

# Annual Corporate Governance Report

## A. Ownership structure

### A.1 Complete the following table on the company's share capital:

Date of last modification	Share capital (€)	Number of shares	Number of voting rights
06-08-2012	4,551,024,586.00	4,551,024,586	4,551,024,586

Indicate whether different types of shares exist with different associated rights:

No

### A.2 List the direct and indirect holders of significant ownership interests in your organization at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	261,514,757	283,680	5.753
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	0	254,697,815	5.596
Blackrock, Inc.	0	177,257,649	3.895

Name or corporate name of indirect shareholder	Through: name or corporate name of direct shareholder	Number of direct voting rights	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Broker Correduría de Seguros y Reaseguros, S.A.	7,856	0.000
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	268,324	0.006
Banco Bilbao Vizcaya Argentaria, S.A.	UNNIM GESFONS SGIIC, S.A.	7,500	0.000
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Caixabank, S.A.	253,970,964	5.581
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Compañía Andaluza de Rentas e Inversiones, S.A.	682,500	0.015
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	VidaCaixa, S.A. de Seguros y Reaseguros	44,351	0.001
Blackrock, Inc.	Blackrock Investment Management (UK)	177,257,649	3.895

Indicate the most significant movements in the shareholder structure during the year.

**A.3 Complete the following tables on company directors holding voting rights through company shares.**

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Mr. César Alierta Izuel	4,339,383	80,053	0.097
Mr. Isidro Fainé Casas	508,875	0	0.011
Mr. José María Abril Pérez	94,586	108,386	0.004
Mr. Julio Linares López	418,946	1,887	0.009
Mr. José María Álvarez-Pallete López	325,734	0	0.007
Mr. Alfonso Ferrari Herrero	586,352	19,499	0.013
Mr. Antonio Massanell Lavilla	2,346	0	0.000
Mr. Carlos Colomer Casellas	17,102	95,448	0.002
Mr. Francisco Javier de Paz Mancho	55,273	0	0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	87,725	447,474	0.012
Mr. Ignacio Moreno Martínez	12,713	0	0.000
Mr. José Fernando de Almansa Moreno-Barreda	19,449	0	0.000
Mr. Luiz Fernando Furlán	34,035	0	0.001
Ms. María Eva Castillo Sanz	97,089	0	0.002
Mr. Pablo Isla Álvarez de Tejera	8,816	0	0.000
Mr. Peter Erskine	71,081	0	0.002
Mr. Santiago Fernández Valbuena	505,949	50,000	0.012

% of total voting rights held by the Board of Directors	0.176
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Complete the following tables on share options held by directors:

Name or corporate name of director	Number of direct share options	Number of indirect share options	Equivalent number of shares	% of total voting rights
Mr. César Alierta Izuel	170,897	0	170,897	0.004
Mr. César Alierta Izuel (2)	100,000	0	10,000,000	0.002
Mr. César Alierta Izuel (3)	574,334	0	897,397	0.013
Mr. Julio Linares López	128,173	0	128,173	0.003
Mr. Julio Linares López (2)	163,828	0	255,983	0.004
Mr. José María Álvarez-Pallete López	77,680	0	77,680	0.002
Mr. José María Álvarez-Pallete López (2)	267,650	0	418,204	0.006
Ms. María Eva Castillo Sanz	95,864	0	149,787	0.002
Mr. Santiago Fernández Valbuena	77,680	0	77,680	0.002
Mr. Santiago Fernández Valbuena (2)	182,742	0	285,536	0.004

**A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are insignificant or arise from ordinary trading or exchange activities.**

**A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are insignificant or arise from ordinary trading or exchange activities.**

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A.

Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding of Banco Bilbao Vizcaya Argentaria, S.A. or any of the Group Companies with Telefónica, S.A., in Telefónica Factoring, S.A., Telefónica Factoring Perú, S.A.A., Telefónica Factoring Colombia, S.A., Telefónica Factoring Brasil, S.A., Telefónica Factoring México, S.A. de C.V. SOFOM, ENR, and Telefónica Factoring Chile, S.A.
Caja de Ahorros y pensiones de Barcelona, "La Caixa"	Corporate	Joint shareholding of CaixaBank, S.A. with Telefónica, S.A. and Banco Bilbao Vizcaya Argentaria, S.A. or any of the Group Companies in Telefónica Factoring, S.A., Telefónica Factoring Perú, S.A.A., Telefónica Factoring Colombia, S.A., Telefónica Factoring Brasil, S.A., Telefónica Factoring México, S.A. de C.V. SOFOM, ENR, and Telefónica Factoring Chile, S.A.

**A.6 Indicate whether any shareholders' agreements have been notified to the company pursuant to article 112 of the Securities' Market Act (Ley del Mercado de Valores). Provide a brief description and list the shareholders bound by the agreement, as applicable.**

Yes

% of share capital affected	0.87
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**Brief description of the agreement:**

In accordance with the provisions of article 112, section 2 of the Securities Market Act 24/1988, of July 28 (currently replaced by article 531 section 1 of the revised text of the Corporate Enterprises Act approved by Royal Legislative decree 1/2010, of 2 July), on 22 October 2009, the Company notified the Spanish Securities Market Commission in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per article 518 of the Corporate Enterprises Act. By virtue of these clauses, Telefónica, while the strategic alliance agreement is in force, is bound not to offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited, at the moment. In addition, China Unicom (Hong Kong) Limited, undertook for a period of one year not to sell, use or transfer, directly or indirectly, its share in Telefónica's voting share capital (excluding intragroup transfers). This undertaking was deprived of effect as with the aforementioned period of one year having expired.

At the same time, both parties also assumed similar obligations as the ones referred above with respect to the share capital of China Unicom (Hong Kong) Limited.

This mutual share exchange agreement, which includes the shareholder agreement, was filed in the Madrid Mercantile Registry on November 24, 2009.

<b>Parties to the shareholders' agreement</b>
China Unicom (Hong Kong) Limited
Telefónica, S.A.

**A.7 Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable.**

No

Expressly indicate any amendments to or termination of such agreements or concerted actions that could have taken place during the year.

On January 23, 2011, Telefónica, S.A. and China Unicom (Hong Kong) Limited ("China Unicom") signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica agreed to acquire through its subsidiary Telefónica Internacional, S.A.U. a number of China Unicom shares to the value of 500 million US dollars from third parties, within nine months from the agreement date. Additionally in recognition of China Unicom's stake in Telefónica, the latter commits to proposing the appointment of a board member nominated by China Unicom in the next General Shareholders' Meeting, in accordance with prevailing legislation and the Company's Bylaws. Executing the stated before, the General Shareholders' Meeting held on May 18, 2011 duly approved the appointment of China Unicom's nominee, Mr. Chang Xiaobing, as member of the Board of Directors.

China Unicom completed the acquisition of Telefónica shares on January 28, 2011, giving it ownership of 1.37% of the Company's capital.

On the other hand, the Telefónica Group purchased China Unicom shares during 2011 to the amount of 358 million euros. At December 31, 2011, the Telefónica Group held a 9.57% stake in the company.

On July 10, 2012, Telefónica, S.A. through its wholly-owned subsidiary Telefónica Internacional, S.A.U., and China United Network Communications Group Company Limited, through a wholly-owned subsidiary, signed an agreement for the purchase by the latter of 1,073,777,121 shares in China Unicom (Hong Kong) Limited owned by Telefónica, equivalent to 4.56% of total capital in that company.

After securing the regulatory authorizations requisite, on July 30, 2012 the sales transaction was completed.

Subsequent to the transaction, both Telefónica and China Unicom remain firmly committed to their strategic partnership.

Telefónica has agreed not to sell the shares it holds directly and indirectly in China Unicom for a period of 12 months as from the date of the agreement.

Telefónica will also continue to enjoy representation on China Unicom's board of directors, while Telefónica's Board of Directors will continue to include a representative of China Unicom.

**A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with article 4 of the Spanish Securities' Market Act. If so, identify.**

No

**A.8 Complete the following tables on the company's treasury shares.**

At the close of the financial year:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
47,847,809	1	1.051

(\*) Through:

Name or corporate name of direct shareholder	Number of shares held directly
Telefónica Móviles Argentina, S.A.	1
<b>Total</b>	<b>1</b>

Give details of any significant changes during the year, in accordance with Royal Decree 1362/2007.

Date of notification	Total number of direct shares acquired	Total number of indirect shares acquired	% of total share capital

14/02/2012	46,947,192	15,177	1.021
21/05/2012	49,627,388	0	1.087
30/10/2012	47,640,860	0	1.047

**Gain/(loss) on treasury shares sold during the year (thousands of euros)**

-39,582

**A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders' Meeting authorizing the Board of Directors to purchase and/or transfer the treasury shares.**

At Telefónica's Ordinary General Shareholders' Meeting held on June 2, 2010, the shareholders resolved to renew the authorization granted at the GSM of June 23, 2009, for the derivative acquisition of treasury stock, either directly or through Group companies, in the terms literally transcribed below:

"To authorize, pursuant to the provisions of Section 75 et seq. of the Spanish Companies Act [Ley de Sociedades Anónimas, or LSA for its initials in Spanish], the derivative acquisition by Telefónica, S.A. –either directly or through any of the subsidiaries of which it is the controlling company– at any time and as many times as it deems appropriate, of its own fully-paid shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 5 years as from the date of this General Shareholders' Meeting and is expressly subject to the limitation that the par value of the Company's own shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company's own shares established by the regulatory Authorities of the markets on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company's shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

To deprive of effect, to the extent of the unused amount, the authorization granted under Item IV on the Agenda by the Ordinary General Shareholders Meeting of the Company on June 23, 2009"

**A.10 Indicate, as applicable, any restrictions imposed by Law or the company's bylaws on exercising voting rights, as well as any legal restrictions on the acquisition or transfer of ownership interests in the share capital.**

Indicate whether there are any legal restrictions on exercising voting rights:

No

**Maximum percentage of voting rights a shareholder can exercise in accordance with legal restrictions**

0

Indicate whether there are any restrictions included in the bylaws on exercising voting rights.

Yes

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Maximum percentage of voting rights a shareholder can exercise in accordance with the company's bylaws

10.000

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Description of restrictions on the exercise of voting rights, under law or the company's bylaws

According to Article 21 of the Company's Bylaws, no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own. This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

The 10 per cent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

Besides, in relation to the above and in accordance with the provisions of article 527 of the Corporate Enterprises Act, any clauses in the bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

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Indicate if there are any legal restrictions on the acquisition or transfer of share capital.

No

**A.11 Indicate whether the General Shareholders' Meeting has agreed to take neutralization measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.**

No

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted.

## B. Company management structure

### B.1 Board of Directors

B.1.1 List the maximum and minimum number of directors as set out in the bylaws.

Maximum number of directors	20
Minimum number of directors	5

B.1.2 Complete the following table with board members' details:

Name or corporate name of director	Representative	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. César Alierta Izuel	-	Chairman	01/29/1997	05/14/2012	Vote at General Shareholders' Meeting
Mr. Isidro Fainé Casas	-	Vice Chairman	01/26/1994	05/18/2011	Vote at General Shareholders' Meeting
Mr. José María Abril Pérez	-	Vice Chairman	07/25/2007	04/22/2008	Vote at General Shareholders' Meeting
Mr. Julio Linares López	-	Vice Chairman	12/21/2005	05/18/2011	Vote at General Shareholders' Meeting
Mr. José María Álvarez-Pallete López	-	Chief Executive Officer	07/26/2006	05/14/2012	Vote at General Shareholders' Meeting
Mr. Alfonso Ferrari Herrero	-	Director	03/28/2001	05/18/2011	Vote at General Shareholders' Meeting
Mr. Antonio Massanell Lavilla	-	Director	04/21/1995	05/18/2011	Vote at General Shareholders' Meeting
Mr. Carlos Colomer Casellas	-	Director	03/28/2001	05/18/2011	Vote at General Shareholders' Meeting
Mr. Chang Xiaobing	-	Director	05/18/2011	05/18/2011	Vote at General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	-	Director	12/19/2007	04/22/2008	Vote at General Shareholders' Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	-	Director	04/12/2002	05/14/2012	Vote at General Shareholders' Meeting
Mr. Ignacio Moreno Martínez	-	Director	12/14/2011	05/14/2012	Vote at General Shareholders' Meeting
Mr. José Fernando de Almansa Moreno-Barreda	-	Director	02/26/2003	04/22/2008	Vote at General Shareholders' Meeting
Mr. Luiz Fernando Furlán	-	Director	01/23/2008	04/22/2008	Vote at General Shareholders' Meeting
Ms. María Eva Castillo Sanz	-	Director	01/23/2008	04/22/2008	Vote at General Shareholders' Meeting
Mr. Pablo Isla Álvarez de Tejera	-	Director	04/12/2002	05/14/2012	Vote at General Shareholders' Meeting
Mr. Peter Erskine	-	Director	01/25/2006	05/18/2011	Vote at General Shareholders' Meeting
Mr. Santiago Fernández Valbuena	-	Director	09/17/2012	09/17/2012	Cooption

Total number of directors	18
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Indicate any board members who left during the reporting period.

Name or corporate name of director	Status of the director at the time	Leaving date
Mr. David Arculus	Independent	09/17/2012

B.1.3 Complete the following tables on board members and their respective categories:

## EXECUTIVE DIRECTORS

Name or corporate name of director	Committee proposing appointment	Post held in the company
Mr. César Alierta Izuel	Nominating, Compensation and Corporate Governance Committee	Executive Chairman
Mr. José María Álvarez-Pallete López	Nominating, Compensation and Corporate Governance Committee	Chief Operating Officer (C.O.O.)
Ms. María Eva Castillo Sanz	Nominating, Compensation and Corporate Governance Committee	Chairwoman Telefónica Europe
Mr. Santiago Fernández Valbuena	Nominating, Compensation and Corporate Governance Committee	Chairman Telefónica Latin America
Total number of executive directors		4
% of the board		22.222

## EXTERNAL PROPRIETARY DIRECTORS

Name or corporate name of director	Committee proposing appointment	Name or corporate name of significant shareholder represented or proposing appointment
Mr. Isidro Fainé Casas	Nominating, Compensation and Corporate Governance Committee	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"
Mr. José María Abril Pérez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Mr. Antonio Massanell Lavilla	Nominating, Compensation and Corporate Governance Committee	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"
Mr. Chang Xiaobing	Nominating, Compensation and Corporate Governance Committee	China Unicom (Hong Kong) Limited
Mr. Ignacio Moreno Martínez	Nominating, Compensation and Corporate Governance Committee	Banco Bilbao Vizcaya Argentaria, S.A.
Total number of proprietary directors		5
% of the board		27.778

## INDEPENDENT EXTERNAL DIRECTORS

Name or corporate name of director	Profile
Mr. Alfonso Ferrari Herrero	Industrial Engineer. Formerly Executive Chairman of Beta Capital, S.A. and senior manager at Banco Urquijo.
Mr. Carlos Colomer Casellas	Graduate in Economics. Chairman of the Colomer Group.
Mr. Francisco Javier de Paz Mancho	Graduate in Information and Advertising. Law Studies. IESE Business Management Program. Formerly Chairman of the State- owned company MERCASA.
Mr. Gonzalo Hinojosa Fernández de Angulo	Industrial Engineer. Formerly Chairman and CEO of Cortefiel Group.
Mr. Luiz Fernando Furlán	Degrees in chemical engineering and business administration, specializing in financial administration. From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil.
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.
Mr. Peter Erskine	Psychology Graduate. Was General manager of Telefónica Europe until 2007. Currently Chairman of Ladbrokes, Plc.
Total number of independent directors	7
% of the board	38.889

## OTHER EXTERNAL DIRECTORS

Name or corporate name of director	Committee proposing appointment
Mr. Julio Linares López	Nominating, Compensation and Corporate Governance Committee
Mr. José Fernando de Almansa Moreno-Barreda	Nominating, Compensation and Corporate Governance Committee
Total number of other external directors	2
% of the board	11.111

List the reasons why these cannot be considered proprietary or independent directors and detail their relationships with the company, its executives or shareholders.

Name or corporate name of director	Reasons	Company, executive or shareholder with whom the relationship is maintained
Mr. Julio Linares López	On September 17, 2012, Mr. Julio Linares López resigned from his post as COO of Telefónica, S.A. and his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the "Other External Directors" category.	Telefónica, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	<p>Mr. de Almansa was appointed a Member of the Board of Directors of Telefónica, S.A. with the qualification of independent Director, on February 26, 2003, following a favorable report from the Nominating, Compensation and Corporate Governance Committee.</p> <p>In accordance with the criteria established in the Unified Code on Good Governance with regard to the qualification of Directors and taking into account the concurrent circumstances in this specific case, the Company considers that Mr. Almansa belongs to the category of "other external Directors", for the following reasons:</p> <ul style="list-style-type: none"> <li>• He is an alternate Director (independent and non-proprietary) of Grupo Financiero BBVA Bancomer, S.A. de C.V. (controlling company of BBVA Group related to financial services in Mexico) and of BBVA Bancomer, S.A., and has never had an executive role.</li> <li>• He was the CEO of the Mexican company Servicios Externos de Apoyo Empresarial, S.A. de C.V., belonging to the BBVA Group, until March 2008.</li> </ul>	BBVA Bancomer

List any changes in the category of each director which have occurred during the year.

Name or corporate name of director	Date of change	Previous classification	Current classification
Mr. Julio Linares López	09/17/2012	Executive	Other external
Ms. María Eva Castillo Sanz	09/17/2012	Independent	Executive
Mr. Peter Erskine	12/31/2012	Other external	Independent

B.1.4 Explain, when applicable, the reasons why proprietary directors have been appointed upon the request of shareholders who hold less than 5% of the share capital:

Name or corporate name of shareholder	Reasons
China Unicom (Hong Kong) Limited	<p>As explained in section A.6 of this report, on January 23, 2011, expanding on their existing strategic partnership, Telefónica, S.A. and China Unicom (Hong Kong) Limited ("China Unicom") signed an extension to their Strategic Partnership Agreement, in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. Telefónica also agreed to propose the appointment of a board member nominated by China Unicom in the next General Shareholders' Meeting, in accordance with prevailing legislation and the Company's Bylaws.</p> <p>The General Shareholders' Meeting held on May 18, 2011 approved the appointment of China Unicom's nominee, Mr. Chang Xiaobing, as member of the Board of Directors in accordance with the addendum to the Strategic Partnership Agreement signed in January 2011. This commitment to China Unicom is a consequence of the Strategic Partnership, which is intended to strengthen Telefónica's position in the global communications market.</p>

Provide details of any rejections of formal requests for board representation from shareholders whose equity interest is equal to or greater than that of other shareholders who have successfully requested the appointment of proprietary directors. If so, explain why these requests have not been entertained:

**No**

B.1.5 Indicate whether any director has resigned from office before their term of office has expired, whether that director has given the board his/her reasons and through which channel. If made in writing to the whole board, list below the reasons given by that director:

**Yes**

Name of director	Reasons for resignation
Mr. David Arculus	Mr. David Arculus tendered his voluntary resignation as director of Telefónica, S.A. based on personal issues to the Chairman of the Board through a letter dated September 14, 2012. The rest of the Board was duly notified at the meeting held on September 17, 2012.

B.1.6 Indicate what powers, if any, have been delegated to the Chief Executive Officer:

• **Mr. César Alierta Izuel – Executive Chairman (Chief Executive Officer)**

The Chairman of the Company, as the Chief Executive Officer, has been expressly delegated all the powers of the Board of Directors, except those that cannot be delegated by Law, by the Company Bylaws, or by the Regulations of the Board of Directors which establishes, in Article 5.4, the competencies that the Board of Directors reserves itself, and may not delegate.

Article 5.4 specifically stipulates that the Board of Directors reserves the power to approve: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its Committees and the Chairman; (iii) appoint Senior Executives, as well as the remuneration of Directors and Senior Executives; and (iv) decide strategic investments.

• **Mr. José María Álvarez-Pallete – Chief Operating Officer**

The Chief Operating Officer has been delegated those powers of the Board of Directors related to the management of the business and the performance of the highest executive functions over all the Company's business areas, except those which cannot be delegated by Law, under the Company Bylaws or according to the Regulations of the Board of Directors.

