

Consolidated Directors' Report

2007 Financial Year

EVOLUTION OF BUSINESS. MOST SIGNIFICANT EVENTS

In 2007, GRUPO RED ELÉCTRICA consolidated its basic strategy as a Spanish TSO (Transmission System Operator). Law 17/2007 confirmed the role of Red Eléctrica de España, S.A. (hereinafter RED ELÉCTRICA or the Company) as a system operator and manager of the transmission network, naming the group as the only transmission operator in Spain.

In addition to the satisfactory economic results obtained in 2007, GRUPO RED ELÉCTRICA, made some significant achievements in the company's different business activities.

Business in Spain

Today, RED ELÉCTRICA owns practically all of the transmission network on the peninsula, with approximately 34,000 km of high voltage lines plus 3,000 substation positions and a transformation capacity of more than 58,000 MVA, which is also one of the fastest-growing. In 2007, the investment efforts of RED ELÉCTRICA focused on its development programme and the structural reinforcement of the transmission network in order to satisfy increased demand and the evacuation needs of the recently installed generating capacity. The Group invested 609.7 million euros in the development of the national transmission, a 19% increase over 2006.

The most significant actions during the financial year included:

- Improving the 220 kV grid in the communities of Valencia and Madrid.
- Reinforcing the transmission network in eastern Andalusia.
- Evacuating the generation capacity of new combined cycle power plants and wind farms.
- Initiating the interconnection between the peninsula and the Balearic Islands via an underwater cable.

Thanks to the maintenance policies and techniques continuously applied by RED ELÉCTRICA, its operating efficiency and service quality rates, which reflect the availability rates of its facilities, are among some of the highest in the world.

In terms of the continuity and security of the electricity supply, while in 2007 there were incidents caused by third parties and meteorological phenomena which affected the company's transmission network, RED ELÉCTRICA made it a priority to restore the service as quickly as possible, bolstering the distribution network and minimising the impact on the total availability of the company's transmission network, which in 2007 was 98.06% (98.24% in 2006), with an average interruption time of 1.10 minutes (1.817 minutes in 2006).

RED ELÉCTRICA, as the operator of the electricity system, guarantees the continuity of the electricity supply by imposing strict standards of efficiency and transparency on agents.

With regard to the key indicators of system performance, in 2007 the annual demand for electricity was 2.9% higher than 2006. As for the satisfaction of that demand, RED ELÉCTRICA made considerable efforts to integrate renewable energies, enabling it to cover 10% of demand with wind power. In order to integrate the maximum production of renewable energies, especially wind power, into the electrical system under safe conditions, RED ELÉCTRICA, as the electricity system operator, has implemented a Renewable Energy Control Centre (CECRE), a pioneer initiative world-wide for the supervision and control of these energy sources which makes it possible to anticipate possible problems affecting the electrical system due to sudden losses of wind power generation.

Within the scope of the Iberian Electricity Market (MIBEL), Redes Energéticas Nacionais, SPGS, S.A. (REN) and RED ELÉCTRICA have signed an agreement which in financial year 2007 resulted in the acquisition of 5% of REN by RED ELÉCTRICA.

In December 2007, the Company founded a wholly-owned subsidiary, Red Eléctrica de España TSO, S. L. which, pursuant to the law, is expected to assume the activities of system operator, transmission network manager and transporter in financial year 2008. The company had no business activity in 2007.

Business Outside Spain

The business activities of GRUPO RED ELÉCTRICA outside of Spain are handled by Red Eléctrica Internacional which, with investments in South America in Bolivia (through TDE) and PERU (through REDESUR) and consulting and technical assistance work for third parties, is responsible for the development of the GROUP's international business.

The turnover from international business was 22.2 million euros with EBITDA of 13.6 million.

The consolidated profits from the GROUP's international business were 2.4 million euros, most of which were contributed by its Bolivian subsidiary TDE.

Both REDESUR in Peru and TDE in Bolivia have focused their activities on their electricity markets, where they have achieved certain standards of quality in the operation and maintenance of their installations that have resulted in availability rates in excess of 99%.

