Committee.
  - > Chairman status may be held by an executive director, although in such case his appointment will require the vote of two third of the directors and a lead director must necessarily be named from amongst the independent directors.
  - > Non-executive directors may only confer a proxy to another non-executive director.
  - > The Company is obliged to provide its directors, sufficiently in advance, with the necessary information to perform their tasks, due to the link between directors' information and their general duty of care.
  - > All Boards of Directors must conduct an annual assessment of Board and Committee operation.

**>> 9. Regarding the appointment and types of directors  
in listed companies:**

- > The co-optation system in listed companies is modified, removing the need for the designated director to be a company shareholder; if a vacancy arises after the Meeting is called, a director may be designated until the next meeting is held.
- > The maximum term of office of directors in listed companies is reduced to four years.
- > Any proposed appointments of directors will include a justifying report from the Board.
- > Proposals for appointment or re-election of independent directors will be entrusted to the Appointments and Remuneration Committee; the Board itself will be responsible for all other directors, subject to a prior opinion from the Committee.
- > Director categories are defined (executive and non-executive-proprietary, independent and other external directors).

**>> 10. Regarding the Board Committees of listed companies:**

- > An Appointments and Remuneration Committee is now mandatory, and its absence will constitute a serious infringement under the LMV.
- > Certain recommendations of the Unified Code of Good Governance are included as mandatory.
- > Both Committees will exclusively consist of non-executive directors and at least two will be independent, including the Chairman.

**>> 11. Regarding the Annual Corporate Governance Report and Annual  
Report on Directors Remuneration:**

- > The LSC now regulates the Annual Corporate Governance Report previously contained in the Securities Market Act (LMV), with minor changes.
- > Likewise, pre-existing rules on the Annual Report on Directors Remuneration are included, subject to some change in order to adjust it to the new directors remuneration system, to particularly include the need for listed companies to approve a directors remuneration policy.

A review of the current recommendations included in the Unified Code of Good Governance (UCGG), conducted by the Expert Committee under the management of CNMV, during 2014, will result in a new Spanish Corporate Governance Code, which will be approved and published shortly.

## CHAPTER II.- INTERNAL FRAMEWORK

The internal corporate rules governing RED ELÉCTRICA are continuously amended to incorporate into the Company the best Corporate Governance practice, and to ensure greater informative transparency for its shareholders. At present, the Company is governed in Corporate Governance matters by the corporate rules and procedures listed below, the individual legal system of which goes beyond the requirements of applicable law.

These rules, as of 31 December 2014, consisted of:

- >> The Corporate By-laws.
- >> The Regulations of the General Shareholders Meeting.
- >> The Regulations of the Board of Directors.
- >> Company Chairman Succession Plan.
- >> The Internal Code of Conduct on the Securities Market.
- >> The Code of Ethics.
- >> Corporate Governance Policy.
- >> The Procedure for proxies, voting and information by remote means at the General Shareholders Meeting (relating to the 2014 Annual General Shareholders Meeting).
- >> The Operating Rules of the Shareholder E-Forum.

### The Corporate By-laws

The Corporate By-laws are constantly being adapted, not only to align them with the legislation, but also to best practices and principles in the area of Corporate Governance, and have been repeatedly amended by the Company's General Shareholders Meeting. In 2014, no change was made to the Corporate By-laws. Following the entry into force of Act 31/2014, of 3 December, amending the Capital Companies Act to improve corporate governance, the Corporate By-laws are being reviewed in order to be presented for approval at the next Ordinary General Shareholders Meeting of the Company, thereby fully adapting them to the new Capital Companies Act.

### Regulations of the General Shareholders Meeting

The Regulations of the General Shareholders Meeting were initially approved by the General Shareholders Meeting of 17 July 2003, and have been amended on numerous occasions.

The Regulations lay the basis for the legal framework of shareholders of Red Eléctrica, in keeping with best practices in the area of Corporate Governance, and include all the new means of shareholder protection and participation, with a view to recognising, promoting and strengthening shareholder rights at the Company to the greatest extent possible.