B.1.7 List the directors, if any, who hold office as directors or executives in other companies belonging to the listed company's group:

Name or corporate name of director	Corporate name of the group company	Post
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A.	Alternate Director
	Telefónica del Perú, S.A.A.	Director
	Telefónica Brasil, S.A.	Director
Mr. Francisco Javier de Paz Mancho	Telefónica de Argentina, S.A.	Director
Mr. Gonzalo Hinojosa Fernández de Angulo	Telefónica del Perú, S.A.A.	Director
	Telefónica Brasil, S.A.	Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Móviles México, S.A. de C.V.	Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
	Telefónica Czech Republic, A.S.	Chairman of Supervisory Board
Ms. María Eva Castillo Sanz	Telefónica Deutschland Holding, A.G.	Chairman of Supervisory Board
	Telefónica Europe, Plc.	Chairwoman
	Colombia Telecomunicaciones, S.A. Esp	Director
	Telefónica América, S.A.	Chairman
	Telefónica Brasil, S.A.	Vice Chairman
	Telefónica Capital, S.A.	Sole Director
	Telefónica Chile, S.A.	Alternate Director
	Telefónica Internacional, S.A.U.	Chairman
	Telefónica Móviles México, S.A. de C.V.	Vice Chairman
Mr. Santiago Fernández Valbuena		

B.1.8 List any company board members who sit on the boards of directors of other non-group companies that are listed on official securities markets in Spain, insofar as these have been disclosed to the company:

Name or corporate name of director	Name of listed company	Post
Mr. César Alierta Izuel	International Consolidated Airlines Group, S.A. ("IAG")	Director
	Caixabank, S.A.	Chairman
Mr. Isidro Fainé Casas	Abertis Infraestructuras, S.A.	Vice Chairman
	Repsol YPF, S.A.	2nd Vice Chairman
	Vueling Airlines, S.A.	Director
	Abertis Infraestructuras, S.A.	Director
Mr. Carlos Colomer Casellas	Inversiones Mobiliarias Urquiola, S.A. SICAV	Chairman
	Ahorro Bursatil, S.A. SICAV	Chairman
Mr. Ignacio Moreno Martínez	Metrovacesa, S.A.	Chairman
Ms. María Eva Castillo Sanz	Bankia, S.A.	Director
Mr. Pablo Isla Álvarez de Tejera	Inditex, S.A.	Chairman- CEO

B.1.9 Indicate and, where appropriate, explain whether the company has established rules about the number of boards on which its directors may sit:

Yes

#### Explanation of rules

The Regulations of the Board of Directors (Article 29.2) establish as one of the obligations of the Directors that they must devote the time and efforts required to perform their duties and, to such end, shall report to the Nominating, Compensation and Corporate Governance Committee on their other professional obligations if they might interfere with the performance of their duties as Directors.

B.1.10 In relation with Recommendation 8 of the Unified Good Governance Code, indicate the company's general policies and strategies that are reserved for approval by the board of directors in plenary session:

Investment and financing policy	Yes
Design of the structure of the corporate group	Yes
Corporate governance policy	Yes
Corporate social responsibility policy	Yes
The strategic or business plans, management targets and annual budgets	Yes
Remuneration and evaluation of senior officers	Yes
Risk control and management, and the periodic monitoring of internal information and control systems	Yes
Dividend policy, as well as the policies and limits applying to treasury stock	Yes

B.1.11 Complete the following tables on the aggregate remuneration paid to directors during the year:

a) In the reporting company:

Concept	Thousands of euros
Fixed remuneration	10,265
Variable remuneration	10,502
Per diems	263
Statutory compensation	0
Share options and/or other financial instruments	0
Other	26,868
<b>Total</b>	<b>47,898</b>

Other benefits	Thousands of euros
Advances	0
Loans	0
Pension funds and plans: Contributions	34
Pension funds and plans: Obligations	0
Life insurance premiums	94
Guarantees issued by the company in favor of directors	0

b) For company directors sitting on other governing bodies and/or holding senior management posts within group companies:

Concept	Thousands of euros
Fixed remuneration	1,557
Variable remuneration	0
Per diems	0
Statutory compensation	0
Share options and/or other financial instruments	0
Other	1,098
<b>Total</b>	<b>2,655</b>

Other benefits	Thousands of euros
Advances	0
Loans	0
Pension funds and plans: Contributions	0
Pension funds and plans: Obligations	0
Life insurance premiums	6
Guarantees issued by the company in favor of directors	0

c) Total remuneration by type of director:

Type of director	By the company	By the group
Executive	11,009	521
External proprietary	1,185	0
External independent	2,200	1,742
Other external	33,504	392
<b>Total</b>	<b>47,898</b>	<b>2,655</b>

d) Remuneration as a percentage of profit attributable to the parent company:

Total remuneration received by directors (in thousands of euros)	50,553
Total remuneration received by directors/profit attributable to parent company (%)	1.3

B.1.12 List any members of senior management who are not executive directors and indicate total remuneration paid to them during the year:

Name or corporate name	Post
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Matthew Key	Chairman Telefónica Digital
Mr. Eduardo Navarro de Carvalho	Director of Strategies and Partnerships
Mr. Ramiro Sánchez de Lerín García-Ovies	General Secretary and of the Board of Directors
Ángel Vilá Boix	General Manager of Finance and Corporate Development
Mr. Ignacio Cuesta Martín-Gil	Director, Internal Audit

Total remuneration received by senior management (in thousands of euros)	25,857
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B.1.13 Identify, in aggregate terms, any indemnity or “golden parachute” clauses that exist for members of the senior management (including executive directors) of the company or of its group in the event of dismissal or changes in control. Indicate whether these agreements must be reported to and/or authorized by the governing bodies of the company or its group:

Number of beneficiaries	10
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	Board of Directors	General Shareholders' Meeting
Body authorizing clauses	Yes	No

Is the General Shareholders' Meeting informed of such clauses?	Yes
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B.1.14 Describe the procedures for establishing remuneration for Board members and the relevant provisions in the bylaws:

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**Process for establishing board members' remuneration and relevant provisions in the bylaws**

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Directors' compensation shall consist of a fixed and specific monthly remuneration for belonging to the Board of Directors, the Steering Committee and the Board's Advisory or Control Committees, and fees for attending meetings of the Advisory or Control committees. The amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders' Meeting, which amount shall remain unchanged until and unless the shareholders decide to modify it. To this effect, the General Shareholders' Meeting held on April 11, 2003 fixed the maximum gross annual sum for remuneration of the Board of Directors at 6 million euros.

The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors.

In accordance with Article 35 of the Regulations of the Board of Directors, Directors shall be entitled to receive the compensation set by the Board of Directors in accordance with the Bylaws and following a report of the Nominating, Compensation and Corporate Governance Committee.

To this effect and in accordance with article 5 of the same regulations, the Board of Directors expressly reserves the powers to approve both the remuneration policy for Directors and decisions on the remuneration of Directors.

The Nominating, Compensation and Corporate Governance Committee has the following powers and duties (article 22 of the Regulations of the Board of Directors):

- To propose to the Board of Directors, within the framework established in the Bylaws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them.
- To propose to the Board of Directors the extent and amount of the compensation, rights and remuneration of a financial nature, of the Chairman and the executive Directors, including the basic terms of their contracts, for the purpose of implementing said contracts.
- To prepare and propose to the Board of Directors an annual report regarding the compensation policy for Directors.

Additionally, apart from such compensation as is provided for under the previous section, other remuneration systems may be established, either indexed to the market value of the shares, or consisting of shares or share options for Directors. The application of such compensation systems must be authorized by the General Shareholders' Meeting, which shall fix the share value that is to be taken as the term of reference thereof, the number of shares to be given to each Director, the exercise price of the share options, the term of this compensation system and such other terms and conditions as are deemed appropriate.

The remuneration systems set out in the preceding paragraphs, arising from membership of the Board of Directors, shall be deemed compatible with any other professional or work-based compensations to which the Directors may be entitled in consideration of whatever executive or advisory services they may provide for the Company other than such supervisory and decision-making duties as may pertain to their posts as Directors, which shall be subject to the applicable legal provisions.

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Indicate whether the board has reserved for plenary approval the following decisions.

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<b>On the proposal of the company's chief executive, the appointment and removal of senior officers, and their compensation clauses.</b>	Yes
<b>Directors' remuneration, and, in the case of executive directors, the additional consideration for their management duties and other contract conditions.</b>	Yes

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B.1.15 Indicate whether the Board of Directors approves a detailed remuneration policy and specify the points included:

**Yes**

The amount of the fixed components, itemized where necessary, of board and board committee attendance fees, with an estimate of the fixed annual payment they give rise to.	Yes
Variable components	Yes
The main characteristics of pension systems, including an estimate of their amount of annual equivalent cost.	Yes
The conditions that the contracts of executive directors exercising executive functions shall respect.	Yes

B.1.16 Indicate whether the board submits a report on the directors' remuneration policy to the advisory vote of the General Shareholders' Meeting, as a separate point on the agenda: Explain the points of the report regarding the remuneration policy as approved by the board for forthcoming years, the most significant departures in those policies with respect to that applied during the year in question and a global summary of how the remuneration policy was applied during the year. Describe the role played by the Remuneration Committee and whether external consultancy services have been procured, including the identity of the external consultants:

Yes

<b>Issues governed by the remuneration policy</b>	
The annual report drawn up by Telefónica, S.A. regarding the policy for Directors' compensation covers the following issues:	
<ul style="list-style-type: none"> <li>Objectives of the compensation policy.</li> <li>Detailed structure of compensation.</li> <li>Scope of application and reference parameters for variable remuneration.</li> <li>Relative importance of variable remuneration with regard to fixed remuneration.</li> <li>Basic terms of the contracts of Executive Directors.</li> <li>Changes in remuneration over time.</li> <li>How the compensation policy was prepared</li> </ul>	
<b>Role of the Remunerations Committee</b>	
<ul style="list-style-type: none"> <li>To propose to the Board of Directors, within the framework established in the Bylaws, the compensation for the Directors.</li> <li>To prepare and propose to the Board of Directors an annual report regarding the policy for Directors' compensation.</li> </ul>	
<b>Have external consultancy firms been used?</b>	
Yes	
<b>Identity of external consultants</b>	
Towers Watson	

B.1.17 List any Board members who are likewise members of the boards of directors, or executives or employees of companies that own significant holdings in the listed company and/or group companies:

Name or corporate name of director	Name or corporate name of significant shareholder	Post
		Chairman of Criteria Caixaholding, S.A.
		Chairman of Caja de Ahorros y Pensiones de Barcelona, "la Caixa"
Mr. Isidro Fainé Casas	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Chairman of Caixabank, S.A.
		Director of Serveis Informàtics de la Caixa, S.A.
		Director of Bousorama, S.A.
		General Manager of Caixabank, S.A.

Mr. Antonio Massanell Lavilla	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Director of Caixa Capital Risc, S.G.E.C.R., S.A.
		Chairman of Barcelona Digital Technological Centre
		Director of e-la Caixa, S.A.
		Director of Mediterranea Beach & Golf Community, S.A.
		Board member of Sociedad de gestión de activos procedentes de la reestructuración bancaria (SAREB for its initials in Spanish)
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Alternate Director of Grupo Financiero BBVA Bancomer, S.A. de C.V.
		Alternate Director of BBVA Bancomer, S.A.

List, if appropriate, any relevant relationships, other than those included under the previous heading, that link members of the Board of Directors with significant shareholders and/or their group companies.

Name or company name of director with relationship	Name or company name of significant shareholder with relationship	Description of relationship
Mr. José María Abril Pérez	Banco Bilbao Vizcaya Argentaria, S.A.	Early retirement. Formerly Wholesale and Investment Banking Manager.
Mr. Ignacio Moreno Martínez	Banco Bilbao Vizcaya Argentaria, S.A.	Formerly General Manager of Chairman's Office

B.1.18 Indicate whether any changes have been made to the regulations of the Board of Directors during the year:

**No**

B.1.19 Indicate the procedures for appointing, re-electing, appraising and removing directors. List the competent bodies and the processes and criteria to be followed for each procedure.

## Appointment

Telefónica's Bylaws state that the Board of Directors shall be composed of a minimum of five members and a maximum of twenty, to be appointed at the General Shareholders' Meeting. The Board of Directors may, in accordance with the Corporate Enterprises Act and the Company Bylaws, provisionally co-opt Directors to fill any vacancies.

To this effect the Board of Directors shall have the power to fill, on an interim basis, any vacancies that may occur therein, by appointing, in such manner as is legally allowed, the persons who are to fill such vacancies until the holding of the next General Shareholders' Meeting.

Also, in all cases, proposed appointments of Directors must follow the procedures set out in the Company's Bylaws and Regulations of the Board of Directors and be preceded by the appropriate favorable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the Committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must report, based on criteria of objectivity and the best interests of the Company, on proposals to appoint, re-appoint or remove Company Directors, taking into account the skills, knowledge and experience required of candidates to fill the vacancies.

In line with the provisions of its Regulations, the Board of Directors, exercising the right to fill vacancies by interim appointment and to propose appointments to the shareholders at the General Shareholders' Meeting, shall ensure that, in the composition of the Board of Directors, external or non-executive Directors represent an ample majority over executive Directors. Similarly, the Board shall ensure that the total number of independent Directors represents at least one third of the total number of Board members.

Similarly the nature of each Director shall be explained by the Board of Directors to the shareholders at the General Shareholders' Meeting at which the appointment thereof must be made or ratified. Furthermore, such nature shall be

reviewed annually by the Board after verification by the Nominating, Compensation and Corporate Governance Committee, and reported in the Annual Corporate Governance Report.

In any case, and in the event of re-election or ratification of Directors by the General Shareholders' Meeting, the report of the Nominating, Compensation and Corporate Governance Committee, or in the case of independent Directors, the proposal of said Committee, will contain an assessment of the work and effective time devoted to the post during the last period in which it was held by the proposed Director.

Lastly, both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that those proposed for the post of Director should be persons of recognized caliber, qualifications and experience, who are willing to devote the time and effort necessary to carrying out their functions, and shall take extreme care in the selection of persons to be appointed as independent Directors.

### **Re-election**

Directors are appointed for a period of five years, and may be re-elected for one or more subsequent five-year periods.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors, by the corresponding proposal by the Committee.

### **Evaluation**

In accordance with the Regulations of the Board of Directors, the latter reserves expressly the duty to approve on a regular basis its functioning and the functioning of its Committees, it being the duty of the Nominating, Compensation and Corporate Governance Committee to organize and coordinate, together with the Chairman of the Board of Directors, the regular assessment of said Body.

In accordance with the above, it should be noted that the Board of Directors and its Committees carry out a periodic evaluation of the operation of the Board of Directors and of the Committees thereof in order to determine the opinion of Directors regarding the workings of these bodies and to establish any proposals for improvements to ensure the optimum working of the company's governing bodies.

### **Removal or dismissal**

Directors' shall cease to hold office when the term for which they were appointed expires, or when so resolved by the shareholders at the General Shareholders' Meeting in the exercise of the powers legally granted to them.

The Board of Directors shall not propose the removal of any independent Director prior to the end of the Bylaw-mandated period for which they have been appointed, unless there are due grounds therefore acknowledged by the Board after a report from the Nominating, Compensation and Corporate Governance Committee. Specifically, due grounds shall be deemed to exist when the Director has failed to perform the duties inherent to his position.

The removal of independent Directors may also be proposed as a result of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

#### **B.1.20 Indicate the cases in which directors must resign.**

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation in the following cases:

- a) When they cease to hold the executive positions to which their appointment as Directors is linked, or when the reasons for which they were appointed no longer exist.
- b) When they are affected by any of the cases of incompatibility or prohibition established by statute.
- c) When they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for having failed to fulfill any of their obligations as Directors.
- d) When their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardize its interests.

The conditions listed above under Recommendation B.1.19 "Removal" must also be taken into consideration.

B.1.21 Indicate whether the duties of chief executive officer fall upon the Chairman of the Board of Directors. If so, describe the measures taken to limit the risk of powers being concentrated in a single person:

**Yes**

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**Measures for limiting risk**

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- Pursuant to the provisions of the Regulations of the Board of Directors, the actions of the Chairman must follow the criteria established by the General Shareholders' Meeting, the Board of Directors and the Board Committees at all times.
  - Likewise, all agreements or decisions of particular significance for the Company must be previously submitted for the approval of the Board of Directors or the relevant Board Committee, as the case may be.
  - The Board of Directors reserves the power to approve: the general policies and strategies of the Company; the evaluation of the Board, its Committees and its Chairman; the appointment of senior executive officers, as well as the compensation policy for Directors and senior executive officers; and strategic investments.
  - In addition, reports and proposals from the different Board Committees are required for the adoption of certain resolutions.
  - It is important to emphasize that the Chairman does not hold the casting vote within the Board of Directors.
  - The Board of Directors of the Company, at its meeting held on December 19, 2007, agreed to appoint Mr. Julio Linares López as the Chief Executive (Chief Operating Officer) of Telefónica, S.A., reporting directly to the Chairman and with responsibility over all of Telefónica Group's Business Units. On September 17, 2012, Julio Linares López was replaced as the Company's Chief Operating Officer by the director José María Álvarez-Pallete.
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Indicate, and if necessary, explain whether rules have been established that enable any of the independent directors to convene board meetings or include new items on the agenda, to coordinate and voice the concerns of external directors and oversee the evaluation by the Board of Directors.

**No**

B.1.22. Are qualified majorities, other than legal majorities, required for any type of decisions?

**No**

Describe how resolutions are adopted by the Board of Directors and specify, at least, the minimum attendance quorum and the type of majority for adopting resolutions.

<b>Description of resolution:</b>	
	All resolutions
<b>Quorum</b>	
Personal or proxy attendance of one half plus one of all Directors.	50.01
<b>Type of majority</b>	
Resolutions shall be adopted by a majority of votes cast by the Directors present at the meeting in person or by proxy, except in those instances in which the Law requires the favorable vote of a greater number of Directors for the validity of specific resolutions and in particular for: (i) the appointment of Directors not holding a minimum of shares representing a nominal value of 3,000 euros, (Article 25 of the Company Bylaws) and (ii) for the appointment of Chairman, Vice Chairman, CEO or member of the Executive Commission, when the requirements explained in the following section shall apply.	50.01

B.1.23 Indicate whether there are any specific requirements, apart from those relating to the directors, to be appointed Chairman.

Yes

<b>Description of requirements</b>
In order for a Director to be appointed Chairman, said Director must have served on the Board for at least three years prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

B.1.24. Indicate whether the Chairman has the casting vote.

No

B.1.25 Indicate whether the bylaws or the regulations of the Board of Directors set any age limit for directors:

No

<b>Age limit for Chairman</b>	<b>Age limit for CEO</b>	<b>Age limit for directors</b>
0	0	0

B.1.26 Indicate whether the bylaws or the regulations of the Board of Directors set a limited term of office for independent directors:

No

<b>Maximum number of years in office</b>
0

B.1.27 If there are few or no female directors, explain the reasons and describe the initiatives adopted to remedy this situation

#### Explanation of reasons and initiatives

The search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to coopt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. María Eva Castillo Sanz as an Independent Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders' Meeting of Telefónica held on April 22, 2008, and she was thus appointed as a Member of the Board of the Company for a term of five years. On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

Likewise, on December 19, 2007, the Board of Directors unanimously agreed, following a favorable report from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary of the Board of Directors of Telefónica.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates ("recognized caliber, qualifications and experience") and their ability to dedicate themselves to the functions of members of the board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

Indicate in particular whether the Appointments and Remunerations Committee has established procedures to ensure the selection processes are not subject to implicit bias that will make it difficult to select female directors, and make a conscious effort to search for female candidates who have the required profile.

**Yes**

#### Indicate the main procedures

In accordance with article 10.3 of the Board Regulations, the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as independent Directors.

B.128 Indicate whether there are any formal processes for granting proxies at Board meetings. If so, give brief details.

In accordance with Article 18 of the Regulations of the Board of Directors, Directors must attend meetings of the Board in person, and when unable to do so in exceptional cases, they shall endeavor to ensure that the proxy they grant to another member of the Board includes, as far as is practicable, appropriate instructions. Such proxies may be granted by letter or any other means that, in the Chairman's opinion, ensures the certainty and validity of the proxy granted.

B.1.29 Indicate the number of Board meetings held during the year and how many times the board has met without the Chairman's attendance and how many times the board has met without the Chairman's attendance:

Number of board meetings	14
Number of board meetings held in the absence of its chairman	0

Indicate how many meetings of the various board committees were held during the year.