PRINCIPAL ECONOMIC INDICATORS

The positive economic-financial indicators in financial year 2007 reflect the attainment of the objectives set by GRUPO RED ELÉCTRICA and the efficient management of the company's business activities.

In 2007, after-tax profits were 243 million euro, which represents an increase of 21.4% over the year 2006.

The consolidated profits, net of energy purchases, were 1,030.9 million euro, an increase of 8.6%, due primarily to the large base of assets to be remunerated by the plants that went into service in 2006.

The gross operating profit (EBITDA) was 723.3 million euro, which represents an 11% increase over 2006, due to the increase in turnover and to:

- The evolution of personnel expenses, which rose by 4.1%.

The average number of employees working for Grupo Red Eléctrica at 31 December 2007 was 1,456 personas, which represents an increase of 2.1% over 2006. The final employee count was 1,468 people, a 1.8% increase over 31 December 2006.

- The evolution of the cost of procurements and other operating expenses. The net expenses, which include the item entitled "other operating expenses" rose by 3.4% compared to the year before.

The net operating profits (EBIT) rose by 17.4% in comparison to 2006.

The net financial costs increased by 10.9%, due primarily to the increase in market rates.

In 2007, the net result of the deterioration of asset value was -12.3 million euro. This figure includes the correction made to the value of certain plants, located primarily in the north-east, whose construction is paralysed due to causes unrelated to the company.

Finally, the effective tax rate for the financial year was 32.8% compared to 28.7% the year before. In 2006, as a consequence of the enactment of Law 35/2006, which modified the corporate income tax rate, the Group recorded net income of 15.6 million euro due to the adjustment of anticipated and deferred taxes to the new tax rates.

The Group invested a total of 727.8 million euro in 2007, which is almost 37.4% higher than the total investments in 2006. These investment efforts focused on the development of the national transmission network, as mentioned above (607.6 million euros), on financial investments in REN (98.8 million euro) and other investments in tangible and intangible assets (21.4 million euro).

In 2007, the Group paid dividends of 121 million euros, equivalent to 0.8984 euro per share, approximately 23% more than the dividends paid in 2006. This amount encompasses both the interim dividend paid in 2007 and the complementary dividend from 2006.

The net financial debt at the end of 2007 was 2,697 million euro, 2% higher than the previous year, with a leverage ratio of 69%. The debt has been maintained at levels similar to those of the year before since the ability to generate cash and the increase in working capital have made it possible to finance many of the investments without the need for external financing.

In addition, the debt structure did not vary significantly during the year: long term debt accounted for 99% of the debt compared to 96% at 31 December 2007. As for interest rates, 73% of the debt is fixed rate and 27% adjustable, maintaining a very low risk profile with reduced exposure to interest rate fluctuations. The credit rating agencies Standard and Poor's and Moody's have maintained their AA- and A2 ratings, respectively, in 2007.

The shareholders' equity of GRUPO RED ELÉCTRICA was 1,202 million euros, an increase of 17.7 compared to the year before, primarily due to increased earnings.

CAPITAL STRUCTURE AND ADDITIONAL INFORMATION FOR PUBLICLY LISTED COMPANIES

(ART 116 bis of the Stock Market Act)

According to the terms of article 116 bis of the Stock Market Act, publicly listed companies must include the following information in their Director's Reports:

a) The capital structure, including the shares not traded on a regulated EC market, indicating the different classes of shares and for each class of shares the rights and obligations inherent thereto and the percentage of the share capital they represent:

Pursuant to the terms of article 5.1 of the Articles of Association, the company's share capital is two hundred seventy million five hundred forty thousand euros (270,540,000 €), represented by one hundred thirty-five million two hundred seventy thousand (135,270,000) shares, all in the same class and series, with a par value of two (2) euros each, fully subscribed and paid in and represented by account entries.

All shares pertain to the same class and series and confer the same rights upon their owners.

b) Restrictions on the transferability of the shares.

The shares representing the share capital of Red Eléctrica de España, S.A. are freely transferable and not subject to any restrictions whatsoever. The laws governing the electricity sector set certain limitations on shareholder participation in the terms set out in part d) below.