As in the case of the Corporate By-laws, during 2014 no change was made to these Regulations. Following the entry into force of Act 31/2014, of 3 December, amending the Capital Companies Act to improve corporate governance, the Regulations are being reviewed in order to present a proposed amendment at the next Ordinary General Shareholders Meeting of the Company, thereby fully adjusting them to the new Capital Companies Act.

### **The Regulations of the Board of Directors**

As indicated in Article 22 of the Corporate By-laws, the main purpose of the Regulations of the Board of Directors is to establish the basic rules on the organisation and functioning of the Board of Directors and its Committees, the rules of conduct for its members and the system of supervision and control of the Board of Directors and its Committees, with a view to ensuring the highest standards of professionalism and efficacy in their actions. This is achieved by encouraging the active participation of its directors, placing the interests of the Company and of its shareholders above their own interests, while upholding the law, the Corporate By-laws and Corporate Governance principles.

The latest amendment of these Regulations was approved at the Board of Directors Meeting of 13 March 2013. The most relevant aspect of this amendment was the Company's adjustment to outstanding practice in Corporate Governance matters, particularly internationally, and the introduction of improvements in the organization and operation of the Board of Directors and its Committees.

Further to the foregoing, measures were adopted to outweigh the concentration of power in the hands of the chief executive and Chairman of the Company's Board of Directors, including other measures, such as specific provisions enabling a personal separation from office, and a non-delegable express reservation in favour of the Board of Directors of certain competences and powers which, for reasons of urgency, had been previously entrusted to the Board Chairman. Another novelty was the formalization of certain practice that had been previously conducted in the Company, such as an annual assessment of the Board of Directors, its Committees and Chairman, by an independent expert. As a novelty, the composition of Board Committees was adapted to investor requirements, strengthening their impartiality, by demanding a majority of independent directors, and the principle of transparency was gathered in relation to the remuneration policy applied to the Board and senior management,

including new components and remuneration structures recently recommended by investors and proxy advisors.

In the same way as the Corporate By-laws and Regulations of the General Shareholders Meeting, the Regulations of the Board of Directors will be reviewed in 2015 in order to adapt them to Act 31/2014, of 3 December, amending the Capital Companies Act to improve corporate governance, and to new practice in good governance matters included in the new Spanish Unified Code of Good Governance, once it is reviewed and published, also gathering other applicable good governance recommendations.

### **Company Chairman Succession Plan**

At a meeting held on 27 October 2011, the Board of Directors approved the Succession Plan for the Company Chairman, following the trend of an increasingly common worldwide Corporate Governance practice, involving the preparation and approval by listed companies of succession plans for their CEO or most senior executive, in order to minimise the impact of the handover on the organisation, and aiming to determine a model profile for the candidates and ensure the continuity of the business, thereby reducing as far as possible the possible risks or negative effects of the appointment of a new chairman, until he or she has fully settled into the role. The Plan establishes a succession procedure that is split into several phases, assigning functions to the managing bodies involved; all with a view to creating an environment in which the appointment of a new chairman may be carried out in an orderly and efficient manner that does not affect the Company's ordinary operations.

It was possible to apply this Plan for the first time in 2012, when Mr. Luis Atienza Serna stepped down as Executive Chairman of the Company, in favour of Mr. José Folgado Blanco, who had already been sitting on the Board of Directors as an independent director since 2008, which

facilitated the handover to the new Chairman, whose independent judgement, knowledge of the Company and the industry, as well as his prior experience, leadership and capacity for dialogue with the energy regulator, were notable qualities.

The Succession Plan was approved in 2011. Given that the Board Regulations have not changed in 2013, it would be appropriate to review the Succession Plan shortly, in order to keep it totally up to date, as foreseen in the Company's Corporate Governance Policy.