Number of meetings of the Executive or Delegated Committee	15
Number of meetings of the Audit and Compliance Committee	9
Number of meetings of the Appointments and Remunerations Committee	11
Number of meetings of the Appointments Committee	0
Number of meetings of the Remunerations Committee	0

B.1.30 Indicate the number of Board meetings held during the financial year without the attendance of all members. Non-attendance will also include proxies granted without specific instructions:

Number of non-attendances by directors during the year	8
% of non-attendances of the total votes cast during the year	3.174

B.1.31 Indicate whether the individual and consolidated financial statements submitted for approval by the board are certified previously:

**No**

Identify, where applicable, the person(s) who certified the company's individual and consolidated financial statements prior to their authorization for issue by the board.

B.1.32 Explain the mechanisms, if any, established by the Board of Directors to prevent the individual and consolidated financial statements it prepares from being submitted to the General Shareholders' Meeting with a qualified Audit Report.

Through the Audit and Control Committee, the Board of Directors plays an essential role in supervising the preparation of the Company's financial information, controlling and coordinating the various players that participate in this process.

In this respect, to achieve this objective the Audit and Control Committee's work addresses the following basic issues:

- 1) To supervise the process of preparing and submitting regulated financial information. With respect thereto, it shall be responsible for supervising the process of preparation and the integrity of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- 2) To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the auditors significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy.
- 3) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of the revised text of the Law on Auditing of Financial Statements approved in Royal Legislative Decree 1/2011, of 1 July.

- 4) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in the previous paragraph.
- 5) To supervise internal audit and, in particular:
  - a) To ensure the independence and efficiency of the internal audit function;

- b) To propose the selection, appointment and removal of the person responsible for internal audit;
- c) To propose the budget for such service;
- d) To review the internal audit work plan and its annual activities report;
- e) To receive periodic information on its activities; and
- f) To verify that the senior executive officers take into account the conclusions and recommendations of its reports.

The Audit and Control Committee verifies both the periodical financial information and the Annual Financial Statements, ensuring that all financial information is drawn up according to the same professional principles and practices. To this effect, the Audit and Control Committee meets whenever appropriate, having held nine (9) meetings in the course of 2012.

Furthermore, the External Auditor participates regularly in the Audit and Control Committee meetings, when called to do so by the Committee, to explain and clarify different aspects of the audit reports and other aspects of its work. Additionally, and when requested by the Committee, other members of the management of the Company and its subsidiaries have attended Committee meetings to explain specific matters that are directly within their scope of competence. In particular, managers from the finance, planning and control areas, as well as those in charge of internal audit, have attended these meetings. The members of the Committee have held separate meetings with each of these when it was deemed necessary to closely monitor the preparation of the Company's financial information.

The above notwithstanding, Article 41 of the Regulations of the Board of Directors establishes that the Board of Directors shall endeavor to prepare the final financial statements in a manner that that will create no reason for qualifications from the Auditor. However, whenever the Board considers that it should maintain its standards, it shall publicly explain the contents and scope of the discrepancies.

B.1.33 Is the secretary of the Board also a director?

**No**

B.1.34 Explain the procedures for appointing and removing the Secretary of the Board, indicating whether his/her appointment and removal have been notified by the Appointments Committee and approved by the board in plenary session.

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#### Appointment and removal procedure

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In accordance with article 15 of the Regulations of the Board of Directors, the Board of Directors, upon the proposal of the Chairman, and after a report from the Nominating, Compensation and Corporate Governance Committee, shall appoint a Secretary of the Board, and shall follow the same procedure for approving his/her removal.

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Does the Appointments Committee propose appointments?	Yes
Does the Appointments Committee advise on dismissals?	Yes
Do appointments have to be approved by the board in plenary session?	Yes
Do dismissals have to be approved by the board in plenary session?	Yes

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Is the Secretary of the board entrusted in particular with the function of overseeing corporate governance recommendations?

**Yes**

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#### Remarks

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The Secretary of the Board shall, at all times, attend to the formal and substantive legality of the Board's actions, the conformance thereof to the Bylaws, the Regulations for the General Shareholders' Meeting and of the Board, and maintain in consideration the corporate governance recommendations assumed by the Company in effect from time to time (article 15 of the Regulations of the Board).

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B.1.35 Indicate the mechanisms, if any, established by the company to preserve the independence of the auditors, of financial analysts, of investment banks and of rating agencies.

With regards to the independence of the external Auditor of the Company, Article 41 of the Regulations of the Board of Directors establishes that the Board shall, through the Audit and Control Committee, establish a stable and professional relationship with the Company's Auditor, strictly respecting the independence thereof.

In addition, the Auditing and Control Committee has a fundamental responsibility, as specified in article 21 of the Regulations of the Board, to establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of the revised text of the Law on Auditing of Financial Statements approved in Royal Legislative Decree 1/2011, of 1 July.

The Committee must also issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in the previous paragraph.

In addition, in accordance with Article 21 of the Regulations of the Board of Directors, it is the Audit and Control Committee that proposes to the Board of Directors, for submission to the shareholders at the General Shareholders' Meeting, the appointment of the Auditor as well as, if necessary, the appropriate terms for the hiring thereof, the scope of its professional engagement and the revocation or non-renewal of its appointment.

Furthermore, the External Auditor has direct access to the Audit and Control Committee and participates regularly in its meetings, in the absence of the Company management team when this is deemed necessary. To this effect, and in keeping with United States legislation on this matter, the external Auditors must inform the Audit and Control Committee at least once a year on the most significant generally accepted auditing policies and practices followed in the preparation of the Company's financial and accounting information affecting key elements in the financial statements which may have been discussed with the management team, and of all relevant communications between the Auditors and the Company management team.

In accordance with internal Company regulations and in line with the requirements imposed by US legislation, the engagement of any service from the Company's external Auditors must always have the prior approval of the Audit and Control Committee. Moreover, the engagement of non-audit services must be done in strict compliance with the Accounts Audit Law and the Sarbanes-Oxley Act published in the United States and subsequent regulations. For this purpose, and prior to the engagement of the Auditors, the Audit and Control Committee studies the content of the work to be done, evaluating any situations that may jeopardize independence of the Company's external Auditor and specifically supervises the percentage the fees paid for such services represent in the total revenue of the auditing firm. In this respect, the Company reports the fees paid to the external auditor, including those paid for non-audit services, in its Notes to the Financial Statements, in accordance with prevailing legislation.

B.1.36 Indicate whether the company has changed its external audit firm during the year. If so, identify the incoming audit firm and the outgoing auditor.

**No**

Outgoing auditor

Incoming auditor

Explain any disagreements with the outgoing auditor and the reasons for the same.

No

B.1.37 Indicate whether the audit firm performs other non-audit work for the company and/or its group. If so, state the amount of fees received for such work and the percentage they represent of the fees billed to the company and/or its group:

No

	Company	Group	Total
Amount of non-audit work (in thousands €)	0	0	0
Amount of non-audit work as a % of the total amount billed by the audit firm	0.000	0.000	0.000

B.1.38 Indicate whether the audit report on the previous year's financial statements is qualified or includes reservations. Indicate the reasons given by the Chairman of the Audit Committee to explain the content and scope of those reservations or qualifications.

No

B.1.39 Indicate the number of consecutive years during which the current audit firm has been auditing the financial statements of the company and/or its group. Likewise, indicate how many years the current firm has been auditing the accounts as a percentage of the total number of years over which the financial statements have been audited:

	Company	Group
Number of consecutive years	8	8
Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)	26.7	36.4

B.1.40 List any equity holdings of the members of the company's Board of Directors in other companies with the same, similar or complementary types of activity to that which constitutes the corporate purpose of the company and/or its group, and which have been reported to the company. Likewise, list the posts or duties they hold in such companies:

Name or corporate name of director	Corporate name of the company in question	% share	Post or duties
Mr. Isidro Fainé Casas	Telecom Italia, S.p.A.	0.004	--
Mr. Isidro Fainé Casas	Abertis Infraestructuras, S.A.	0.008	Vice Chairman

B.1.41 Indicate and give details of any procedures through which directors may receive external advice:

Yes

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Details of procedure

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Article 28 of the Regulations of the Board of Directors stipulates that in order to receive assistance in the performance of their duties, the Directors or any of the Committees of the Board may request that legal, accounting, financial or other experts be retained at the Company's expense. The engagement must necessarily be related to specific problems of a certain significance and complexity that arise in the performance of their office.

The decision to retain such services must be communicated to the Chairman of the Company and shall be implemented through the Secretary of the Board, unless the Board of Directors does not consider such engagement to be necessary or appropriate.

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B.1.42 Indicate whether there are procedures for directors to receive the information they need in sufficient time to prepare for meetings of the governing bodies.

Yes

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Details of procedure

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The Company adopts the measures necessary to ensure that the Directors receive the necessary information, specially drawn up and geared to preparing the meetings of the Board and its Committees, sufficiently in advance. Under no circumstances shall such requirement not be fulfilled on the grounds of the importance or the confidential nature of the information, except in absolutely exceptional cases.

In this regard, at the beginning of each year the Board of Directors and its Committees shall set the calendar of ordinary meetings to be held during the year. The calendar may be amended by resolution of the Board itself, or by decision of the Chairman, in which case the Directors shall be made aware of the amendment as soon as practicable.

Also, and in accordance with Recommendation 19 of the Unified Good Governance Code, at the beginning of the year the Board and its Committees shall prepare an Action Plan detailing the actions to be carried out and their timing for each year, as per their assigned powers and duties.

Likewise, all the meetings of the Board and the Board Committees have a pre-established Agenda, which is communicated at least three days prior to the date scheduled for the meeting together with the call for the session. For the same purpose, the Directors are sent the documentation related to the Agenda of the meetings sufficiently in advance. Such information is subsequently supplemented with the written documentation and presentations handed out to the Directors at the meeting.

To provide all the information and clarifications necessary in relation to certain points deliberated, the Group's senior executive officers attend nearly all the Board and Committee meetings to explain the matters within their competencies.

Furthermore, and as a general rule, the Regulations of the Board of Directors expressly establish that Directors are granted the broadest powers to obtain information about all aspects of the Company, to examine its books, records, documents and other data regarding corporate transactions. The exercise of the right to receive information shall be channeled through the Chairman or Secretary of the Board of Directors, who shall respond to the requests made by the Directors, providing them with the requested information directly or offering them the proper contacts at the appropriate level of the organization.

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B.1.43 Indicate and, where appropriate, give details of whether the company has established rules obliging directors to inform the board of any circumstances that might harm the organization's name or reputation, tendering their resignation as the case may be:

Yes

## Details of rules

In accordance with Article 12 of the Regulations of the Board of Directors, Directors must tender their resignation to the Board of Directors and formalize such resignation when their remaining on the Board might affect the Company's credit or reputation in the market or otherwise jeopardizes its interests.

Likewise, article 32. h) of the Regulations establishes that Directors must report to the Board any circumstances related to them that might damage the credit or reputation of the Company as soon as possible.

B.1.44 Indicate whether any director has notified the company that he/she has been indicted or tried for any of the offences stated in article 124 of the Spanish Companies Act (LSA for its initials in Spanish):

No

Indicate whether the Board of Directors has examined this matter. If so, provide a justified explanation of the decision taken as to whether or not the director should continue to hold office.

No

Decision	Explanation

## B.2. Committees of the board of directors

B.2.1 Give details of all the committees of the board of directors and their members:

### NOMINATING, COMPENSATION AND CORPORATE GOVERNANCE COMMITTEE

Name	Post	Type
Mr. Alfonso Ferrari Herrero	Chairman	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent
Mr. Peter Erskine	Member	Independent

### AUDIT AND CONTROL COMMITTEE

Name	Post	Type
Mr. Gonzalo Hinojosa Fernández de Angulo	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary

### HUMAN RESOURCES, CORPORATE REPUTATION AND CORPORATE RESPONSIBILITY COMMITTEE

Name	Post	Type
Mr. Francisco Javier de Paz Mancho	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. Pablo Isla Álvarez de Tejera	Member	Independent

## REGULATION COMMITTEE

Name	Post	Type
Mr. Pablo Isla Álvarez de Tejera	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Other external
Ms. María Eva Castillo Sanz	Member	Executive

## SERVICE QUALITY AND CUSTOMER SERVICE COMMITTEE

Name	Post	Type
Mr. Antonio Massanell Lavilla	Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Ms. María Eva Castillo Sanz	Member	Executive
Mr. Pablo Isla Álvarez de Tejera	Member	Independent

## INTERNATIONAL AFFAIRS COMMITTEE

Name	Post	Type
Mr. José Fernando de Almansa Moreno-Barreda	Chairman	Other external
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José María Abril Pérez	Member	Proprietary
Mr. Luiz Fernando Furlán	Member	Independent

## EXECUTIVE COMMISSION

Name	Post	Type
Mr. César Alierta Izuel	Chairman	Executive
	Vice	
Mr. Isidro Fainé Casas	Chairman	Proprietary
	Vice	
Mr. José María Abril Pérez	Chairman	Proprietary
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Carlos Colomer Casellas	Member	Independent
Mr. Francisco Javier de Paz Mancho	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José María Álvarez-Pallete López	Member	Executive
Mr. Peter Erskine	Member	Independent

## STRATEGY COMMITTEE

Name	Post	Type
Mr. Peter Erskine	Chairman	Independent
Mr. Alfonso Ferrari Herrero	Member	Independent
Mr. Gonzalo Hinojosa Fernández de Angulo	Member	Independent
Mr. José Fernando de Almansa Moreno-Barreda	Member	Other external

Ms. María Eva Castillo Sanz	Member	Executive
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## INNOVATION COMMITTEE

Name	Post	Type
Mr. Carlos Colomer Casellas	Chairman	Independent
Mr. Antonio Massanell Lavilla	Member	Proprietary
Mr. José María Abril Pérez	Member	Proprietary
Mr. Peter Erskine	Member	Independent

B.2.2 Indicate whether the Audit Committee is responsible for the following:

To supervise the preparation process, monitoring the integrity of financial information on the company and, if applicable, the group, and revising compliance with regulatory requirements, the adequate boundaries of the scope of consolidation and correct application of accounting principles.	Yes
To regularly review internal control and risk management systems, so main risks are correctly identified, managed and notified.	Yes
To safeguard the independence and efficacy of the internal audit function; propose the selection, appointment, reappointment and removal of the head of internal audit; propose the department's budget; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.	Yes
To establish and supervise a mechanism whereby staff can report, confidentially and, if necessary, anonymously, any irregularities they detect in the course of their duties, in particular financial or accounting irregularities, with potentially serious implications for the firm.	Yes
To submit to the board proposals for the selection, appointment, reappointment and removal of the external auditor, and the engagement conditions.	Yes
To receive regular information from the external auditor on the progress and findings of the audit program and check that senior management are acting on its recommendations.	Yes
To ensure the independence of the external auditor.	Yes
In the case of groups, the committee should urge the group auditor to take on the auditing of all component companies.	Yes

B.2.3 Describe the organizational and operational rules and the responsibilities attributed to each of the board committees.

### International Affairs Committee

#### a) Composition

The International Affairs Committee shall consist of such number of Directors as the Board of Directors determines from time to time, but in no case less than three, and the majority of its members shall be external Directors.

The Chairman of the International Affairs Committee shall be appointed from among its members.

#### b) Duties

Notwithstanding any other duties that the Board of Directors may assign thereto, the primary mission of the International Affairs Committee shall be to strengthen and bring relevant international issues to the attention of the Board of Directors for the proper development of the Telefónica Group. In that regard, it shall have the following duties, among others:

- 1) To pay special attention to institutional relations in the countries in which the companies of the Telefónica Group operate.
- 2) To review those matters of importance that affect it in international bodies and forums, or those of economic integration.
- 3) To review regulatory and competition issues and alliances.

- 4) To evaluate the programs and activities of the Company's various Foundations and the resources used to promote its image and international social presence.

**c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the International Affairs Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the International Affairs Committee.

**Audit and Control Committee**

Pursuant to the provisions of Article 31 bis of the Company Bylaws of Telefónica, S.A., Article 21 of the Regulations of the Board of Directors regulates the Audit and Control Committee in the following terms:

**a) Composition**

The Audit and Control Committee shall be comprised of a minimum of three and a maximum of five Directors appointed by the Board of Directors. All members of the Committee must be External Directors, not Executive Directors, and at least one must be an Independent Director. When appointing such members, the Board of Directors shall take into account the appointees' knowledge and experience in matters of accounting, auditing and risk management.

The Chairman of the Audit and Control Committee, who shall in all events be an independent Director, shall be appointed from among its members, and shall be replaced every four years; he/she may be re-elected after the passage of one year from the date when he/she ceased to hold office.

**b) Duties**

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

- 1) To report, through its Chairman, to the General Shareholders' Meeting on matters raised thereat by the shareholders that are within the purview of the Committee;
- 2) To propose to the Board of Directors, for submission to the shareholders at the General Shareholders' Meeting, the appointment of the Auditor mentioned in Article 264 of the Companies Act (Ley de Sociedades de Capital), as well as, where appropriate, terms for the hiring thereof, the scope of its professional engagement and the revocation or renewal of its appointment.
- 3) To supervise internal audit and, in particular:
  - a) To ensure the independence and efficiency of the internal audit function;
  - b) To propose the selection, appointment and removal of the person responsible for internal audit;
  - c) To propose the budget for such service;
  - d) To review the internal audit work plan and its annual activities report;
  - e) To receive periodic information on its activities; and
  - f) To verify that the senior executive officers take into account the conclusions and recommendations of its reports.

- 4) To supervise the process of preparing and submitting regulated financial information. With respect thereto, it shall be responsible for supervising the process of preparation and the integrity of the financial information relating to the Company and the Group, reviewing compliance with regulatory requirements, the proper determination of the scope of consolidation, and the correct application of accounting standards, informing the Board of Directors thereof.
- 5) To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the auditors significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following:
  - a) the types of risk (operational, technological, financial, legal and reputational) facing the company;
  - b) the setting of the risk level which the company considers acceptable;
  - c) the measures to mitigate the impact of the identified risks, in case they materialize;
  - d) the control and information systems to be used to control and manage the above-mentioned risks.
- 6) To establish and supervise a system that allows employees to confidentially and anonymously report potentially significant irregularities, particularly any financial and accounting irregularities detected within the Company.
- 7) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive, on an annual basis, written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor or by the persons or entities related thereto pursuant to the provisions of the revised text of the Law on Auditing of Financial Statements approved in Royal Legislative Decree 1/2011, of 1 July.

- 8) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in paragraph 7) above.

**c) Operation**

The Audit and Control Committee shall meet at least once every quarter and as often as appropriate, when called by its Chairman.

In the performance of its duties, the Audit and Control Committee may require that the Company's Auditor and the person responsible for internal audit, and any employee or senior executive officer of the Company, attend its meetings.

**d) Action Plan and Report**

As with the Board and its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Audit and Control Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Audit and Control Committee.

### **Service Quality and Customer Service Committee**

#### **a) Composition**

The Service Quality and Customer Service Committee shall consist of such number of Directors as the Board of Directors determines from time to time, but in no case less than three, and the majority of its members shall be external Directors.

The Chairman of the Service Quality and Customer Service Committee shall be appointed from among its members.

#### **b) Duties**

Without prejudice to any other duties that the Board of Directors may assign thereto, the Service Quality and Customer Service Committee shall have at least the following duties:

- 1) To periodically examine, review and monitor the quality indices of the principal services provided by the companies of the Telefónica Group.
- 2) To evaluate levels of customer service provided by such companies.

#### **c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Service Quality and Customer Service Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Service Quality and Customer Services Committee.

### **Strategy Committee**

#### **a) Composition**

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Strategy Committee shall be appointed from among its members.

#### **b) Duties**

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Strategy Committee shall be to support the Board of Directors in the analysis and follow up of the global strategy policy of the Telefónica Group.

#### **c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Strategy Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Strategy Committee.

### **Innovation Committee**

#### **a) Composition**

The Board of Directors shall determine the number of members of this Committee.

The Chairman of the Innovation Committee shall be appointed from among its members.

#### **b) Duties**

The Innovation Committee is primarily responsible for advising and assisting in all matters regarding innovation. Its main object is to perform an examination, analysis and periodic monitoring of the Company's innovation projects, to provide guidance and to help ensure its implementation and development across the Group.