Like any other publicly listed company, the acquisition of a significant number of shares must be reported to the issuer and to the *Comisión Nacional del Mercado de Valores*, as provided for in article 53 of the Stock Market Act 24/1988 of 28 July, Royal Decree 1362/2007 of 19 October and Circular 2/2007 of the *Comisión Nacional del Mercado de Valores* dated 19 December which sets the initial threshold for notification at 3% of the share capital or voting rights.

c) Significant direct or indirect shareholdings.

On 31 December 2007 and according to the information available to the Company, at the time of this report the significant shareholders of Red Eléctrica de España., S.A. stock were as follows:

Shareholder	No. shares	% capital
Sociedad Estatal de Participaciones Industriales (SEPI)	27,054,000	20

d) Any restriction on voting rights.

Each share carries one vote. Any shareholder can attend the General Meeting without the need to own a minimum number of shares, as occurred at the Extraordinary General Meeting of Shareholders held on 17 July 2003 in which the statutory requirement to own at least 50 shares in order to attend the General Meetings was eliminated.

The passage of Law 17/2007 of 4 July, which modified Law 54/1997 of 27 November on the Electricity Sector, to adapt it to the terms of Directive 2003/54/CE of the European Parliament and the Council dated 26 June 2003 on common standards for the internal electricity market, introduced different changes into Law 54/1997 which affected restrictions on voting rights.

Specifically, section two of the third additional provision of Law 17/2007 sets new maximum limits on exercising political rights in order to guarantee the independence of companies operating in the electricity sector and which constitute a basic service, as provided for in Law 54/1997 of 27 November on the Electricity Sector.

Hence, any individual or legal entity may be a shareholder in the company as long as their direct or indirect ownership of the company's capital does not exceed five percent of the shares and their political rights do not exceed three percent.

These shares may not be syndicated under any circumstances.

For those operating in the electricity sector and those individuals or legal entities holding a direct or indirect interest of more than five percent in the share capital of the former, they may not exercise political rights in the company responsible for operating the system in excess of one percent.

The special regimen for the *Sociedad Estatal de Participaciones Industriales (SEPI)* remains unchanged, with no modification, and must in all cases maintain an interest of not less than ten percent (10%).

e) Shareholders' Agreements.

At 31 December 2007, the Company had no knowledge of the existence of agreements between shareholders which would oblige them to adopt a common policy by voting in a particular way at the General Meetings or which would restrict or condition the free transferability of the shares.

f) The rules applicable to the appointment and replacement of members of the Board of Directors and amendment of the Company's Articles of Association.

1. Appointment and Replacement.

Article 19 of the Rules of the Board establishes that Directors shall be designated by the General Meeting or by the Board of Directors by co-option. The proposed appointment of a Director, including by co-option, must be approved by the Appointments, Remuneration and Corporate Governance Committee. The Board of Directors, within the scope of its authority, shall endeavour to ensure that the proposed candidates are persons of recognised solvency, competence and experience, as established in article 20 of the Rules.

According to article 21 of the Rules, the Directors' term of office shall be that established in the Articles of Associations. Proposals of the appointment or re-election of Directors presented by the Board to the General Meeting of Shareholders, as well as temporary appointments by co-option, shall be approved by the Board:

- i) Upon the proposal of the Appointments, Remuneration and Corporate Governance Committee in the case of independent directors.
- ii) Following the report of the Appointments, Remuneration and Corporate Governance Committee in the case of all other directors.

According to Article 20 of the Articles of Association, the term of office of a director is four years and directors may be re-elected indefinitely. As established in Article 7 of the Rules of the Board, independent directors may not sit on the Board for more than twelve years in a row.

Article 22 of the Rules of the Board establishes that Directors shall step down when their term of office has expired or when the General Meeting so decides, making use of the authority vested in it under the law or the bylaws. The Board of Directors shall not propose the removal of independent directors before the term of office for which they were appointed has expired, without just cause and a report from the Appointments, Remuneration and Corporate Governance Committee.