#### **The Internal Code of Conduct on the Securities Market**

This was approved by the Board of Directors on 25 June 2009. At a meeting held on 30 June 2011 the Board of Directors approved an update to the Code in order to adapt the Internal Code of Conduct on the Securities Market to the new corporate structure of the Group, and to record the change of name of the current Corporate Responsibility and Governance Committee. At its meeting on 26 July 2012, the Board of Directors approved a new change to the Internal Code of Conduct on the Securities Market in order to expressly set out certain periods prior to the presentation of the Group's results during which certain persons with access to information on these results are prohibited from transactions with the Company's securities. Finally, on 24 June 2014, the Board of Directors approved another update of the Code, basically to adjust it to best practice in treasury stock matters, with particular emphasis on the CNMV's recommendations issued in July 2013 regarding volume, pricing and trading time. The Code is expected to be reviewed in order to fully adjust it, as necessary, to the new Capital Companies Act.

#### **The Code of Ethics**

The origins of the Company's Code of Ethics date back to 1987, in which year it adopted the so-called Basic principles of action, which contained an initial set of values to be shared by the organization and which were later reinforced in the Code of Ethics and Corporate Values approved in 2007. Financial year 2013 represents another milestone for Red Eléctrica in the management of business ethics, as discussed below.

The Code of Ethics of the Red Eléctrica Group aims to bring together a set of principles and recommendations regarding its conduct, the application of which will contribute to ethical and responsible management in the business activities of Group companies, and in the relationships established with the various stakeholders. The Code of Ethics is one of the main elements of Corporate Responsibility management at the Company. It constitutes the main foundation for development of the corporate values that the Company seeks to strengthen between its members and includes explicit models and conduct guidelines to be followed by all members.

The Code is applicable to all persons working at the Red Eléctrica Group in the performance of their duties and responsibilities, and in all of the professional fields in which they represent the Company, including directors, managers and employees.

It applies to majority-owned companies of the Group, regardless of their geographic location, and to those countries where they may be providing professional services, consultancy or any other activity related to the Group. Its proper application ensures that the results of the Red Eléctrica Group are achieved while at the same time respecting the law and protecting the reputation the Company wishes to transmit both domestically and abroad.

The Code of Ethics is a regulatory instrument for establishing, in a general way, the conduct guidelines in the different professional spheres in which the employees of the Red Eléctrica Group are active. It is intended to serve as a general guideline when making decisions in certain situations in which the professionals of the Red Eléctrica Group may find themselves.

The company has appointed an Ethics Manager to receive and to respond to any questions that may arise and to collect, analyse and resolve on the various complaints received. The appointed person is the Company's General Secretary and Secretary of the Board of Directors of Red Eléctrica. This role, which has a direct relationship with the Chairman and the Board of Directors, is responsible for maintaining the confidentiality of business processes and is responsible for the development, consolidation and



continuous improvement of the management of the Code of Ethics of Red Eléctrica.

The Board of Directors, at its meeting of 28 May 2013, approved the amendment to the Code of Ethics. This new edition of the Code of Ethics has been developed with the aim of taking on board the requirements of stakeholders in the Company and society at large, in addition to the recommendations of the most reputed international organizations in this field. It represents a firm commitment by the Company to ethical management as a driver of its brand and reputation.

Shareholders, investors, clients, suppliers, the tertiary sector, analysts and the general public are demanding ever greater levels of accountability from companies, and providing an effective response to such demands is key to its reputation, where each person, through their activities and the relationships they establish with these groups, may influence the reputation and the image that Red Eléctrica wishes to convey both domestically and abroad.

With the changes introduced, the Company is looking to bring together the best practices identified at international level, adjust the scope and content of the materials covered in the Code of Ethics and adapt the ethical management system to the contents of the latest version of the Criminal Code.

The Code of Ethics has two parts: one on the corporate values and another on conduct guidelines and commitments. The corporate values have been reduced from 10 to 5, and are as follows:

- > reliability,
- > accountability,
- > environmental awareness,
- > leadership and creativity,
- > respect.

The newly introduced commitments relate to:

- > eradication of forced labour,
- > right to privacy,
- > ban on contributions to political parties,
- > control of donations and sponsorships,
- > control of activities in tax havens,
- > responsible relationship with lobbyists,
- > conservation of biodiversity,
- > protection of ethnic minorities.