#### **c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Innovation Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Innovation Committee.

### **Nominating, Compensation and Corporate Governance Committee**

#### **a) Composition**

The Nominating, Compensation and Corporate Governance Committee shall consist of not less than three and not more than five Directors appointed by the Board of Directors. All members of the Committee must be external Directors and the majority thereof must be independent Directors.

The Chairman of the Nominating, Compensation and Corporate Governance Committee, who shall in all events be an independent Director, shall be appointed from among its members.

#### **b) Duties**

Notwithstanding other duties entrusted it by the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall have the following duties:

- 1) To report, following standards of objectivity and conformity to the corporate interest, on the proposals for the appointment, re-election and removal of Directors and senior executive officers of the Company and its subsidiaries, and evaluate the qualifications, knowledge and experience required of candidates to fill vacancies.
- 2) To report on the proposals for appointment of the members of the Executive Commission and of the other Committees of the Board of Directors, as well as the Secretary and, if applicable, the Deputy Secretary.
- 3) To organize and coordinate, together with the Chairman of the Board of Directors, a periodic assessment of the Board, pursuant to the provisions of Article 13.3 of these Regulations.
- 4) To inform on the periodic assessment of the performance of the Chairman of the Board of Directors.

- 5) To examine or organize the succession of the Chairman such that it is properly understood and, if applicable, to make proposals to the Board of Directors so that such succession occurs in an orderly and well-planned manner.
- 6) To propose to the Board of Directors, within the framework established in the By-Laws, the compensation for the Directors and review it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 35 of these Regulations.
- 7) To propose to the Board of Directors, within the framework established in the By-Laws, the extent and amount of the compensation, rights and remuneration of a financial nature, of the Chairman, the executive Directors and the senior executive officers of the Company, including the basic terms of their contracts, for purposes of contractual implementation thereof.
- 8) To prepare and propose to the Board of Directors an annual report regarding the Director compensation policy.
- 9) To supervise compliance with the Company's internal rules of conduct and the corporate governance rules thereof in effect from time to time.
- 10) To exercise such other powers and perform such other duties as are assigned to such Committee in these Regulations.

**c) Operation**

In addition to the meetings provided for in the annual schedule, the Nominating, Compensation and Corporate Governance Committee shall meet whenever the Board of Directors of the Company or the Chairman thereof requests the issuance of a report or the approval of proposals within the scope of its powers and duties, provided that, in the opinion of the Chairman of the Committee, it is appropriate for the proper implementation of its duties.

**d) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Nominating, Compensation and Corporate Governance Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Nominating, Compensation and Corporate Governance Committee.

**Human Resources, Corporate Reputation and Corporate Responsibility Committee**

**a) Composition**

The Human Resources and Corporate Reputation and Responsibility Committee shall consist of such number of Directors as the Board of Directors determines from time to time, but in no case less than three and the majority of its members shall be external Directors.

The Chairman of the Human Resources, Reputation and Corporate Responsibility Committee shall be appointed from among its members.

**b) Duties**

Without prejudice to any other tasks that the Board of Directors may assign thereto, the Human Resources and Corporate Reputation and Responsibility Committee shall have at least the following duties:

- 1) To analyze, report on and propose to the Board of Directors the adoption of the appropriate resolutions on personnel policy matters.

- 2) To promote the development of the Telefónica Group's Corporate Reputation and Responsibility project and the implementation of the core values of the Group.

**c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Human Resources, Corporate Reputation and Responsibility Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Human Resources, Corporate Reputation and Responsibility Committee.

**Regulation Committee**

**a) Composition**

The Regulation Committee shall consist of such number of Directors as the Board of Directors determines from time to time, but in no case less than three, and the majority of its members shall be external Directors.

The Chairman of the Regulation Committee shall be appointed from among its members.

**b) Duties**

Notwithstanding other duties entrusted to it by the Board of Directors, the Regulation Committee shall have at least the following functions:

- 1) To monitor on a permanent basis the principal regulatory matters and issues affecting the Telefónica Group at any time, through the study, review and discussion thereof.
- 2) To act as a communication and information channel between the Management Team and the Board of Directors in regulatory matters and, where appropriate, to advise the latter of those matters deemed important or significant to the Company or to any of the companies of its Group in respect of which it is necessary or appropriate to make a decision or adopt a particular strategy.

**c) Action Plan and Report**

As with the Board and the rest of its Committees, at the beginning of each year and in accordance with Article 19 b) 3. of the Regulations of the Board of Directors, the Regulation Committee shall prepare an Action Plan detailing the actions to be taken and their timing for each year in each of their fields of action.

The Committee also draws up an internal Activities Report summarizing the main activities and actions taken during the year, detailing the issues discussed at its meetings and highlighting certain aspects regarding its powers and duties, composition and operation.

As per Article 19 b) 3. of the Regulations of the Board of Directors, in order that it may properly exercise its duties, the Board of Directors is kept fully informed of the issues dealt with by the Regulation Committee.

**Executive Commission**

**a) Composition**

The Executive Commission shall consist of the Chairman of the Board, once appointed as a member thereof, and not less than three nor more than ten Directors appointed by the Board of Directors.

In the qualitative composition of the Executive Commission, the Board of Directors shall seek to have external or non-executive Directors constitute a majority over the executive Directors.

In all cases, the affirmative vote of at least two-thirds of the members of the Board of Directors shall be required in order for the appointment or re- appointment of the members of the Executive Commission to be valid.

**b) Duties**

The Board of Directors, always subject to the legal provisions in force, has delegated all its powers to an Executive Commission, except those that cannot be delegated by Law, by the Company Bylaws, or by the Regulations of the Board of Directors.

The Executive Commission provides the Board of Directors with a greater efficiency and effectiveness in the executions of its tasks, since it meets more often.

**c) Operation**

The Executive Commission shall meet whenever called by the Chairman, and shall normally meet every fifteen days.

The Chairman and Secretary of the Board of Directors shall act as the Chairman and Secretary of the Executive Commission. One or more Vice Chairmen and a Deputy Secretary may also be appointed.

A quorum of the Executive Commission shall be validly established with the attendance, in person or by proxy, of one-half plus one of its members.

Resolutions shall be adopted by a majority of the Directors attending the meeting (in person or by proxy), and in the case of a tie, the Chairman shall cast the deciding vote.

**d) Relationship with the Board of Directors**

The Executive Commission shall report to the Board in a timely manner on the matters dealt with and the decisions adopted at the meetings thereof, with a copy of the minutes of such meetings made available to the members of the Board (article 20.C of the Regulations of the Board of Directors).

B.2.4 Identify any advisory or consulting powers and, where applicable, the powers delegated to each of the committees:

Committee name	Brief description
International Affairs Committee	Consultative and control committee
Audit and Control Committee	Consultative and control committee
Service Quality and Customer Service Committee	Consultative and control committee
Strategy Committee	Consultative and control committee
Innovation Committee	Consultative and control committee
Nominating, Compensation and Corporate Governance Committee	Consultative and control committee
Human Resources, Corporate Reputation and Corporate Responsibility Committee	Consultative and control committee
Regulation Committee	Consultative and control committee
Executive Commission	Corporate Body with general decision-making powers and express delegation of all powers corresponding to the Board of Directors except for those that cannot be delegated by law, bylaws or regulations.

B.2.5 Indicate, as appropriate, whether there are any regulations governing the board committees. If so, indicate where they can be consulted, and whether any amendments have been made during the year. Also indicate whether an annual report on the activities of each committee has been prepared voluntarily.

#### **International Affairs Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Audit and Control Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. In addition, the Audit and Control Committee is specifically regulated in article 31 bis of the Bylaws. These documents are available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year, detailing the issues discussed at the meetings and highlighting certain aspects regarding their powers and duties, composition and operation.

#### **Service Quality and Customer Service Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Strategy Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Innovation Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Nominating, Compensation and Corporate Governance Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Human Resources, Corporate Reputation and Corporate Responsibility Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Regulation Committee**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. This document is available for consultation on the company website.

As mentioned in section B.2.3 above, the Board Committees draw up an internal Report summarizing the main activities and actions taken during the year detailing the issues discussed at the meetings and highlighting certain aspects regarding the powers and duties, composition and operation.

#### **Executive Commission**

The organization and operation of the Board of Directors Committees are governed by specific regulations contained in the Regulations of the Board of Directors. The Executive Commission is also regulated by Article 31 of the Bylaws. These documents are available for consultation on the company website.

B.2.6 Indicate whether the composition of the Executive Committee reflects the participation within the board of the different types of directors:

**Yes**

## C. Related party transactions

**C.1** Indicate whether the board plenary sessions have reserved the right to approve, based on a favorable report from the Audit Committee or any other committee responsible for this task, transactions which the company carries out with directors, significant shareholders or representatives on the board, or related parties:

Yes

**C.2** List any relevant transactions entailing a transfer of assets or liabilities between the company or its group companies and the significant shareholders in the company:

Name or corporate name of significant shareholder	Name or corporate name of the company or its group company	Nature of the relationship	Type of transaction	Amount (thousands of euros)
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Gain from sale or disposal of assets	1
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance arrangements: loans and capital contributions (lender)	37,791
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance leases (lessor)	53
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other expenses	986
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	6,315
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees and deposits received	471,002
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Leases	392
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance agreements, loans and capital contributions (borrower)	95,361
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Commitments acquired	25,025
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	14,150
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Commitments acquired	5,718
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance income	22,268
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Services rendered	218,026
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance costs	106,471
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Acquisition of property, plant and equipment, intangible assets and other fixed assets	18,970
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other income	3,745
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees and deposits received	326
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans and capital contributions (lender)	622,155
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance income	3,747
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance arrangements: loans and capital contributions (borrower)	449,472
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	27,627
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	285,564
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends received	16,083
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance costs	5,377
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Commitments acquired	12,905,663
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Leases	770
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Services rendered	38,680
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Other expenses	64
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Commitments acquired	48,550
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Guarantees and deposits received	139,546
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Commitments acquired	53

Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Receipt of services	33,879
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance income	5
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance costs	11,706
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	6,244
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Receipt of services	25,387
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance agreements, loans and capital contributions (borrower)	384,519
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance income	2,274
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Commitments acquired	2,661,335
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance arrangements: loans and capital contributions (lender)	618,021
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	134,535
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Guarantees and deposits received	9,800
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance costs	5,424

**C.3 List any relevant transactions entailing a transfer of assets or liabilities between the company or its group companies, and the company's managers or directors.**

**C.4 List any relevant transactions undertaken by the company with other companies in its group that are not eliminated in the process of drawing up the consolidated financial statements and whose subject matter and terms set them apart from the company's ordinary trading activities.**

**C.5 Identify, where appropriate, any conflicts of interest affecting company directors pursuant to article 127 of the LSA.**

**Yes**

**Name or corporate name of director**

Mr. Isidro Fainé Casas

**Description of the situation of conflict of interest**

At the meeting of Telefónica, S.A.'s Executive Committee held on October 19, 2012, the Directors representing Caja de Ahorros y Pensiones de Barcelona, "La Caixa", and Banco Bilbao Vizcaya Argentaria, S.A., Mr. Isidro Fainé Casas and Mr. José María Abril Pérez, respectively, abstained from voting on the resolution relating to a bid to purchase preferred stock of Telefónica Finance USA LLC and, additionally to the simultaneous sale of treasury shares of Telefónica, S.A. and the subscription of newly issued plain-vanilla bonds, since both companies cooperate as financial institutions in that project.

**Name or corporate name of director**

Mr. José María Abril Pérez

**Description of the situation of conflict of interest**

At the meeting of Telefónica, S.A.'s Executive Committee held on October 19, 2012, the Directors representing Caja de Ahorros y Pensiones de Barcelona, "La Caixa", and Banco Bilbao Vizcaya Argentaria, S.A., Mr. Isidro Fainé Casas and Mr. José María Abril Pérez, respectively, abstained from voting on the resolution relating to a bid to purchase preferred stock of Telefónica Finance USA LLC and, additionally to the simultaneous sale of treasury shares of Telefónica, S.A. and the subscription of newly issued plain-vanilla bonds, since both companies cooperate as financial institutions in the project.

**C.6 List the mechanisms established to detect, determine and resolve any possible conflicts of interest between the company and/or its group, and its directors, management or significant shareholders.**

Company policy establishes the following principles governing possible conflicts of interest that may affect Directors, senior executive officers or significant shareholders:

- With respect to Directors, Article 32 of the Regulations of the Board of Directors establishes that Directors shall inform the Board of Directors of any situation of direct or indirect conflict they may have with the interest of the company. In the event of conflict, the Director affected shall refrain from participating in the deliberation to which the conflict refers.

Moreover, and in accordance with the provisions set out in the Regulations of the Board, Directors shall refrain from participating in votes that affect matters in which they or persons related to them have a direct or indirect interest.

Likewise, the aforementioned Regulations establish that Directors shall not directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of the Group, if such transactions are unrelated to the ordinary course of business of the Company or not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, with the prior report of the Nominating, Compensation and Corporate Governance Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors present in person or by proxy.

Directors must also report with respect to themselves as well as the persons related thereto (a) the direct or indirect interests held by them and (b) the offices held or duties performed at any company that is in a situation of real competition with the Company.

For purposes of the provisions of this paragraph, the following shall not be deemed to be in a situation of actual competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled thereby (within the meaning of Article 42 of the Commercial Code); and (ii) companies with which Telefónica, S.A. has established a strategic alliance. Likewise, for purposes of the provisions hereof, proprietary Directors of competitor companies appointed at the request of the Company or in consideration of the Company's interest in the capital thereof shall not be deemed to be in a situation of competition.

- With regards to significant shareholders, Article 39 of the Regulations of the Board of Directors stipulates that the Board of Directors shall know the transactions that the Companies enter into, either directly or indirectly, with Directors, with significant shareholders or shareholders represented on the Board, or with persons related thereto.

The performance of such transactions shall require the authorization of the Board, after a favorable report of the Nominating, Compensation and Corporate Governance Committee, unless they are transactions or operations that form part of the customary or ordinary activity of the parties involved that are performed on customary market terms and in insignificant amounts for the Company.

The transactions referred to in the preceding sub-section shall be assessed from the point of view of equal treatment of shareholders and the arm's-length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the periodic information of the Company upon the terms set forth in applicable laws and regulations.

- With respect to senior executive officers, the Internal Code of Conduct for Securities Markets Issues sets out the general principles of conduct for the persons subject to the said regulations who are involved in a conflict of interest. The aforementioned Code includes all the Company Management Personnel within the concept of affected persons.

In accordance with the provisions of this Code, senior executive officers are obliged to (a) act at all times with loyalty to the Telefónica Group and its shareholders, regardless of their own or other interests; (b) refrain from interfering in or influencing the making of decisions that may affect individuals or entities with whom there is a conflict; and (c) refrain from receiving information classified as confidential which may affect such conflict. Furthermore, these persons are obliged to inform the Company Regulatory Compliance Unit of all transactions that may potentially give rise to conflicts of interest.

**C.7 Is more than one group company listed in Spain?**

**No**

Identify the listed subsidiaries in Spain

## D RISK CONTROL SYSTEMS

### D.1 Give a general description of risk policy in the company and/or its group, detailing and evaluating the risks covered by the system, together with evidence that the system is appropriate for the profile of each type of risk.

The Telefónica Group's business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The main risks and uncertainties facing the Company which could affect its business, financial position and results, are as follows:

#### Group-related risks

- **Country risk (investments in Latin America)**

At December 31, 2012, approximately 48.9% of the Telefónica Group's revenue (approximately 49.6% of its assets) is generated by the Latin American segment (primarily in Brazil, Argentina, Venezuela, Chile and Peru); 78.3% of those assets are generated in countries classified as investment grade (Brazil, Chile, Peru, Colombia, Mexico, Uruguay and Panama) by some of the credit rating agencies. The Telefónica business is especially sensitive to any of the risks related to Latin America described in this section, particularly if they affect or arise in Brazil, which at December 31, 2012 accounted for 50.6% of assets and 44.6% of revenue from Latin American operations.

The Group's investments and operations in Latin America could be affected by a series of risks related to economic, political and social factors in these countries, collectively denominated "country risk," including risks related to the following:

- government regulation or administrative policies may change unexpectedly, including changes that modify the terms and conditions of licenses and concessions and their renewal (or delay their approval) which could negatively affect the Group's interests in such countries;
- the effects of inflation, currency depreciation or currency restrictions and other restraints on transfer of funds may be imposed. For example, in Venezuela, the official US Dollar to Bolivar fuerte exchange rate is established by the Central Bank of Venezuela and the Minister of Finance. Additionally, the acquisition of foreign currencies by Venezuelan companies to pay foreign debt or dividends is subject to the pre-authorization of the relevant Venezuelan authorities;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies; and
- economic downturns, political instability and civil disturbances may negatively affect the Telefónica Group's operations in such countries.

- **Foreign currency and interest rate risk**

The Telefónica Group's business is exposed to various types of market risks, above all the impact of changes in interest rates or foreign currency exchange rates.

At December 31, 2012, 23% of the Group's net debt was at floating rates, while 20% was denominated in a currency other than the euro.

To illustrate the sensitivity of financial expenses to a change in short-term interest rates at December 31, 2012: (i) a 100 basis points increase in interest rates in all currencies in which Telefónica has a financial position at that date would lead to an increase in financial expenses of 96 million euros, (ii) whereas a 100 basis points decrease in interest rates in all currencies except the euro, dollar and the pound sterling, in order to avoid negative rates, would lead to a reduction in

financial expenses of 36 million euros. These calculations were made assuming a constant currency and balance position equivalent to the position at that date and bearing in mind the derivative financial instruments arranged.

As for the impact on the income statement, specifically exchange gains and losses in the financial result at December 31, 2012, the impact of a 10% increase or decrease in the exchange rate would be 159 million euros (assuming a constant currency position with an impact on profit or loss at that date including derivative instruments arranged and that Latin American currencies would fall against the US dollar and the rest of the currencies against the euro by 10%).

The Telefónica Group uses a variety of strategies to manage this risk, mainly through the use of financial derivatives, which themselves are also exposed to risk, including counterparty risk. Furthermore, the Group's risk management strategies may not achieve the desired effect, which could adversely affect the Group's business, financial condition, results of operations and cash flows.

- **Dependence on external sources of financing**

The performance, expansion and improvement of networks, the development and distribution of the Telefónica Group's services and products, as well as the development and implementation of new technologies or the renewal of licenses require a substantial amount of financing.

The performance of financial markets in terms of liquidity, cost of credit, access and volatility, continues to be overshadowed by persisting uncertainty regarding certain factors such as the pace of economic recovery, the health of the international banking system or the concerns regarding the burgeoning deficits of some European countries. The worsening international financial market conditions caused by some of these factors could make it more difficult and more expensive to refinance existing financial debt (at December 31, 2012, gross maturities in 2013, including the net position in derivative financial instruments, certain current payables and expected early redemptions amounted to around 10,074 million euros, or 9,574 million euros should Telefónica elect not to exercise expected early redemptions, and in 2014 to 7,850 million euros) or arrange new debt if necessary, and more difficult and costly to raise funds from our shareholders.

Furthermore, obtaining financing on the international capital markets could also be restricted (in terms of access and cost) if Telefónica's credit ratings are revised downwards, either due to lower solvency or operating performance, or as a result of a downgrade in the rating for Spanish sovereign risk by rating agencies. Any of these situations could have a negative impact on our ability to honor our debts.

Moreover, market conditions could make it harder to renew existing undrawn bilateral credit lines, 18% of which, at December 31, 2012, initially mature prior to December 31, 2013.

#### Risks related to the Group's industry

- **Current global economic situation**

The Telefónica Group's business is impacted by general economic conditions in each of the countries in which it operates. The uncertainty about whether economic recovery will continue may negatively affect the level of demand from existing and prospective customers, as customers may no longer deem critical the services offered by the Group. The main macroeconomic factors that could have an adverse impact on consumption and, accordingly, demand for our services and the Telefónica Group's results include the dearth of credit as banks adjust their balance sheets, trends in the labor market, further erosion of consumer confidence, with an immediate increase in saving rates, or needs for greater fiscal adjustment, which would undermine household income levels. This risk is higher in Europe, but less relevant in other countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain euro-area countries and rating downgrades in some of these countries should be taken into account. Any further deterioration in sovereign debt markets or greater restrictions on credit in the banking sector could have an adverse impact on Telefónica's ability to raise financing and/or obtain liquidity. This could have a negative effect on the Group's business, financial condition, results of operations or cash flows. In addition, there could be other possible follow-on effects from the economic crisis on the Group's business, including insolvency of key customers or suppliers.