Furthermore, directors shall step down under the following circumstances:

- a) When they reach the age of 70.
- b) When they are affected by a situation of incompatibility of legal prohibition.
- c) When they are found guilty of an offence or sanctioned by the stock market, energy and telecommunications supervisory authorities in the course of disciplinary proceedings for a serious or very serious offence.
- d) When they have seriously violated their obligations as directors.
- e) When they no longer hold the executive positions with which their appointments as directors were associated.
- f) When remaining on the Board poses a risk to the Company's interests, particularly in relation to section 30.4 of these Rules and when two-thirds of the components of the Board consider this to be true. Should a director be charged with a crime or should there be a hearing for any of the crimes mentioned in article 124 of the Public Limited Companies Act, the Board will examine the case as quickly as possible and, based on the particular circumstances, decide whether or not the director should continue to sit on the Board. All of this will be mentioned in the Annual Corporate Governance Report.
- g) In the case of a nominee director, when the shareholder whose interest that director represents on the Board disposes of its shares in the Company or reduces them to a level below that which would reasonably justify the appointment of a nominee director.

Committee members shall step down when they are no longer directors. Directors who step down before the end of their terms of office, for whatever reasons, shall explain the reason behind their decision to resign in a letter sent to all of the members of the Board, and mention shall be made of this in the Annual Corporate Governance Report.

2. Amendment of Articles of Association.

The rules governing the amendment of Articles of Association are no different than those contained in article 144 of the Public Limited Companies Act, which shall require the approval of the General Meeting of Shareholders with the quorums foreseen in article 103 of the Act. One of the powers of the General Meeting contained in article 3 of the Rules of the General Meeting of Shareholders includes the amendment of the Articles of Association, with the same majorities as those stipulated in the law.

g) The powers of the members of the Board of Directors, in particular, those relative to issuing and repurchasing shares.

At the General Meeting of Shareholders held on 31 May 2007, the Board of Directors was authorised, pursuant to the terms of article 75 and related articles of the Public Limited Companies Act, to proceed with the derivative acquisition of shares in Red Eléctrica de España, S.A., directly or indirectly, to the extent deemed appropriate under the circumstances and under the following conditions. The term of the authorisation is 18 months from the date of the General Meeting. The maximum number of shares that may be acquired may not exceed the legal limit and must comply with all other legal requirements. The price paid for the shares may not be higher than the stock market price at the time of the purchase or lower than 50% of the stock market value of the shares at that time. The shares may be acquired under a purchase-sale, swap or any other onerous business arrangement, depending on the circumstances at the time. The Board of Directors, pursuant to the terms of the third paragraph of article 75 1º of the Public Limited Companies Act, may use some or all of the treasury stock acquired and all of the shares already owned by the Company.

Furthermore, at the Ordinary General Meeting of Shareholders held on 26 May 2006, the Board of Directors was delegated with the authority, for a term of five years, to issue documented debt in the form of non-convertible bonds, bonds of any kind, promissory notes, coupons and warrants, either directly or through its subsidiaries, or any other fixed income securities in euros or other currencies, which may be subscribed in cash or in kind, represented by titles or account entries, simple or with guarantees including mortgage guarantees, with or without the inclusion of rights to the warrants, subordinated or not, with a specific or undefined term, as provided for in the applicable legislation.

Article 25 of the Articles of Association determined that the Chairman of the Board is also the President of the Company and as such is responsible for the executive management of the company and for representing the company in all matters, acting with the powers vested in him by the Board. In this regard, the Board of Directors, at its meeting held on 29 July 2004, in accordance with the proposal of the Appointments and Remuneration Committee, unanimously agreed to: "Delegate to the Chairman of the Board of Directors all of the powers of the Board of Directors which may be delegated under the law and the Articles of Association", in accordance with the terms of article 141 of the Public Limited Companies Act, article 149 of the Business Registrar Regulations, article 22 of the Articles of Association and article 5 of the Rules of the Board of Directors.