Throughout this process, the Company has received expert advice in the field of business ethics, on the basis of the contributions made by its stakeholders, in accordance with best management practices in business ethics.

The 2013 Annual Report on the Code of Ethics was approved on 29 July 2014. The Report describes the actions taken by the Company to raise awareness of the importance of the Code of Ethics and of the procedure for dealing with queries and complaints. The queries received are also listed, the majority of which related to the way in which the commitments stated in the Code should be interpreted in specific situations. Mention is also made of the complaints received and handled by the Ethics Manager, as well as their resolution.

As part of its Plan to encourage awareness of ethical management, approved by the Company's Corporate Responsibility Committee, during 2014 (to continue over 2015) a set of presentations have been made at all the company's work centres, in order to improve knowledge of the ethics management system, reflecting on the values and commitments acquired by the organization and examining the role and tasks of the Ethics Manager. These meetings have been attended by Rafael García de Diego, Ethics Manager and ombudsman for Red Eléctrica's stakeholders.

In turn, the corporate website has published a list of indicators related to application of the Code of Ethics, to provide relevant information that enables a socially responsible investor to understand the necessary ethical components required for its investment decision-making, in addition to traditional economic and financial criteria.

#### **Corporate Governance Policy**

The Board of Directors, at its meeting held on 25 November 2014, approved the Company's Corporate Governance Policy. The Policy provides that its foundations are the corporate values governing its relationship with various stakeholders, helping achieve the Company's strategies and sustainably maximizing its value. These values are reflected in the principles governing the Group's corporate governance policy. Briefly, the Policy describes the catalogue of principles evidencing not only the Company's compliance with applicable regulations, but also its alignment with national and international recommendations and trends in corporate governance matters, which the Company has been voluntarily undertaking since it was listed on the stock market in 1999. These principles included are expected to remain in the long term in the organization, given that without prejudice to their continuous update along with future commitments, they constitute the corporate governance culture of Red Eléctrica. The Corporate Governance Policy intends to align the Company's interests with those of its shareholders and other stakeholders, by protecting and encouraging a value shared by all, incorporating economic, social, environmental and good governance criteria, thereby contributing not only to the Company's sustainability, solvency and good reputation amongst its shareholders and other stakeholders, but also reinforcing trust, stability, progress and social and economic development of society.

Title II below provides a detailed description of the principles and practice included in the Company's Corporate Governance Policy. This Policy is available on the corporate website, under Corporate Governance, "*Our Commitment*".

#### **The procedure for proxies, voting and information by remote means at the Shareholders Meeting**

At the Board of Directors Meeting held on 2 April 2014, rules were approved for voting and remote proxies and the right of information by electronic means, for the Ordinary General Shareholders Meeting held on 9 May 2014.

As in previous years, the procedure has produced satisfactory results: 289 shareholders, holding 77,150 shares, have voted or delegated a proxy by electronic means, resulting in 7.9% of the 3,659 shareholders, present or represented on the Meeting, participating by remote means.

#### **The Operating Rules of the Shareholder E-Forum**

The Operating Rules of the Shareholder E-Forum were approved by the Board of Directors Meeting of 2 April 2014, in the same terms and conditions (subject to minor formal adjustments) approved by the Board of Directors in previous years.

The Shareholder E-Forum deployed by RED ELÉCTRICA CORPORACIÓN, S.A. on its website -[www.ree.es](http://www.ree.es)- on the occasion of its General Shareholders Meetings, responds to the requirement established in the last paragraph of Article 117.2 of Act 24/1988, of 28 July, on the Securities Market, introduced by Act 12/2010, of 30 June, and Article 539.2 of the revised text of the Capital Companies Act (LSC), approved by Royal Legislative Decree 1/2010, of 2 July, which has not been amended by Act 31/2014, reforming the LSC.

The Shareholder E-Forum aims to facilitate communication between the shareholders of the Company (individuals, natural persons or legal entities, and the voluntary associations they may form) on the occasion of the Company's General Shareholders Meeting. Shareholders have the possibility of sending, for publication on the Forum, communications in accordance with the Law, together with their contact details, thereby enabling the shareholders to communicate with each other.