Lastly, in Latin America, the exchange rate risk in Venezuela (as reflected by the recent currency devaluation in February 2013) and Argentina (with a constant devaluation of the Argentinean peso against U.S. dollar) exists in relation to the negative impact any unexpected weakening in their currencies could have on cash flows from these countries. On February 8, 2013, the Venezuelan bolivar fuerte was devalued from 4.3 bolivar fuertes per U.S. dollar to 6.3 bolivar fuertes per U.S. dollar. The decision of the Venezuelan government affects the estimates made by the Group of the net asset value of the foreign currency position related to investments in Venezuela, which translates to an approximate pre-tax loss of 438 million euros on the 2012 financial statements.

- **Highly regulated markets**

As a multinational telecommunications company that operates in regulated markets, the Telefónica Group is subject to different laws and regulations in each of the jurisdictions in which it provides services and in which supranational regulators such as the European Union and national, state, regional and local authorities intervene to varying degrees and as appropriate. This regulation is strict in the countries in which the Company holds a significant market power position.

In Europe, wholesale mobile network termination rates came down in 2011. There were considerable reductions in many of the countries where the Group operates, notably in the UK (with a final reduction scheduled for 2015 and a decrease in prices of over 83% compared to the end of 2010) and Germany (cuts of over 50% since December 2010). In Spain, the schedule for reducing mobile call termination rates came into play on April 16, 2012, and the target price (1.09 euros) will be attained in July 2013, with a decrease of approximately 75% in wholesale prices. Other countries where rates will fall as from 2012 are the Czech Republic (slightly more than 49%), Ireland (approximately 72%) and Slovakia (approximately 58%).

Other services with regulated prices in Europe include call roaming, SMS and data services. The European Parliament and Council has approved the new Roaming III regulation which replaces all previous regulations. The objective of this Regulation is to set maximum prices for voice and SMS retail and wholesale services between July 2012 and July 2014, which will then be progressively reduced. It also regulates retail and wholesale data roaming charges for the first time.

Additionally, according to Roaming III, from July 2014, mobile operators would be forced to separate the sale of roaming services from their domestic services. This would allow users to choose a different operator for calls made in other Member States. Lastly, in relation to net neutrality, the new European regulatory framework establishes as a general principle the importance of ensuring European citizens have free internet access. Nevertheless, regulators could also adopt at any time measures or additional requirements to reduce roaming prices and fixed and/or mobile termination rates, and force Telefónica to provide third-party access to its networks.

Moreover, in Latin America there is tendency to review –and reduce– mobile network termination rates. For instance, reductions of 61% and 60% have been approved in Mexico and Chile, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates through to 2014 by applying a CPI-factor, which results in a reduction of approximately 29% in 2012-2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend towards reductions in termination rates in Peru, Venezuela and Colombia.

The new regulatory principles established in Europe's common regulatory framework, adopted in 2009 and transposed in the national legislation of each Member State in which Telefónica operated during 2011 and 2012 could result in increased regulatory pressure on the local competitive environment. Specifically, this framework supports the possibility of national regulators, in specific cases and under exceptional conditions, establishing the functional separation between the wholesale and retail businesses of operators with significant market power and vertically integrated operators, whereby they would be required to offer equal wholesale terms to third-party operators that acquire these products.

The recommendation on the application of the European regulatory policy to next-generation broadband networks drawn up by the European Commission (EC) could also play a key role in the incentives for operators to invest in net fixed broadband networks in the short-term and medium-term, thus affecting the outlook for the business and competition in this market segment. Nonetheless, the EC is currently drafting respective recommendations on cost accounting and non-discrimination, and it is expected that these recommendations, which will affect the earlier recommendation, will be approved in mid-2013. According to statements by Commissioner Kroes, initial evaluations are that the Commission could make the regulation for new generation networks more flexible in exchange for stricter measures on new operators concerning non-discrimination.

Meanwhile, as the Group provides most of its services under licenses, authorizations or concessions, it is vulnerable to economic fines for serious breaches and, ultimately, revocation or failure to renew these licenses, authorizations or concessions or the granting of new licenses to competitors for the provisions of services in a specific market.

The Telefónica Group pursues their renewal to the extent provided by the contractual conditions, though it cannot guarantee that it will always complete this process successfully or under the most beneficial terms for the Group. In many cases it must satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in fines or even revocation or forfeiture of the license, authorization or concession.

Additionally, the Telefónica Group could be affected by regulatory actions carried out by antitrust or competition authorities. These authorizations could prohibit certain actions, such as new acquisitions or specific practices, create obligations or lead to heavy fines. Any such measures implemented by the competition authorities could result in economic and/or reputational loss for the Group, in addition to a loss of market share and/or in harm to the future growth of certain businesses.

- **Highly competitive markets and markets subject to constant technological development.**

The Telefónica Group operates in markets that are highly competitive and subject to constant technological development. Therefore, it is subject to the effects of actions by competitors in these markets and its ability to anticipate and adapt to constant technological changes taking place in the industry.

To compete effectively, the Telefónica Group needs to successfully market its products and services and respond to both commercial actions by competitors and other competitive factors affecting these markets, anticipating and adapting promptly to technological changes, changes in consumer preferences and general economic, political and social conditions. Failure to do so appropriately could have an adverse impact on the Group's financial condition, results of operations and cash flows.

New products and technologies arise constantly, while the development of existing products and technologies can render obsolete the products and services the Telefónica Group offers and the technology it uses. This means that Telefónica must invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, and which may result in the decrease of the Group's revenue margins. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are deriving from mobile internet and connectivity services that are being launched. Research and development costs amounted to 1,071 million euros and 983 million euros in 2012 and 2011, respectively, representing 1.7% and 1.6% of the Group's consolidated revenue, respectively.

One technology that telecommunications operators, including Telefónica (in Spain and Latin America), are focused on is the new FTTx-type network, which offers broadband access using optical fiber with superior services, e.g. internet speed of up to 100mb or HD television services. However, substantial investment is required to deploy these networks, which entails fully or partially substituting copper loop access with optic fiber. As things stand today, scant demand for the capabilities offered by these new networks to end users could make it difficult to quantify the return on investment and justify the high investment.

In addition, many of the aforementioned works directed to network upgrade and to offer new products or services are not entirely under the Telefónica Group's control and could be constrained by applicable regulation.

- **Limitations on spectrum capacity could be costly and curtail growth.**

Telefónica's mobile operations in a number of countries may rely on the availability of spectrum. The Company's failure to obtain sufficient or appropriate spectrum capacity or its capacity to assume the related costs, could have an adverse impact on the quality on the launching and provision of new services and on the Company's ability to maintain the quality of existing services, which may adversely affect the Group's financial condition, results of operations and cash flows

In 2012, Telefónica Ireland invested 127 million euros to obtain spectrum in the 800, 900 and 1800 MHz bands. On February 20, 2013, Telefónica UK was granted two blocks of 10 MHz in the 800 MHz spectrum band for the rollout of a nationwide 4G network, total investment was of approximately 645 million euros. Meanwhile, in 2012, an investment was made in spectrum capacity in Nicaragua amounting to 5 million euros. In Brazil, Vivo was awarded a block of band with "X" of 2500 MHz (20+20 MHz), including the 450 MHz band in certain states in 2012. In Venezuela, in August 2012, a

concession agreement was signed between Telefónica Venezuela and the regulator for the additional 20 MHz in the 1900 MHz frequency that had been granted to this company. Also in August 2012, Telefónica Móviles Chile, S.A. was awarded radiofrequencies for 4G technology. As regards new spectrum allocations in the countries where the Telefónica Group operates, in 2013 we are expecting auctions to take place in Slovakia, Colombia and Uruguay.

- **Supplier failures**

As a mobile and fixed telephony operator and provider of telecommunications services and products, the Telefónica Group, like other companies in the industry, depends upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. Telefónica Group depends on 13 handset suppliers and five network infrastructure suppliers, which together accounted for 80% of orders in 2012. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements.

If these suppliers fail to deliver products and services to the Telefónica Group on a timely basis, it could jeopardize network deployment and expansion plans, which in some cases could adversely affect the Telefónica Group's ability to satisfy its license terms and requirements or have an adverse impact on the Group's business, financial condition, results of operations and cash flows.

- **Risks associated with unforeseen network interruptions**

Unanticipated network interruptions as a result of system failures, including those due to network, hardware or software or cyber-attacks, which affect the quality of or cause an interruption in the Telefónica Group's service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, penalties or other measures imposed by regulatory authorities and could harm the Telefónica Group's reputation.

Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and other physical and logical security. However, these measures are not always effective. Although the Telefónica Group has insurance policies to cover this type of incidents and risks, these policies may not be sufficient to cover all possible monetary losses, although the claims and loss in revenue caused by service interruptions to date have been covered by these policies.

- **Electromagnetic radio emissions and possible health risks**

Currently, there is significant public concern regarding alleged potential effects of electromagnetic fields, emitted by mobile telephones and base stations, on human health. This social concern has caused certain governments and administrations to take measures that have hindered the deployment of the infrastructures necessary to ensure quality of service and affected the deployment criteria of new networks.

In May 2011, the specialized cancer research body of the World Health Organization (IARC) classified the electromagnetic fields in mobile telephony as "possibly carcinogenic," a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in its fact sheet no. 193 published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health.

The most recent official study (to the best of our knowledge), published in 2012 by Advisory Group on Non-ionising Radiation (AGNIR), concludes that there are not convincing evidences showing that mobile phone technologies cause adverse effects in the health of individuals. It cannot be certain that future reports and medical studies establish a link between the electromagnetic signals or emissions of radio frequencies and health problems.

Irrespective of the scientific evidence that may be obtained and even though the Telefónica Group has considered these risks and has an action plan for the various countries in which it provides services to ensure compliance with codes of good practice and relevant regulations, this concern, may affect the capacity to capture or retain customers, discourage the use of mobile telephones, or lead to legal costs and other expenses.

Society's worries about radiofrequency emissions could reduce the use of mobile telephones, which could cause the public authorities to implement measures restricting where transmitters and cell sites can be located and how they operate, and the use of our mobile devices, telephones and other products using mobile technology. This could lead to the Company being unable to expand or improve its mobile network. Furthermore, if any relevant authorities request that the thresholds of exposure to electromagnetic fields be reduced, the Company may have to invest in reconstructing its network to comply with these guidelines.

The adoption of new measures by governments or administrations or other regulatory interventions in this respect that may also arise in the future may adversely affect the Group's business, financial condition, results of operations and cash flows.

- **Risk of asset impairment**

The Telefónica Group reviews on an annual basis, or more frequently when the circumstances require it, the value of assets and cash-generating units, to assess whether their carrying values can be supported by the future expected cash flows, including, in some cases synergies allowed for in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets.

Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations. In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. In 2012, an impairment loss was recognized on the stake in Telco, S.p.A. which, coupled with the impact of the recovery of all the operational synergies considered at the time of the investment and the profit contribution for the year, resulted in a negative impact of 1,277 million euros. In 2012, an impairment loss in goodwill was recognized amounting to 414 million euros for Telefónica operations in Ireland which, combined with the write-off of the intangible asset associated with the customer portfolio allocated to this market, resulted in a negative impact of 527 million euros.

- **Risks associated with internet**

Our internet access and hosting services may involve us in civil liability for illegal or illicit use of the internet. In addition, Telefónica, like all telecommunications services providers, may be held liable for the loss, release or inappropriate modification of the customer data stored on its services or carried by its networks

In most countries in which Telefónica operates, the provision of its internet access and hosting services (including the operation of websites with shelf-generated content) are regulated under a limited liability regime applicable to the content that it makes available to the public as a technical service provider, particularly content protected by copyright or similar laws. However, regulatory changes have been introduced imposing additional obligations on access providers (such as blocking access to a website) as part of the struggle against some illegal or illicit uses of the internet, notably in Europe.

#### Other risks

- **Litigation and other legal proceedings**

- Telefónica and Telefónica Group companies are party to lawsuits and other legal proceedings in the ordinary course of their businesses, the financial outcome of which is unpredictable. An adverse outcome or settlement in these or other proceedings could result in significant costs and may have a material adverse effect on the Group's business, financial condition, results of operations and cash flows.

#### **D.2 Indicate whether the company or group has been exposed to different types of risk (operational, technological, financial, legal, reputational, fiscal, etc.) during the year:**

Yes

If so, indicate the circumstances and whether the established control systems worked adequately.

## Risks occurring in the year

Risk of asset impairment.

### Circumstances responsible for this occurrence

The Telefónica Group has taken impairment losses on certain of its investments, affecting the results of the year when they were made.

### Operation of control systems

The Telefónica Group reviews on an annual basis (or more frequently where the circumstances require), the value of assets and cash-generating units, to assess whether their carrying values can be supported by projected future cash flows, including, in some cases synergies included in acquisition cost. Potential changes in the regulatory, business, economic or political environment may result in the need to introduce changes to the estimates made and recognize impairment losses in goodwill, intangible assets or fixed assets. Although the recognition of impairments of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the results of the Telefónica Group's operations.

In this respect, the Telefónica Group has experienced impairment losses on certain of its investments, affecting the results of the year in which they were made. Therefore, in 2012, as recorded in the Company's financial statements, an impairment loss was recognized on the stake in Telco, S.p.A. which, coupled with the impact of the recovery of part of the operational synergies considered in the investment, resulted in a negative impact of 1,277 million euros before tax. In 2012, an impairment loss in goodwill was recognized amounting to 414 million euros for Telefónica operations in Ireland which, combined with the write-off of the intangible asset associated with the customer portfolio allocated to this market, resulted in a negative of 527 million euros.

## D.3 Indicate whether there is a committee or other governing body in charge of establishing and supervising these control systems.

Yes

If so, please explain its duties.

Name of the Committee or Body	Description of duties
Audit and Control Committee	<p>The Board of Directors of Telefónica, S.A. has constituted an Audit and Control Committee whose powers and duties and rules of operation are set out in the Company Bylaws and in the Regulations of the Board of Directors. Such regulations comply with all legal requirements as well as with the recommendations for good corporate governance issued by both national and international bodies.</p> <p>Unless dealing with specific issues, the following shall be invited to attend Committee meetings: the External Auditor, representatives of the Legal General Secretariat and the Board, as well as representatives from the following departments: Strategic, Finance and Development, Internal Audit, Intervention and Inspection, Planning, Budgets and Control, Operations and Human Resources.</p> <p>Occasionally, as mentioned above, other managers from within the Group are invited to inform the Committee on specific areas of interest to it.</p>

	<p>The duties of the Committee are established in the Company Bylaws of Telefónica, S.A. (art. 31 bis), and in the Regulations of the Board of Directors (art. 21), as described in section B.2.3 of this Report.</p> <p>In addition, the Company has designed a system of information to which the Chairman and the members of the Audit and Control Committee have access, through which they can obtain, if they wish, information on the conclusions of internal auditing reports and on the fulfillment of recommendations subject to specific monitoring.</p> <p>Likewise, within the Group, Committees have been set up in those companies whose shares are listed on stock market in countries other than Spain, with similar duties to those described for the Audit and Control Committee of Telefónica, S.A.</p>
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**D.4 Identify and describe the processes for compliance with the regulations applicable to the company and/or its group.**

The vast majority of the companies comprising the Telefónica Group operate in the telecommunications sector, which is subject to regulation in nearly all the countries where the Group is present. Among the basic objectives of the internal control model described above is compliance with laws and regulations that affect the Telefónica Group's activities. In particular, the Group has units exercising specific control over this type of risk, especially through its legal services and in the areas of corporate regulation in the Group companies.

## E. General Shareholders' Meetings

**E.1 Indicate the quorum required for constitution of the General Shareholders' Meeting established in the company's bylaws. Describe how it differs from the system of minimum quorums established in the LSA.**

No

	Quorum % other than that established in article 102 of the LSA for general cases	Quorum % other than that established in article 103 of the LSA for the special cases described in article 103
Quorum required for first call	0	0
Quorum required for second call	0	0

**E.2 Indicate and, as applicable, describe any differences between the company's system of adopting corporate resolutions and the framework set forth in the LSA.**

No

**E.3 List all shareholders' rights regarding the General Shareholders' Meetings other than those established under the LSA.**

Telefónica grants all shareholders the rights related to the General Shareholders' Meetings set out in the LSA.

Likewise, with a view to encouraging shareholders' participation in the GSM, pursuant to Article 11 of the Regulations for the General Shareholders' Meeting of Telefónica, S.A., shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders' Meeting and the powers of the shareholders thereat.

**E.4 Indicate the measures, if any, adopted to encourage shareholder participation at General Shareholders' Meetings.**

The primary goal of the Regulations of the General Shareholders' Meeting of Telefónica, S.A. is to offer the shareholder a framework that guarantees and facilitates the exercise of their rights in their relationship with the governing body of the Company. Particular emphasis is placed on the shareholders' right to receive information and to participate in the deliberations and voting, by ensuring the widest possible dissemination of the call to meeting and of the proposed resolutions that are submitted to the shareholders at the General Shareholders' Meeting. In addition to the measures required by the applicable law in effect, the following are specific measures envisaged in the Regulation of the General Shareholders' Meeting with a view to facilitating shareholders' attendance and participation in the Meeting:

### WEBSITE

From the date of publication of the notice of the call to the General Shareholders' Meeting, and in order to facilitate shareholders' attendance and participation therein, the Company shall include in its website, to the extent available and in addition to the documents and information required by the Law, all materials that the Company deems advisable for such purposes and in particular, but not exclusively, the following:

- e) Meeting notice.
- f) Total number of shares and voting rights on the date of the call, broken down by class of shares, if applicable.
- g) Documents to be presented at the General Shareholders' Meeting, especially reports of directors, auditors and independent experts.
- h) The text of all proposed resolutions or, where none exist, a report by the governing bodies commenting on each agenda point. On receipt, any proposed resolutions submitted by shareholders, would be included.
- i) Lines of communication between the Company and its shareholders, especially any pertinent explanations to enable shareholders to exercise their rights to information, indicating the postal and electronic email addresses to which shareholders should send any requests.
- j) The means to grant proxy for the General Shareholders' Meeting and cast votes from a distance, including the procedure to obtain attendance cards or certificates issued by the entities legally authorized to do so.
- k) Information regarding the place where the General Shareholders' Meeting is to be held, describing, when appropriate, the means of access to the meeting room.
- l) Any other matters of interest for purposes of following the proceedings at the Meeting, such as whether or not simultaneous interpretation services will be provided, the possibility that the General Shareholders' Meeting be followed by audio-visual means, or information in other languages.

The Company shareholders may obtain all the aforementioned information through the corporate website, or may request that it be sent or delivered to them without charge through the mechanisms established on the website for this purpose.

### **Suggestions made by the shareholders**

As indicated above, without prejudice to the shareholders' right, in such cases and under such terms as are provided in the Law, to have certain matters included in the Agenda for the Meeting that they request be called, the shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders' Meeting and the powers of the shareholders thereat.

Likewise, through the Shareholder Service, shareholders may request all types of information, documentation and clarifications required in relation to the General Shareholders' Meeting, either through the Company website or by calling the toll-free line.

### **Electronic shareholders' forum**

On occasion of the call to meeting and until each General Shareholders' Meeting is held, the Company shall place into operation on its website ([www.telefonica.com](http://www.telefonica.com)) an Electronic Shareholders' Forum, which shall be accessible, with appropriate safeguards, by both individual shareholders and by any voluntary associations they may create as provided by law, in order to facilitate their communication prior to a General Shareholders' Meeting being held. Proposed resolutions sought to be presented as a supplement to the agenda notified in the call to meeting may be published in the Forum, together with requests for adherence to such proposals, initiatives to reach the percentage sufficient to exercise a minority right provided by Law as well as proxy offers or solicitations.

### **Proxy granting and representation**

The Chairman of the General Shareholders' Meeting, or the Secretary for the Meeting acting under a delegation of powers, shall resolve all questions arising in connection with the validity and effectiveness of the documents setting forth the right of any shareholder to attend the General Shareholders' Meeting, whether individually or by grouping shares with other shareholders, as well as the granting of a proxy or of powers of representation to another person, and shall ensure that only such documents as fail to meet the minimum essential requirements are considered invalid or ineffective and provided that the defects therein have not been cured.