Notwithstanding the powers expressly vested in him, the Chairman is authorised to adopt the urgent measures which are deemed to be in the Company's best interest, reporting immediately to the Board of Directors and keeping the Board regularly informed, at its ordinary sessions, of the progress of the Company's business operations and requesting the pertinent approvals of the resolutions submitted to the Board. Starting in 1999, with the creation of the Audit Committee and the Appointments, Remuneration and Corporate Governance Committee, composed entirely of members of the Board of Directors specialising in their areas of competence, the basic and strategic responsibilities of the company have been more specifically controlled by persons other than just the Chairman.

The powers delegated to the Chairman notwithstanding, in reality the Board of Directors actually takes all strategic and relevant decisions affecting the Company.

h) Significant agreements signed by the Company which take effect, are modified or conclude if the control over the Company changes as a result of a takeover bid and the effects of such agreements, unless revealing this information would be seriously harmful to the Company. This exception does not apply when the Company is legally obligated to publicise this information.

There are no significant agreements signed by the Company which take effect, are modified or conclude if the control over the Company changes as a result of a takeover bid.

i) Agreements between the Company and its officers, executives or other employees who are entitled to receive an indemnity when they resign or are illegally dismissed or if the employment relationship comes to an end by reason of a takeover bid.

There are guarantee or shielding clauses for the executive director in the event of dismissal or a change of control. This contract was approved by the Appointments and Remuneration Committee and the Board of Directors was informed of the agreement. These clauses, which are consistent with common market practices, provide for indemnities of up to one year of salary if the employment relationship is terminate, unless a higher indemnity is required by law.

There are also guarantee or shielding clauses for two executive level directors in the event of dismissal. These clauses, which are consistent with common market practices, provide for indemnities of up to one year of salary if the employment relationship is terminate, unless a higher indemnity is required by law. The contracts containing these clauses have been approved by the Appointments and Remuneration Committee and they have been reported to the Company's Board of Directors.

STOCK MARKET EVOLUTION AND SHAREHOLDER YIELDS

RED ELÉCTRICA is part of IBEX-35 with a weight of 1.11% on this index at the end of financial year 2007. Throughout 2007, the Company's free-float rate was 80%.

The Company's stock market capitalisation at the end of 2007 was 5,849 million euro. RED ELÉCTRICA's shares performed very favourably in 2007, closing the year at 43.24 euro/share, an increase of 33.1% over the year before, outranking the appreciation rates of most of the world's stock market indices.

In addition, RED ELÉCTRICA has upheld its commitment to maximise value for its shareholder, offering them high profitability through dividends in 2007.

TREASURY STOCK

In 2007, in order to provide investors with adequate levels of stock liquidity, the Company acquired 4,546,806 shares for a total par value of 9 million euros and a cash value of 158 million euros. Moreover, the Company disposed of 5,896,824 shares with a total par value of 12 million and a cash value of 204 million euros.

At 31 December 2007, the Company's shares in its possession represented 0.22% of the share capital, with 295,165 shares with a total par value of 0.6 million euros and a market value of 13 million euros.

The Company has complied with its obligations pursuant to article 75.2 and the first additional provision of the Public Limited Companies Act which establishes, in relation to the shares traded on secondary markets, that the par value of the share acquired when added to those already in the hands of the company or its subsidiaries, may not exceed 5% of the share capital. The subsidiaries do not own any treasury stock.

RISK MANAGEMENT

GRUPO RED ELÉCTRICA has a Risk Control System in place that covers all of its activities and is properly suited to its risk profile. The Risk Policy and the General Procedures for Comprehensive Risk Management and Control are based on the integral business management framework contained in COSO II Report (*Committee of sponsoring organizations*).

The principal risks affecting the achievement of the strategic objectives are regulatory in nature, since most of GRUPO RED ELÉCTRICA's operations are subject to regulation. There are also operational risks associated primarily with its electricity system operations, as well as financial and environmental risks.

The Risk Control System includes financial risk management. The policies for covering each type of risk are described in Note 15 of the Notes to the Consolidated Financial Statements.

THE ENVIRONMENT

One of the challenges faced by GRUPO RED ELÉCTRICA is to make the development of electrical infrastructures compatible with environmental conservation in order to strike an effective balance between business and sustainability.