At the General Shareholders' Meeting held on May 14, 2012, the Board of Directors, pursuant to articles 17 and 20bis of the By-Laws and articles 13 and 20bis of the Regulations for the General Shareholders' Meeting of Telefónica, S.A., agreed to enable procedures for distance representation and voting rights.

**E.5 Indicate whether the General Shareholders' Meetings is presided by the Chairman of the Board of Directors. List measures, if any, adopted to guarantee the independence and correct operation of the General Shareholders' Meeting.**

Yes

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**Details of measures**

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The General Shareholders' Meeting of Telefónica, S.A. has established its principles of organization and operation in a set of Regulations, approved by the General Shareholders' Meeting, and the Chairman must always act in line with the principles, criteria and guidelines set out therein.

In addition to establishing the principles of organization and operation of the General Shareholders' Meeting, gathering and organizing the different aspects of calling, organizing and holding the General Shareholders' Meeting in a single text, the document provides mechanisms to:

- Facilitate shareholders' exercise of their relevant rights, with particular attention to the shareholders' right to information and to participate in the deliberations and voting.
- Ensure the utmost transparency and efficiency in the establishment of the shareholders' will and in decision-making at the Meeting, ensuring the widest possible dissemination of the call to meeting and of the proposed resolutions.

Furthermore, in accordance with the Regulations of the Board of Directors, the conduct of the Chairman of the Board must always be in accordance with the decisions and criteria established by the shareholders at the General Shareholders' Meeting (in addition to the Board of Directors and the Board Committees).

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**E.6 Indicate the amendments, if any, made to the General Shareholders' Meeting regulations during the year.**

At the General Shareholders' Meeting held on May 14, 2012, shareholders approved a partial amendment of the Regulations of the General Shareholders' Meeting primarily to make technical improvements to the wording thereof and to adjust them to the amendments introduced in the revised text of the Corporate Enterprises Act approved by royal legislative decree 1/2010, of July 2, Law 25/2011, of August 1, partially reforming the Corporate Enterprises Act, and the incorporation of Directive 2007/36/EC of the European Parliament and Council of July 11 on the exercise of certain rights of shareholders in listed companies.

This reform of the Regulations of the General Shareholders' Meeting was also complemented with the reform of the Company Bylaws which was also approved by the General Shareholders' Meeting of 14 May 2012, responding additionally to the need to ensure the internal consistency of the regulations and corporate governance of Telefónica, S.A.

The specific amendments introduced to the Regulations of the General Shareholders' Meeting were:

- Article 3.- Pursuant to the wording of the new Article 18 bis of the Company's Bylaws, the name of the Company's corporate website is deleted so that any change to this corporate website does not necessarily imply having to amend the article.
- Article 7.- In order to (i) grant the Board of Directors sole powers to call the General Shareholders' Meeting, as a technical improvement; and (ii) adapt this article to the new wording of Article 168 of the Corporate Enterprises Act laid down in Law 25/2011, pursuant to the amendment to Article 15.3 of the Bylaws, this article is amended to establish the period during which the General Shareholders' Meeting should be held whenever it is so requested by the holders of at least five per cent of the share capital.
- Article 8.- In accordance with the amendment to Article 16 of the Bylaws, this article is amended to bring it into line with the new wording of Articles 516 and 519 of the Corporate Enterprises Act enacted by Law 25/2011 in relation to the call to the General Shareholders' Meeting, and the right of shareholders representing at least five per cent of the share

capital to submit proposals for resolutions and new items on the agenda of the Ordinary General Shareholders' Meeting.

- Article 9.- In order to incorporate the amendments to Article 518 of the Corporate Enterprises Act enacted by Law 25/2011 regarding information that the Company shall publish continuously on its website prior to the General Shareholders' Meeting.
- Article 10.- In line with the amendment to Article 18 of the Bylaws, this article is amended to bring it into line with the wording of Article 520 of the Corporate Enterprises Act, subsequent to being amended by Law 25/2011, which (i) expands on the content of shareholders' information rights to include the content of the auditor's report, and gives them the powers to ask questions regarding information accessible to the public that the Company has provided to the National Securities Market Commission since the holding of the immediately prior General Shareholders' Meeting; and (ii) facilitate the smooth running of the General Shareholders' Meeting by providing information in question-and-answer format.
- Article 11.- Pursuant to the wording of the new Article 18 bis of the Company's Bylaws, the name of the Company's corporate website is deleted so that any change to this corporate website does not necessarily imply having to amend the article.
- Article 13.- This article is amended to update reference to the former Article 514 of the Corporate Enterprises Act, currently Article 526, and to develop and clarify representation at the General Shareholders' Meeting, especially in those circumstances where the proxy is affected by any of the conflicts of interest contemplated in the Corporate Enterprises Act.
- Article 27.- This article is amended to bring it into line with the wording of Article 525 of the Corporate Enterprises Act, which subsequent to the amendments laid down in Law 25/2011 stipulates that the resolutions approved at the General Shareholders' Meeting and the result of the votes shall be published within five days following the close of the Meeting.

#### E.7 Indicate the attendance figures for the General Shareholders' Meetings held during the year.

Date of general meeting	Attendance data				
	% attending in person	% by proxy	% remote voting		Total
14/05/2012	16.240	38.040	0.000	0.000	54.280

#### E.8 Briefly indicate the resolutions adopted at the General Shareholders' Meetings held during the year and the percentage of votes with which each resolution was adopted.

#### GENERAL SHAREHOLDERS' MEETING – MAY 14, 2012

Items on agenda	Summary of proposal	Votes in favor	Votes against	Abstentions	Result of the vote
I	Approval of the Annual Accounts for Fiscal Year 2011.	2,211,561,004 (89.28%)	15,034,488 (0.61%)	250,541,455 (10.11%)	Approved
II.1	Re-Election of the director Mr. César Alierta Izuel.	1,871,251,071 (75.54%)	327,847,806 (13.23%)	278,038,070 (11.22%)	Approved
II.2	Re-Election of the director Mr. José María Álvarez-Pallete López.	1,813,177,017 (73.20%)	350,173,598 (14.14%)	313,786,332 (12.67%)	Approved
II.3	Re-Election of the director Mr. Gonzalo Hinojosa Fernández de Angulo.	1,822,654,379 (73.58%)	318,538,838 (12.86%)	335,943,730 (13.56%)	Approved
II.4	Re-Election of the director Mr. Pablo Isla Álvarez de Tejera.	1,796,342,903 (72.52%)	338,726,659 (13.67%)	342,067,385 (13.81%)	Approved
II.5	Ratification of the director Mr. Ignacio Moreno Martínez	1,785,622,936 (72.08%)	376,675,310 (15.21%)	314,838,701 (12.71%)	Approved
III	Re-election of the Auditor for 2012.	2,211,642,913 (89.28%)	13,597,797 (0.55%)	251,896,237 (10.17%)	Approved
IV	Amendment of Articles, 15, 16, 18, 27, 34 and 35 of the Bylaws and addition of a new Article 18 bis.	2,224,189,264 (89.79%)	2,515,369 (0.10%)	250,432,314 (10.11%)	Approved
V	Amendment of Articles 3, 7, 8, 9, 10, 11, 13 and 27 of the Regulations for the General Shareholders' Meeting.	2,224,313,257 (89.79%)	2,418,545 (0.10%)	250,405,145 (10.11%)	Approved

VI.1	Distribution of a dividend to be charged to unrestricted reserves.	2,214,180,049 (89.38%)	13,766,150 (0.56%)	249,190,748 (10.06%)	Approved
VI.2	Shareholder compensation by means of a scrip dividend.	2,202,515,877 (88.91%)	24,808,525 (1.00%)	249,812,545 (10.08%)	Approved
VII	Reduction of the share capital through the cancellation of treasury shares.	2,224,566,845 (89.80%)	2,967,157 (0.12%)	249,602,945 (10.08%)	Approved
VIII	Approval of the corporate website	2,227,159,258 (89.91%)	685,161 (0.03%)	249,292,528 (10.06%)	Approved
IX	Delegation of powers to formalize, interpret, correct and implement the resolutions adopted by the General Shareholders' Meeting.	2,226,593,452 (89.89%)	1,199,713 (0.05%)	249,343,782 (10.07%)	Approved
X	Consultative vote on the Report on Director Compensation Policy	1,500,696,825 (60.58%)	617,036,246 (24.91%)	359,403,876 (14.51%)	Approved

**E.9 Indicate whether the bylaws impose any minimum requirement on the number of shares required to attend the General Shareholders' Meetings.**

Yes

<b>Number of shares required to attend the General Shareholders' Meetings</b>	300
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**E.10 Indicate and explain the policies pursued by the company with reference to proxy voting at the General Shareholders' Meeting.**

As indicated above, with a view to facilitating shareholders' attendance and participation in the General Shareholders' Meetings, the Company has established the following policies in keeping with the legislation in effect:

**Voting by proxy at the General Shareholders' Meeting**

- Every shareholder having the right to attend the General Shareholders' Meeting may be represented thereat by another person, even if not a shareholder. The proxy must be granted specifically for each Meeting, either by using the proxy-granting form printed on the attendance card or in any other manner permitted by the Law.
- Shareholders that do not hold the minimum number of shares required to attend the Meeting (300 shares) may at all times grant a proxy in respect thereof to a shareholder having the right to attend the Meeting, as well as group together with other shareholders in the same situation until reaching the required number of shares, following which a proxy must be granted to one of such shareholders.

**Voting instructions**

- The documents setting forth the proxies or powers of attorney for the General Shareholders' Meeting shall contain instructions regarding the direction of the vote. Unless otherwise expressly indicated by the shareholder granting the proxy, it shall be understood that the shareholder gives specific instructions to vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda.
- If there are no voting instructions because the shareholders acting at the General Shareholders' Meeting are to decide matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the Meeting, the proxy-holder shall vote in such direction as he deems most appropriate, taking into account the interest of the Company and that of the shareholder granting the proxy. The same rule shall apply when the relevant proposal or proposals submitted to the shareholders at the Meeting have not been made by the Board of Directors.

**Proxies**

- If the document setting forth the proxy or power of attorney does not state the specific person or persons to whom the shareholder grants the proxy, such proxy shall be deemed granted in favor of any of the following: the Chairman of the Board of Directors of the Company, or the person that stands in for him as Chairman of the General Shareholders'

Meeting, or such person as is appointed by the Board of Directors, with notice of such appointment being given in advance in the official notice of the call to meeting. If the Chairman of the Board of Directors of the Company, or the person acting in his stead, or the person appointed by the Board of Directors, as applicable, is affected by any of the conflicts of interest contemplated in the Corporate Enterprises Act and the document setting forth the proxy does not contain any specific instructions, the proxy shall be deemed granted to the Secretary for the General Shareholders' Meeting.

Finally, to facilitate the maximum participation by shareholders, the Chairman of the General Shareholders' Meeting, or the Secretary for the Meeting acting under a delegation of powers, shall resolve all questions arising in connection with the validity and effectiveness of the documents setting forth the right of any shareholder to attend the General Shareholders' Meeting, as well as the granting of a proxy or of powers of representation to another person, and shall ensure that only such documents as fail to meet the minimum essential requirements are considered invalid or ineffective and provided that the defects therein have not been rectified.

**E.11 Indicate whether the company is aware of the policy of institutional investors on whether or not to participate in the company's decision-making processes.**

No

**E.12 Indicate the address and mode of accessing corporate governance content on your company's website.**

Telefónica complies with the applicable legislation and best practices in terms of the content of the website concerning Corporate Governance. In this respect, it fulfills both the technical requirements for access and for content for the Company website, through direct access from the homepage of **Telefónica, S.A. ([www.telefonica.com](http://www.telefonica.com))** in the section **"Shareholders and Investors"** (<http://www.telefonica.com/accionistasinversores/>), which includes not only all of the information that is legally required, but also information that the Company considers to be of interest.

All the available information included on the Company website, except for certain specific documents, is available in two languages: Spanish and English.

## F. Degree of compliance with corporate governance recommendations

Indicate the degree of the company's compliance with Corporate Governance recommendations.

Should the company not comply with any of them, explain the recommendations, standards, practices or criteria the company applies.

**F.1 The bylaws of listed companies should not place an upper limit on the votes that can be cast by a single shareholder, or impose other obstacles to the takeover of the company by means of share purchases on the market.**

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[See sections](#)

9, B.1.22, B.1.23, E.1 and E.2.

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### Explain

According to Article 21 of the Company's Bylaws, no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own. This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

In addition, Article 25 of the Bylaws stipulates that no person may be appointed as Director unless they have held, for more than three years prior to their appointment, a number of shares of the Company representing a nominal value of at least 3,000 euros, which shares the Director may not transfer while in office. These requirements shall not apply to those persons who, at the time of their appointment, are related to the Company under an employment or professional relationship, or when the Board of Directors resolves to waive such requirements with the favorable vote of at least 85 percent of its members.

Article 26 of the Bylaws establishes that, in order for a Director to be appointed Chairman, Vice Chairman, Chief Executive Officer or member of the Executive Commission, it shall be necessary for such Director to have served on the Board for at least the three years immediately prior to any such appointment. However, such length of service shall not be required if the appointment is made with the favorable vote of at least 85 percent of the members of the Board of Directors.

The Company Bylaws (article 21) restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group in order to achieve a suitable balance and protect the position of minority shareholders, thus avoiding a potential concentration of votes among a reduced number of shareholders, which could impact on the guiding principle that the General Shareholders' Meeting must act in the interest of all the shareholders. Telefónica believes guarantees that any takeover shall require, in the interest of all shareholders, an offer for one hundred percent of the capital, because, naturally, and as taught by experience, potential offerors may make their offer conditional upon the removal of the defense mechanism.

In relation to the above and in accordance with the provisions of article 527 of the Corporate Enterprises Act, any clauses in the bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder by shareholders belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

In addition, the special requirements for appointment as Director (Article 25 of the Bylaws) or as Chairman, Vice Chairman, Chief Executive Officer or member of the Executive Commission (Article 26 of the Bylaws) are justified by the desire that access to the management decision-making body and to the most significant positions thereon is reserved to persons who have demonstrated their commitment to the Company and who, in addition, have adequate experience as members of the Board, such that continuity of the management model adopted by the Telefónica Group may be assured in the interest of all of its shareholders and stakeholders. In any event, these special requirements may be waived by broad consensus among the members of the Board of Directors, namely, with the favorable vote of at least 85 percent of its members, as provided by the aforementioned articles of the Bylaws.

**F.2 When a dominant and a subsidiary company are stock market listed, the two should provide detailed disclosure on:**

- a) The type of activity they engage in, and any business dealings between them, as well as between the subsidiary and other group companies;
- b) The mechanisms in place to resolve possible conflicts of interest.

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[See sections](#)

C.4 and C.7

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Not applicable

**F.3 Even when not expressly required under company law, any decisions involving a fundamental corporate change should be submitted to the General Shareholders' Meeting for approval or ratification. In particular:**

- a) The transformation of listed companies into holding companies through the process of subsidiarization, i.e. reallocating core activities to subsidiaries that were previously carried out by the originating firm, even though the latter retains full control of the former;
- b) Any acquisition or disposal of key operating assets that would effectively alter the company's corporate purpose;
- c) Operations that effectively add up to the company's liquidation.

Complies

**F.4 Detailed proposals of the resolutions to be adopted at the General Shareholders' Meeting, including the information stated in Recommendation 28, should be made available at the same time as the publication of the Meeting notice.**

Complies

**F.5 Separate votes should be taken at the General Meeting on materially separate items, so shareholders can express their preferences in each case. This rule shall apply in particular to:**

- a) The appointment or ratification of directors, with separate voting on each candidate;
- b) Amendments to the bylaws, with votes taken on all articles or group of articles that are materially different.

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[See section](#)E.8

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**Complies**

**F.6. Companies should allow split votes, so financial intermediaries acting as nominees on behalf of different clients can issue their votes according to instructions.**

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[See section](#)E.4

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**Complies**

**F.7. The Board of Directors should perform its duties with unity of purpose and independent judgment, according all shareholders the same treatment. It should be guided at all times by the company's best interest and, as such, strive to maximize its value over time.**

It should likewise ensure that the company abides by the laws and regulations in its dealings with stakeholders; fulfils its obligations and contracts in good faith; respects the customs and good practices of the sectors and territories where it does business; and upholds any additional social responsibility principles it has subscribed to voluntarily.

**Complies**

**F.8 The board should see the core components of its mission as to approve the company's strategy and authorize the organizational resources to carry it forward, and to ensure that management meets the objectives set while pursuing the company's interests and corporate purpose. As such, the board in full should reserve the right to approve:**

- a) The company's general policies and strategies, and, in particular:**
  - i. The strategic or business plan, management targets and annual budgets;**
  - ii. Investment and financing policy;**
  - iii. Design of the structure of the corporate group;**
  - iv. Corporate governance policy;**
  - v. Corporate social responsibility policy;**
  - vi. Remuneration and evaluation of senior officers;**
  - vii. Risk control and management, and the periodic monitoring of internal information and control systems.**
  - viii. Dividend policy, as well as the policies and limits applying to treasury stock.**

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[See sections](#)B.1.10, B.1.13, B.1.14 and D.3

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- b) The following decisions:**

- i. On the proposal of the company's chief executive, the appointment and removal of senior officers, and their compensation clauses.

See section

B.1.14

- ii. Directors' remuneration, and, in the case of executive directors, the additional consideration for their management duties and other contract conditions.

See section

B.1.14

- iii. The financial information that all listed companies must periodically disclose.
  - iv. Investments or operations considered strategic by virtue of their amount or special characteristics, unless their approval corresponds to the General Shareholders' Meeting;
  - v. The creation or acquisition of shares in special purpose vehicles or entities resident in countries or territories considered tax havens, and any other transactions or operations of a comparable nature whose complexity might impair the transparency of the group.
- c) Transactions which the company conducts with directors, significant shareholders, shareholders with board representation or other persons related thereto ("related-party transactions").

However, board authorization need not be required for related-party transactions that simultaneously meet the following three conditions:

1. They are governed by standard form contracts applied on an across-the-board basis to a large number of clients;
2. They go through at market prices, generally set by the person supplying the goods or services;
3. Their amount is no more than 1% of the company's annual revenues.

It is advisable that related-party transactions should only be approved on the basis of a favorable report from the Audit Committee or some other committee handling the same function; and that the directors involved should neither exercise nor delegate their votes, and should withdraw from the meeting room while the board deliberates and votes.

Ideally the above powers should not be delegated with the exception of those mentioned in b) and c), which may be delegated to the Executive Committee in urgent cases and later ratified by the full board.

See sections

C.1 and C.6

## Complies

- F.9 In the interests of maximum effectiveness and participation, the Board of Directors should ideally comprise no fewer than five and no more than fifteen members

See section

B.1.1

## Explain

The complexity of the Telefónica Group organizational structure, given the considerable number of companies it comprises, the variety of sectors it operates in, its multinational nature, as well as its economic and business relevance, justify the fact that the number of members of the Board is adequate to achieve an efficient and operative operation.

In addition, it is important to bear in mind the Company's large number of Board committees, which ensures the active participation of all its Directors.

- F.10 External directors, proprietary and independent, should occupy an ample majority of board places, while the number of executive directors should be the minimum practical bearing in mind the complexity of the corporate group and the ownership interests they control.**

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[See sections](#)

A.2, A.3, B.1.3 and B.1.14.

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**Complies**

- F.11 In the event that some external director can be deemed neither proprietary nor independent, the company should disclose this circumstance and the links that person maintains with the company or its senior officers, or its shareholders.**

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[See section](#)

B.1.3

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**Complies**

- F.12 That among external directors, the relation between proprietary members and independents should match the proportion between the capital represented on the board by proprietary directors and the remainder of the company's capital.**

This proportional criterion can be relaxed so the weight of proprietary directors is greater than would strictly correspond to the total percentage of capital they represent:

1. In large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings, but where there are shareholders with high absolute value shareholdings.
2. In companies with a plurality of shareholders represented on the board but not otherwise related.

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[See sections](#)

B.1.3, A.2 and A.3

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**Explain**

The aforementioned recommendation number 12 refers to the composition of the group of external Directors. As stated in section B.1.3 of this Annual Corporate Governance Report, at 31 December 2012, the group of external Directors of Telefónica, S.A. was composed of 14 members (of a total of 18 Members), of whom five are proprietary Directors, seven are independent and two fall under the "other external Directors" category.

Of the five proprietary directors, two act in representation of Caja de Ahorros y Pensiones de Barcelona ("la Caixa"), which holds 5.596% of the capital stock of Telefónica, S.A., and two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 5.753% of the capital stock, and one acts in representation of China Unicom (Hong Kong) Limited (China Unicom) which holds 1.37% of the capital stock.

Applying the proportional criteria established in article 243 of the Corporate Enterprises Act (and formerly in article 137 of the Spanish Companies Act, to which Recommendation 12 of the Unified Code refers to), regarding the total number of directors, the stakes held by "la Caixa" and BBVA are sufficient to entitle each entity to appoint a director.

Moreover, it must be taken into account that Recommendation 12 stipulates that this strict proportionality criterion can be relaxed so the weight of proprietary directors is greater than would strictly correspond to the total percentage of capital they represent in large cap companies where few or no equity stakes attain the legal threshold for significant shareholdings, despite the considerable sums actually invested.

In this regard, Telefónica is the listed company on Spanish stock exchanges with the third highest stock market capitalization, reaching the figure of 46,375 million euros at 31 December 2012, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 2,595 million euros, and that of BBVA is 2,668 million euros), which justifies the overrepresentation of these entities on the Board of Directors, rising from one member of the board each (to which they would strictly have the right in accordance with Article 243 of the Spanish Corporations Law) to two members, i.e. permitting the appointment of just one more proprietary director over the strictly legal proportion.

On January 23, 2011, China Unicom, expanding on the existing strategic partnership, signed an extension to their Strategic Partnership Agreement with Telefónica, S.A., in which both companies agreed to strengthen and deepen their strategic cooperation in certain business areas, and committed to investing the equivalent of 500 million US dollars in ordinary shares of the other party. In recognition of China Unicom's stake in Telefónica, approval was given at Telefónica's General Shareholders' Meeting held on May 18, 2011 for the appointment of a board member named by China Unicom.

#### **F.13 The number of independent directors should represent at least one third of all board members.**

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[See section](#)

B.1.3

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**Complies**

**F.14 The nature of each director should be explained to the General Meeting of Shareholders, which will make or ratify his or her appointment. Such determination should subsequently be confirmed or reviewed in each year's Annual Corporate Governance Report, after verification by the Nomination Committee. Said Report should also disclose the reasons for the appointment of proprietary directors at the urging of shareholders controlling less than 5% of capital; and explain any rejection of a formal request for a board place from shareholders whose equity stake is equal to or greater than that of others applying successfully for a proprietary directorships.**

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[See sections](#)

B.1.3 and B.1.4

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**Complies**

**F.15 When women directors are few or non existent, the board should state the reasons for this situation and the measures taken to correct it; in particular, the Nomination Committee should take steps to ensure that:**

- a) The process of filling board vacancies has no implicit bias against women candidates;**

- b) The company makes a conscious effort to include women with the target profile among the candidates for board places.

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[See sections](#)

B.1.2, B.1.27 and B.2.3

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### Explain

In fact, the search for women who meet the necessary professional profile is a question of principle and, in this regard, it is clear that Telefónica has taken this concern on board. In this regard, it should be noted that, on January 23, 2008, the Board of Directors unanimously agreed to coopt, at the proposal of the Nominating, Compensation and Corporate Governance Committee, Ms. María Eva Castillo Sanz as an Independent Director of Telefónica. This appointment was ratified by the Ordinary General Shareholders' Meeting of Telefónica held on April 22, 2008, and she was thus appointed as a Member of the Board of the Company for a term of five years. On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

Likewise, on December 19, 2007, the Board of Directors unanimously agreed, following a favorable report from the Nominating, Compensation and Corporate Governance Committee, to appoint Ms. María Luz Medrano Aranguren as the Deputy Secretary General and Secretary of the Board of Directors of Telefónica.

Article 10.3. of the Regulations of the Board of Directors stipulates that the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, within the scope of their respective powers, that the candidates chosen are persons of recognized caliber, qualifications and experience, who are willing to devote a sufficient portion of their time to the Company, and shall take extreme care in the selection of the persons to be appointed as Independent Directors.

Therefore, the selection procedure described above is based exclusively on the personal merits of the candidates ("recognized caliber, qualifications and experience") and their ability to dedicate themselves to the functions of members of the board, so there is no implicit bias capable of impeding the selection of women directors, if, within the potential candidates, there are women candidates who meet the professional profile sought at each moment.

- F.16 The Chairman, as the person responsible for the proper operation of the Board of Directors, should ensure that directors are supplied with sufficient information in advance of board meetings, and work to procure a good level of debate and the active involvement of all members, safeguarding their rights to freely express and adopt positions; he or she should organize and coordinate regular evaluations of the board and, where appropriate, the company's chief executive, along with the chairmen of the relevant board committees.**

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[See section](#)

B.1.42

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### Complies

- F.17 When a company's Chairman is also its chief executive, an independent director should be empowered to request the calling of board meetings or the inclusion of new business on the agenda; to coordinate and give voice to the concerns of external directors; and to lead the board's evaluation of the Chairman.**

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[See section](#)

B.1.21

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**Partially complies**

Although there are no specific powers granted to an independent Director to these effects, the Company considers that this recommendation can be deemed as complied with for the following reasons:

- In accordance with Article 29 of the Regulations of the Board of Directors, all the Directors of the Company, including all independent Directors, may also request that a meeting of the Board of Directors be called whenever they consider it necessary, or that the items they deem appropriate be included in the Agenda.
- In addition, in accordance with article 13.3 of said Regulations, the Chairman of the Nominating, Compensation and Corporate Governance Committee –a post that shall always be given to an independent Director (article 22 of the Regulations)- and the Chairman of the Board of Directors shall be responsible for organizing and coordinating a periodic assessment of the Board.

**F.18 The Secretary should take care to ensure that the board's actions:**

- a) Adhere to the spirit and letter of laws and their implementing regulations, including those issued by regulatory agencies;
- b) Comply with the company bylaws and the regulations of the General Shareholders' Meeting, the Board of Directors and others;
- c) Are informed by those good governance recommendations of the Unified Code that the company has subscribed to.

In order to safeguard the independence, impartiality and professionalism of the Secretary, his or her appointment and removal should be proposed by the Nomination Committee and approved by a full board meeting; the relevant appointment and removal procedures being spelled out in the board's regulations.

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[See section](#)

B.1.34

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**Complies**

**F.19 The board should meet with the necessary frequency to properly perform its functions, in accordance with a calendar and agendas set at the beginning of the year, to which each director may propose the addition of other items.**

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[See section](#)

B.1.29

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**Complies**

**F.20 Director absences should be kept to the bare minimum and quantified in the Annual Corporate Governance Report. When directors have no choice but to delegate their vote, they should do so with instructions.**

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[See sections](#)

B.1.28 and B.1.30

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**Complies**

- F.21** When directors or the Secretary express concerns about some proposal or, in the case of directors, about the company's performance, and such concerns are not resolved at the meeting, the person expressing them can request that they be recorded in the minute book.

Complies

- F.22** The board in full should evaluate the following points on a yearly basis:

- a) The quality and efficiency of the board's operation;
- b) Starting from a report submitted by the Nomination Committee, how well the Chairman and chief executive have carried out their duties;
- c) The performance of its committees on the basis of the reports furnished by the same.

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[See section](#)

B.1.19

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Complies

- F.23** All directors should be able to exercise their right to receive any additional information they require on matters within the board's competence. Unless the bylaws or board regulations indicate otherwise, such requests should be addressed to the Chairman or Secretary.

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[See section](#)

B.1.42

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Complies

- F.24** All directors should be entitled to call on the company for the advice and guidance they need to carry out their duties. The company should provide suitable channels for the exercise of this right, extending in special circumstances to external assistance at the company's expense.

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[See section](#)

B.1.41

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Complies

- F.25** Companies should organize induction programs for new directors to acquaint them rapidly with the workings of the company and its corporate governance rules. Directors should also be offered refresher programs when circumstances so advise.

Complies

- F.26** Companies should require their directors to devote sufficient time and effort to perform their duties effectively, and, as such:

- a) Directors should apprise the Nomination Committee of any other professional obligations, in case they might detract from the necessary dedication;
- b) Companies should lay down rules about the number of directorships their board members can hold.

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[See sections](#)

B.1.8, B.1.9 and B.1.17

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**Complies**

- F.27** The proposal for the appointment or renewal of directors which the board submits to the General Shareholders' Meeting, as well as provisional appointments by the method of co-option, should be approved by the board:
- a) On the proposal of the Nomination Committee, in the case of independent directors.
  - b) Subject to a report from the Nomination Committee in all other cases.

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[See section](#)

B.1.2

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**Complies**

- F.28** Companies should post the following director particulars on their websites, and keep them permanently updated:
- a) Professional experience and background;
  - b) Directorships held in other companies, listed or otherwise;
  - c) An indication of the director's classification as executive, proprietary or independent; In the case of proprietary directors, stating the shareholder they represent or have links with.
  - d) The date of their first and subsequent appointments as a company director; and
  - e) Shares held in the company and any options on the same.

**Complies**

- F.29** Independent directors should not stay on as such for a continued period of more than 12 years.

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[See section](#)

B.1.2

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**Complies**

- F.30** Proprietary directors should resign when the shareholders they represent dispose of their ownership interest in its entirety. If such shareholders reduce their stakes, thereby losing some of their entitlement to proprietary directors, the latter's number should be reduced accordingly.

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[See sections](#)A.2, A.3 and B.1.2

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**Complies**

- F.31** The Board of Directors should not propose the removal of independent directors before the expiry of their tenure as mandated by the bylaws, except where just cause is found by the board, based on a proposal from the Nomination Committee. In particular, just cause will be presumed when a director is in breach of his or her fiduciary duties or comes under one of the disqualifying grounds enumerated in section III. 5 (Definitions) of this Code.

The removal of independents may also be proposed when a takeover bid, merger or similar corporate operation produces changes in the company's capital structure, in order to meet the proportionality criterion set out in Recommendation 12.

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[See sections](#)B.1.2, B.1.5 and B.1.26

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**Complies**

- F.32** Companies should establish rules obliging directors to inform the board of any circumstance that might harm the organization's name or reputation, tendering their resignation as the case may be, with particular mention of any criminal charges brought against them and the progress of any subsequent trial.

The moment a director is indicted or tried for any of the crimes stated in article 124 of the Public Limited Companies Act, the board should examine the matter and, in view of the particular circumstances and potential harm to the company's name and reputation, decide whether or not he or she should be called on to resign. The board should also disclose all such determinations in the Annual Corporate Governance Report.

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[See sections](#)B.1.43 and B.1.44

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**Complies**

- F.33** All directors should express clear opposition when they feel a proposal submitted for the board's approval might damage the corporate interest. In particular, independents and other directors unaffected by the conflict of interest should challenge any decision that could go against the interests of shareholders lacking board representation.

When the board makes material or reiterated decisions about which a director has expressed serious reservations, then he or she must draw the pertinent conclusions. Directors resigning for such causes should set out their reasons in the letter referred to in the next Recommendation.

This terms of this Recommendation should also apply to the Secretary of the board, director or otherwise.

**Complies**

- F.34** Directors who give up their place before their tenure expires, through resignation or otherwise, should state their reasons in a letter to be sent to all members of the board. Irrespective of whether such resignation is filed as a significant event, the motive for the same must be explained in the Annual Corporate Governance Report.

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[See section](#)

B.1.5

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**Complies**

- F.35** The company's remuneration policy, as approved by its Board of Directors, should specify at least the following points:

- a) The amount of the fixed components, itemised where necessary, of board and board committee attendance fees, with an estimate of the fixed annual payment they give rise to.
- b) Variable components, in particular:
  - 1) The types of directors they apply to, with an explanation of the relative weight of variable to fixed remuneration items;
  - 2) Performance evaluation criteria used to calculate entitlement to the award of shares or share options or any performance-related remuneration;
  - 3) The main parameters and justification for any system of annual bonuses or other, non cash benefits;
  - 4) An estimate of the sum total of variable payments rising from the remuneration policy proposed, as a function of degree of compliance with pre-set targets or benchmarks.
- c) The main characteristics of pension systems (for example, supplementary pensions, life insurance and similar arrangements), with an estimate of their amount or annual equivalent cost.
- d) The conditions to apply to the contracts of executive directors exercising senior management functions, among them:
  - 1) Duration;
  - 2) Notice periods; and
  - 3) Any other clauses covering hiring bonuses, as well as indemnities or "golden parachutes" in the event of early termination of the contractual relation between company and executive director.

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[See section](#)

B.1.15

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**Complies**

- F.36** Remuneration comprising the delivery of shares in the company or other companies in the group, share options or other share-based instruments, payments linked to the company's performance or membership of pension schemes should be confined to executive directors.

The delivery of shares is excluded from this limitation when directors are obliged to retain them until the end of their tenure.

**Complies**

- F.37** External directors' remuneration should sufficiently compensate them for the dedication, abilities and responsibilities that the post entails, but should not be so high as to compromise their independence.

**Complies**

- F.38** In the case of remuneration linked to company earnings, deductions should be computed for any qualifications stated in the external auditor's report.

**Not applicable**

- F.39** In the case of variable awards, remuneration policies should include technical safeguards to ensure they reflect the professional performance of the beneficiaries and not simply the general progress of the markets or the company's sector, atypical or exceptional transactions or circumstances of this kind.

**Complies**

- F.40** The Board should submit a report on the directors' remuneration policy to the advisory vote of the General Shareholders' Meeting, as a separate point on the agenda. This report can be supplied to shareholders separately or in the manner each company sees fit.

The report will focus on the remuneration policy the board has approved for the current year, with reference, as the case may be, to the policy planned for future years. It will address all the points referred to in Recommendation 35, except those potentially entailing the disclosure of commercially sensitive information. It will also identify and explain the most significant changes in remuneration policy with respect to the previous year, with a global summary of how the policy was applied over the period in question.

The role of the Remuneration Committee in designing the policy should be reported to the Meeting, along with the identity of any external advisors engaged.

**Complies**

- F.41** The notes to the annual accounts should list individual directors' remuneration in the year, including:
- a) A breakdown of the compensation obtained by each company director, to include where appropriate:
    - 1) Participation and attendance fees and other fixed directors payments;
    - 2) Additional compensation for acting as chairman or member of a board committee;
    - 3) Any payments made under profit-sharing or bonus schemes, and the reason for their accrual;

- 4) Contributions on the director's behalf to defined-contribution pension plans, or any increase in the director's vested rights in the case of contributions to defined-benefit schemes;
  - 5) Any severance packages agreed or paid;
  - 6) Any compensation they receive as directors of other companies in the group;
  - 7) The remuneration executive directors receive in respect of their senior management posts;
  - 8) Any kind of compensation other than those listed above, of whatever nature and provenance within the group, especially when it may be accounted a related-party transaction or when its omission would detract from a true and fair view of the total remuneration received by the director.
- b) An individual breakdown of deliveries to directors of shares, share options or other share-based instruments, itemised by:
- 1) Number of shares or options awarded in the year, and the terms set for their execution;
  - 2) Number of options exercised in the year, specifying the number of shares involved and the exercise price;
  - 3) Number of options outstanding at the annual close, specifying their price, date and other exercise conditions;
  - 4) Any change in the year in the exercise terms of previously awarded options.
- c) Information on the relation in the year between the remuneration obtained by executive directors and the company's profits, or some other measure of enterprise results.

Complies

- F.42** When the company has an Executive Committee, the breakdown of its members by director category should be similar to that of the board itself. The Secretary of the board should also act as secretary to the Executive Committee.

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[See sections](#)

B.2.1 and B.2.6

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Complies

- F.43** The board should be kept fully informed of the business transacted and decisions made by the Executive Committee. To this end, all board members should receive a copy of the Committee's minutes.

Complies

- F.44** In addition to the Audit Committee mandatory under the Securities Market Act, the Board of Directors should form a committee, or two separate committees, of Nomination and Remuneration.

The rules governing the make-up and operation of the Audit Committee and the committee or committees of Nomination and Remuneration should be set forth in the board regulations, and include the following:

- a) The Board of Directors should appoint the members of such committees with regard to the knowledge, aptitudes and experience of its directors and the terms of reference of each committee;

discuss their proposals and reports; and be responsible for overseeing and evaluating their work, which should be reported to the first board plenary following each meeting;

- b) These committees should be formed exclusively of external directors and have a minimum of three members. Executive directors or senior officers may also attend meetings, for information purposes, at the Committees' invitation.
- c) Committees should be chaired by an independent director.
- d) They may engage external advisors, when they feel this is necessary for the discharge of their duties.
- e) Meeting proceedings should be minuted and a copy of the minutes sent to all board members.

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[See sections](#)

B.2.1 and B.2.3

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#### **Complies**

- F.45 The job of supervising compliance with internal codes of conduct and corporate governance rules should be entrusted to the Audit Committee, the Nomination Committee or, as the case may be, separate Compliance or Corporate Governance committees.

#### **Complies**

- F.46 All members of the Audit Committee, particularly its chairman, should be appointed with regard to their knowledge and background in accounting, auditing and risk management matters.

#### **Complies**

- F.47 Listed companies should have an internal audit function, under the supervision of the Audit Committee, to ensure the proper operation of internal reporting and control systems.

#### **Complies**

- F.48 The head of internal audit should present an annual work program to the Audit Committee, report to it directly on any incidents arising during its implementation, and submit an activities report at the end of each year.

#### **Complies**

- F.49 Control and risk management policy should specify at least:

- a) The different types of risk (operational, technological, financial, legal, reputational, ...) the company is exposed to, with the inclusion under financial or economic risks of contingent liabilities and other off-balance sheet risks;
- b) The determination of the risk level the company sees as acceptable;
- c) Measures in place to mitigate the impact of risk events should they occur;
- d) The internal reporting and control systems to be used to control and manage the above risks, including contingent liabilities and off-balance sheet risks.

**Complies****F.50 The Audit Committee's role should be:****1<sup>st</sup>. With respect to internal control and reporting systems:**

- a) Monitor the preparation and the integrity of the financial information prepared on the company and, where appropriate, the group, checking for compliance with legal provisions, the accurate demarcation of the consolidation perimeter, and the correct application of accounting principles.
- b) Review internal control and risk management systems on a regular basis, so main risks are properly identified, managed and disclosed.
- c) Monitor the independence and efficacy of the internal audit function; propose the selection, appointment, reappointment and removal of the head of internal audit; propose the department's budget; receive regular report-backs on its activities; and verify that senior management are acting on the findings and recommendations of its reports.
- d) Establish and supervise a mechanism whereby staff can report, confidentially and, if necessary, anonymously, any irregularities they detect in the course of their duties, in particular financial or accounting irregularities, with potentially serious implications for the firm.

**2<sup>nd</sup>. With respect of the external auditor:**

- a) Make recommendations to the board for the selection, appointment, reappointment and removal of the external auditor, and the terms of his engagement.
- b) Receive regular information from the external auditor on the progress and findings of the audit programme, and check that senior management are acting on its recommendations.
- c) Monitor the independence of the external auditor, to which end:
  - i) The company should notify any change of auditor to the CNMV as a significant event, accompanied by a statement of any disagreements arising with the outgoing auditor and the reasons for the same.
  - ii) The Committee should ensure that the company and the auditor adhere to current regulations on the provision of non-audit services, the limits on the concentration of the auditor's business and, in general, other requirements designed to safeguard auditors' independence;
  - iii) The Audit Committee will investigate the issues giving rise to the resignation of any external auditor.
- d) In the case of groups, the Committee should urge the group auditor to take on the auditing of all component companies.

**Complies**

- F.51** The Audit Committee should be empowered to meet with any company employee or manager, even ordering their appearance without the presence of another senior officer.

**Complies**

- F.52** The Audit Committee should prepare information on the following points from Recommendation 8 for input to board decision-making:

- a) The financial information that all listed companies must periodically disclose. The Committee should ensure that interim statements are drawn up under the same accounting principles as the annual statements and, to this end, may ask the external auditor to conduct a limited review.
- b) The creation or acquisition of shares in special purpose vehicles or entities resident in countries or territories considered tax havens, and any other transactions or operations of a comparable nature whose complexity might impair the transparency of the group.
- c) Related-party transactions, except where their scrutiny has been entrusted to some other supervision and control committee.