In 2007, not only did the Group continue its policy of conducting environmental impact studies for all projects involving new installations, regardless of whether an Environmental Impact Study was legally required, but also through RED ELÉCTRICA, as the manager of the transmission network, the Group collaborated with Ministry of Industry, Trade and Tourism to incorporate environmental sustainability criteria into the general planning of the transmission network, subject to strategic environmental assessment since 2006.

All of the activities carried out by GRUPO RED ELÉCTRICA which strive to protect the environment (environmental supervision, protection of avifauna, prevention of contamination, environmental training, compensatory measures, etc.) are part of the Environmental Management System and are included in the environmental report published annually.

RESEARCH, DEVELOPMENT AND INNOVATION (R+D+i)

As part of its corporate strategy, the research, development and innovation (R+d+i) activities of GRUPO RED ELÉCTRICA seek to guarantee the efficiency and safety of the infrastructures that support the electrical system.

In 2007, GRUPO RED ELÉCTRICA invested four million euros in more than 50 R+D+i projects. Notable among these, from a technological point of view, were the completion of the acoustical screening of substations and the European RELIANCE project focused on the long term identification of common R+D+i objectives of European TSOs. In this regard, in 2007 RED ELÉCTRICA continued to participate in the European Union's Framework Research Programme, acting as the coordinator on some projects including IS-POWER, the goal of which is to foster the integration of renewable energies in isolated electricity systems, or the WIND ON THE GRID project which promotes the wide-scale integration of wind power in the European market.

GRUPO RED ELÉCTRICA is also part of different technological platforms including the Spanish Electrical Grid Platform (FUTUREDD), and the GAD project (Active Demand Management) sponsored by the Ministry of Industry, Trade and Tourism as part of the CENIT Programme (Strategic National Consortia of Technical Research) whose goal is to optimise residential energy consumption.

Also in 2007, in keeping with GRUPO RED ELÉCTRICA's desire to reinforce its R+D+i activities as a basic element of its corporate strategy, the Group participated in the LIDER+ *benchmarking* project headed by the Management Excellence Club, with the goal of gearing its innovation management model towards the most modern models of reference.

THE STAFF

The operations of GRUPO RED ELÉCTRICA are guided by its vocation to serve society and a commitment to ethical responsibility, the values which underlie the Group's human resources policies.

The GROUP's commitment to its employees' development can be seen in the following actions, among others:

- The creation of stable, quality jobs. In 2007, GRUPO RED ELÉCTRICA created a net total of 26 new jobs.
- The development of policies that foster equal opportunities. At the end of the financial year, 21% of GRUPO RED ELÉCTRICA's employees were women, one of the highest rates in the electricity sector.
- Conciliation of work and family life, with policies that go beyond just complying with the laws on the subject.

- A commitment to professional development of employees and to improving the professional development and talent management models. In 2007, for example, 97% of employees participated in the training plans in place at RED ELÉCTRICA, with 102,926 hours of training, 11% more than in 2006. This is equivalent to 79 hours per employee.

Without a doubt, these actions help to strengthen the employees' commitment to the GROUP and its business project, one of the basic pillars of the Group's corporate culture.

EVENTS SUBSEQUENT TO 31 DECEMBER 2007

There were no relevant events subsequent to 31 December 31 2007.

FUTURE OUTLOOK

GRUPO RED ELÉCTRICA, as a Spanish TSO, will keep its strategy focused on service quality in order to guarantee its leadership in terms of the reliability and safety of the Spanish electricity system, making the investments required to develop the grid according to the Infrastructure Plan.

RED ELÉCTRICA will combine with programme of network improvement and expansion with a management model geared towards optimising its operating margins and maintaining service reliability levels.

Assuming the functions entrusted to the Group under the new regulations and making the investments planned for the coming years, along with a transparent, adequate and stable remunerative environment, will guarantee the growth of GRUPO RED ELÉCTRICA in the Spanish electricity sector.

Furthermore, maintaining an efficient capital structure will enable GRUPO RED ELÉCTRICA to continue offering its shareholders high yields and solid, low-risk growth in the years to come.

All of this creates long term value, a lasting competitive edge and an excellent corporate reputation focused on providing the best possible service to society, the characteristic that sets the Group apart from the rest.