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[See sections](#)

B.2.2 and B.2.3

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**Complies**

- F.53** The Board of Directors should seek to present the annual accounts to the General Shareholders' Meeting without reservations or qualifications in the audit report. Should such reservations or qualifications exist, both the Chairman of the Audit Committee and the auditors should give a clear account to shareholders of their scope and content.

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[See section](#)

B.1.38

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**Complies**

- F.54** The majority of Nomination Committee members – or Nomination and Remuneration Committee members as the case may be – should be independent directors.

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[See section](#)

B.2.1

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**Complies**

- F.55.** The Remuneration Committee should have the following functions in addition to those stated in earlier recommendations:

- a) Evaluate the balance of skills, knowledge and experience on the board, define the roles and capabilities required of the candidates to fill each vacancy, and decide the time and dedication necessary for them to properly perform their duties.

- b) Examine or organize, in appropriate form, the succession of the chairman and chief executive, making recommendations to the board so the handover proceeds in a planned and orderly manner.
- c) Report on the senior officer appointments and removals which the chief executive proposes to the board.
- d) Report to the board on the gender diversity issues discussed in Recommendation 14 of this Code.

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[See section](#)

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B.2.3

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**Complies**

**F.56. The Nomination Committee should consult with the company's Chairman and chief executive, especially on matters relating to executive directors.**

Any board member may suggest directorship candidates to the Nomination Committee for its consideration.

**Complies**

**F.57. The Remuneration Committee should have the following functions in addition to those stated in earlier recommendations:**

- a) Make proposals to the Board of Directors regarding:
  - i) The remuneration policy for directors and senior officers;
  - ii) The individual remuneration and other contractual conditions of executive directors.
  - iii) The standard conditions for senior officer employment contracts.
- b) Oversee compliance with the remuneration policy set by the company.

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[See sections](#)

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B.1.14 and B.2.3

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**Complies**

**F.58. The Remuneration Committee should consult with the Chairman and chief executive, especially on matters relating to executive directors and senior officers.**

**Complies**

## G. Other information of interest

If you consider that there is any material aspect or principle relating to the Corporate Governance practices followed by your company that has not been addressed in this report, specify and explain below.

**ALL NOTES ON SECTION G ARE ATTACHED AS APPENDIX A TO THIS CORPORATE GOVERNANCE REPORT.**

You may include in this section any other information, clarification or observation related to the above sections of this report, where relevant and not repetitive.

Specifically indicate whether the company is subject to corporate governance legislation from a country other than Spain and, if so, include the compulsory information to be provided when different to that required by this report.

### **Binding definition of independent director:**

List any independent directors who maintain, or have maintained in the past, a relationship with the company, its significant shareholders or managers, when the significance or importance thereof would dictate that the directors in question may not be considered independent pursuant to the definition set forth in section 5 of the Unified Good Governance Code:

**No**

Date and signature:

This annual corporate governance report was adopted by the company's Board of Directors at its meeting held on February 27, 2013.

List whether any directors voted against or abstained from voting on the approval of this report.

**No**

## APPENDIX TO THE TELEFÓNICA, S.A. 2012 ANNUAL CORPORATE GOVERNANCE REPORT

### I.- SECTION G OF THE ANNUAL CORPORATE GOVERNANCE REPORT: OTHER INFORMATION OF INTEREST

If you consider that there is any material aspect or principle relating to the Corporate Governance practices followed by your company that has not been addressed in this report, indicate and explain below.

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the financial year ended on December 31, 2012, except in those issues in which a different date of reference is specifically mentioned.

#### - Note 1 to Section A.3.

It should be noted that the Company has an Internal Code of Conduct for Securities Markets Issues, among its governing rules setting out, among other issues, the general operating principles for Directors and senior executive officers when carrying out personal trades involving securities issued by Telefónica and financial instruments and contracts whose underlying securities or instruments are issued by the Company.

The general operating principles of this Internal Code of Conduct include transactions subject to notification, action limitations as well as the minimum holding period when acquiring securities in the Company, during which time these may not be transferred, except in the event of extraordinary situations that justify their transfer, subject to authorization by the Regulatory Compliance Committee.

#### - Note 2 to Section A.3

On January 11, 2013, Mr. César Alierta Izuel notified the CNMV of the transfer of 80,053 Telefónica, S.A. shares held indirectly, and the direct acquisition of 80,053 Telefónica, S.A. shares.

On January 18, 2013, Mr. César Alierta Izuel, Mr. José María Álvarez-Pallete López, and Mr. Santiago Fernández Valbuena notified the CNMV of their acquisition of 9 Telefónica, S.A. shares each.

On February 18 and 19, 2013, Mr. César Alierta Izuel, Mr. José María Álvarez-Pallete López, and Mr. Santiago Fernández Valbuena notified the CNMV of their acquisition of 10 Telefónica, S.A. shares each.

#### - Note 3 to Section A.3

On September 16, 2011, the Executive Chairman of the Company, Mr. César Alierta Izuel, notified the CNMV of the purchase of 100,000 call options granting the right to acquire 10 million shares of Telefónica, S.A. up to the maturity date on June 20, 2014, with an exercise price of 18 euros.

Likewise, the amounts appearing in Section A.3. of this report under "Number of direct options" (i.e. Mr. César Alierta Izuel, 170,897; Mr. Julio Linares López, 128,173; Mr. José María Álvarez-Pallete López, 77,680; and Mr. Santiago Fernández Valbuena, 77,680) related to the maximum number of shares corresponding to the fifth phase of the "Performance Share Plan" to be delivered (from July 1, 2013) if all the terms established for such delivery are met.

At the General Shareholders' Meeting of Telefónica, S.A. on May 18, 2011, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of the Group (including Executive Directors) known as the Performance & Investment Plan ("PIP"). Under this plan, participants who met the qualifying requirements were awarded a certain number of Telefónica, S.A. shares as a form of variable compensation. In addition said General Shareholders'

Meeting approved the maximum number of shares to be awarded to Executive Directors subject to their meeting the Co-Investment requirement established in the Plan and the maximum target TSR established for each phase.

In accordance with the above, the amounts appearing in Section A.3. of this report under "Number of direct options" and "Equivalent number of shares" (i.e. Mr. César Alierta Izuel, 574,334-897,397; Mr. Julio Linares López, 163,828-255,983; Mr. José María Álvarez-Pallete López, 267,650-418,204; Mr. Santiago Fernández Valbuena, 182,742-285,536; and Ms. Eva Castillo Sanz, 95,864-149,787) relate to the theoretical number of shares assigned and the maximum possible number of shares to be received in the first and second phase if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

#### **- Note 4 to Section B.1.3**

On September 17, 2012, Mr. Julio Linares López resigned from his post as the Company's Chief Operating Officer (CCO) of Telefónica, S.A. and his managerial post in the Telefónica Group and therefore went from being an Executive Director to being classified in the "Other External Directors" category.

On September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an Independent Director to an Executive Director.

On December 31, 2012, five years after he stopped performing executive duties in the Telefónica Group (as an employee and director), Mr. Peter Erskine was reclassified from "Other External Directors" to Independent Director.

#### **- Note 5 to Section B.1.10**

Although the investment and financing policy is not included literally in article 5.4. of the Regulations of the Board of Directors, in practice said policy is the exclusive competency of the Board of Directors of the Company.

#### **- Note 6 to Section B.1.11**

In order to ensure maximum transparency in this matter, and in accordance with the information provided in the Notes to the Financial Statements corresponding to the financial year 2012, below we provide the remuneration and benefits received by the Directors of Telefónica, S.A. in the year 2012.

##### **i) Directors' compensation**

The compensation of Telefónica members of the Board of Directors is governed by Article 28 of the Bylaws, which states that the compensation amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders' Meeting. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the directors. This compensation, as laid down in said article of the Bylaws, is compatible with other professional or employment compensation accruing to the Directors by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors.

Accordingly, the shareholders, at the Annual General Shareholders Meeting held on April 11, 2003, set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros, including a fixed payment and fees for attending meetings of the Board of Director's Advisory or Control Committees. Total compensation paid to Telefónica's Directors for discharging their duties in 2012 amounted to 4,001,151 euros in fixed compensation and attendance fees.

The compensation of Telefónica, S.A. directors in their capacity as members of the Board of Directors, the Executive Commission and/or the Advisory and Control Committees consists of a fixed amount payable monthly, and fees for attending the meetings of the Board's Advisory or Control Committees. Executive Directors other than the Chairman do not receive any amounts for their directorships, but only the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

It is hereby stated that the Company's Board of Directors, at its meeting of July 25, 2012, agreed a 20% reduction of the amounts that the Board members receive for discharging their duties.

The tables below presents the fixed amounts established in 2012 for membership to Telefónica Board of Directors, Executive Commission and Advisory or Control Committees and the attendance fees of the Advisory or Control Committees.

#### Compensation of members of the Board of Directors and Board Committees

(Amounts expressed in annual terms applicable up to the 20% reduction agreed by the Board of Directors on July 25, 2012).

##### Figures in euros

Post	Board of Directors	Executive Committee	Advisory or Control Committees (*)
Chairman	300,000	100,000	28,000
Vice Chairman	250,000	100,000	–
Board member:			
Executive	–	–	–
Proprietary	150,000	100,000	14,000
Independent	150,000	100,000	14,000
Other external	150,000	100,000	14,000

(\*) In addition, the amounts paid for attendance to each of the Advisory or Control Committee's meetings was 1,250 euros.

#### Current compensation of members of the Board of Directors and Board Committees

(Amounts expressed in annual terms applicable from the 20% reduction agreed by the Board of Directors on July 25, 2012 and effective for payments for the period between July 1, and December 31, 2012).

##### Figures in euros

Post	Board of Directors	Executive Committee	Advisory or Control Committees (*)
Chairman	240,000	80,000	22,400
Vice Chairman	200,000	80,000	–
Board member:			
Executive	–	–	–
Proprietary	120,000	80,000	11,200
Independent	120,000	80,000	11,200
Other external	120,000	80,000	11,200

(\*) In addition, the amounts paid for attendance to each of the Advisory or Control Committee's meetings is 1,000 euros.

#### ii) Individual breakdown

The following table presents the individual breakdown by item of the compensation and benefits paid by Telefónica, S.A. to member of the Company's Board of Directors in 2012:

Euros					
Director	Wage/compensation <sup>1</sup>	Fixed Payment Board	Attendance	Short-term Variable	Other items <sup>5</sup> TOTAL2012

		Committees <sup>2</sup>	fees <sup>3</sup>	Compensation <sup>4</sup>		
<b>Executive</b>						
Mr. César Alierta Izuel	2,500,800	90,000	--	3,493,433	264,899	6,349,132
Mr. José María Álvarez-Pallete López	1,474,284	--	--	1,042,088	93,338	2,609,710
Ms. Eva Castillo Sanz	461,670	29,400	19,000	--	7,684	517,754
Mr. Santiago Fernández Valbuena	--	--	--	--	--	--
<b>Proprietary</b>						
Mr. Isidro Fainé Casas	225,000	90,000	--	--	11,500	326,500
Mr. José María Abril Pérez	225,000	115,200	12,750	--	--	352,950
Mr. Antonio Massanell Lavilla	135,000	63,000	26,000	--	11,250	235,250
Mr. Ignacio Moreno Martínez	135,000	--	--	--	--	135,000
Mr. Chang Xiaobing	135,000	--	--	--	--	135,000
<b>Independent</b>						
Mr. David Arculus	105,000	19,600	4,500	--	--	129,100
Mr. Carlos Colomer Casellas	135,000	140,400	24,750	--	21,250	321,400
Mr. Peter Erskine	135,000	140,400	33,000	--	3,750	312,150
Mr. Alfonso Ferrari Herrero	135,000	190,800	50,750	--	21,500	398,050
Mr. Luiz Fernando Furlán	135,000	12,600	1,000	--	--	148,600
Mr. Gonzalo Hinojosa Fernández de Angulo	135,000	178,200	45,250	--	22,750	381,200
Mr. Pablo Isla Álvarez de Tejera	135,000	63,000	13,750	--	--	211,750
Mr. Francisco Javier de Paz Mancho	135,000	140,400	12,500	--	10,000	297,900
<b>Other external</b>						
Mr. Julio Linares López	1,688,216	--	--	5,966,275	25,159,663	32,814,154
Mr. Fernando de Almansa Moreno-Barreda	135,000	50,400	19,500	--	9,000	213,900

1 **Wage**: Cash compensation with a predefined payment frequency, accruable or not over time and payable by the Company contractually, irrespective of effective attendance by the Director of Telefónica, S.A. to Telefónica, S.A. Board Meetings. Includes non-variable remuneration accrued, as appropriate, by the Director for discharging any related executive duties.

2 **Fixed Payment Board Committees**: Amount of items other than attendance to meetings payable to Directors for membership to the Executive Committee or Advisory or Control Committees of Telefónica, S.A., irrespective of effective attendance to meetings of said Committees.

3 **Attendance fees**: Amounts payable for attendance to meetings of the Advisory or Control Committees of Telefónica, S.A.

4 **Short-term variable compensation**: Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year. For Mr. Julio Linares López, includes the amount of two annual payments (2011-2012).

5 **Other items**: Includes, *inter alia*, (i) 24,748,696 euros in compensation paid to Mr. Julio Linares López on stepping down from his executive duties; and (ii) other amounts paid for membership of the various Regional Advisory Committees in Spain, and the Telefónica Corporate University Advisory Council.

With respect to the information contained in the preceding table, the following is noted: (i) On December 31, 2012, five years after he stopped performing executive duties in the Telefónica Group (as an employee and director), Mr. Peter Erskine was reclassified from "Other external" to "Independent;" (ii) on September 17, 2012, Mr. Julio Linares López resigned from his post as the Company's CCO of Telefónica, S.A. and his executive duties in the Telefónica Group and therefore being reclassified from "Executive" Director to "Other external"; (iii) on September 17, 2012, Ms. Eva Castillo Sanz was appointed as Chairwoman of Telefónica Europe, and therefore changed from being an "Independent" director to an "Executive" director, showing in the table the compensation as Chairwoman of Telefónica Europa from October 2012; (iv) on September 17, 2012, Mr. Santiago Fernández Valbuena was appointed Director of the Company as an "Executive" Director, with the compensation paid for his position Chairman of Telefónica Latinoamérica from October 2012 shown in the table "Other amounts received from other Group Companies". The compensation paid to him as an Executive Director for his position as Chairman of Telefónica Latinoamérica from January to October 2012 is included under "Senior executives' compensation;" and (v) on September 17, 2012, Mr. David Arculus stepped down as Director of the Company, with amount in the table showing the compensation paid to him until October 2012.

In addition, to detail the amounts included in the preceding table, the following table presents the specific compensation paid to Directors of Telefónica for membership of the various Advisory or Control Committees in 2012, including both fixed payments and attendance fees:

Figures in euros

Director	Audit and Control	Nomination, Compensation and Corporate Governance	Human Resources, Corporate Reputation and Responsibility	Regulation	Service Quality and Customer Service	International Affairs	Innovation	Strategy	TOTAL 2012
Mr. César Alierta Izuel	-	-	-	-	-	-	-	-	-
Mr. Isidro Fainé Casas	-	-	-	-	-	-	-	-	-
Mr. Julio Linares López	-	-	-	-	-	-	-	-	-
Mr. José María Abril Pérez	-	-	-	-	-	14,850	23,100	-	37,950
Mr. José María Álvarez-Pallete López	-	-	-	-	-	-	-	-	-
Mr. José Fernando de Almansa Moreno-Barreda	-	-	-	17,100	-	28,450	-	24,350	69,900
Mr. David Arculus	-	-	-	13,300	-	10,800	-	-	24,100
Ms. Eva Castillo Sanz	-	-	-	13,300	14,550	-	-	20,550	48,400
Mr. Carlos Colomer Casellas	-	19,850	-	-	17,350	-	37,950	-	75,150
Mr. Peter Erskine	-	23,100	-	-	-	-	23,350	36,950	83,400
Mr. Santiago Fernández Valbuena	-	-	-	-	-	-	-	-	-
Mr. Alfonso Ferrari Herrero	23,100	36,700	17,350	17,100	18,350	14,600	-	24,350	151,550
Mr. Luiz Fernando Furlán	-	-	-	-	-	13,600	-	-	13,600
Mr. Gonzalo Hinojosa Fernández de Angulo	35,700	24,100	17,350	-	17,100	14,850	-	24,350	133,450
Mr. Pablo Isla Álvarez de Tejera	-	21,850	12,600	29,700	12,600	-	-	-	76,750
Mr. Antonio Massanell Lavilla	19,850	-	14,850	-	30,950	-	23,350	-	89,000
Mr. Ignacio Moreno Martínez	-	-	-	-	-	-	-	-	-
Mr. Francisco Javier de Paz Mancho	-	-	29,950	17,100	-	15,850	-	-	62,900
Mr. Chang Xiaobing	-	-	-	-	-	-	-	-	-
<b>TOTAL</b>	<b>78,650</b>	<b>125,600</b>	<b>92,100</b>	<b>107,600</b>	<b>110,900</b>	<b>113,000</b>	<b>107,750</b>	<b>130,550</b>	<b>866,150</b>

On the other hand, the following table presents a breakdown of the amounts received from other Telefónica Group companies other than Telefónica, S.A., by Company's Directors for discharging executive duties or for membership of the companies' governing bodies and/or Advisory Boards of such companies:

Euros

Director	Wage/Compensation <sup>1</sup>	Attendance fees <sup>2</sup>	Short-term variable compensation <sup>4</sup>	Other items <sup>4</sup>	TOTAL
<b>Executive</b>					
Ms. Eva Castillo Sanz	48,034	--	--	136,500	184,534
Mr. Santiago Fernández Valbuena	361,143	--	--	48,605	409,748
<b>Independent</b>					
Mr. David Arculus	--	--	--	63,565	63,565
Mr. Peter Erskine	--	--	--	84,754	84,754
Mr. Alfonso Ferrari Herrero	100,950	--	--	175,500	276,450
Mr. Luiz Fernando Furlán	105,991	--	--	175,500	281,491
Mr. Gonzalo Hinojosa Fernández de Angulo	17,322	--	--	--	17,322

Mr. Francisco Javier de Paz Mancho	658,688	--	--	175,500	834,188
<b>Other external</b>					
Mr. Fernando de Almansa Moreno-Barreda	216,293	--	--	175,500	391,793

1 **Wage:** Cash compensation with a predefined payment frequency, whether or not consolidable over time, and payable by Group companies in consideration of the mere fact of employment by them, regardless of the Director's attendance to Board meetings or analogous of the Telefónica Group entity in question. Also includes non-variable remuneration accrued, as appropriate, by the Director for discharging executive duties.

2 **Attendance fees:** Amounts payable for attendance to meetings of the Board of Directors or similar bodies of any Telefónica Group company.

3 **Short-term variable compensation:** Variable amount linked to the performance or achievement of individual or group objectives (quantitative or qualitative) and commensurate with other compensation or any other reference in euros for a period of up to a year.

4 **Other items:** Includes, *inter alia*, amounts paid for membership of Regional Advisory Committees.

With respect to employee benefits, the following table presents a breakdown of contributions made in 2012 to both long-term savings schemes (including retirement and any other survival benefit) financed fully or partially by the Company for Telefónica Directors, for discharging executive duties, along with any other compensation in kind received by the Director during the year:

Euros Director	Contributions to pension plans	Contribution to the Pension Plan for Senior Executives <sup>2</sup>	Compensation in kind <sup>3</sup>
Mr. César Alierta Izuel	8,402	1,014,791	45,917
Mr. Julio Linares López	9,468	474,895	39,141
Mr. José María Álvarez-Pallete López	7,574	414,716	12,765
Ms. Eva Castillo Sanz	8,402	98,443	1,617
Mr. Santiago Fernández Valbuena <sup>1</sup>	--	110,112	6,564

1 The contribution to the Pension Plan was made when Mr. Fernández Valbuena was not classified as an Executive Director and is therefore shown under "Senior Executives Compensation." The amount was 8,402 euros.

2 Contributions to the Pension Plan for Executives set up in 2006, funded exclusively by the Company to complement the existing Company's general Pension Plan. It entails defined contributions equivalent to a certain percentage of the Directors' fixed remuneration in accordance with their professional category within the Telefónica Group's organization.

3 "Compensation in kind" includes life and other insurance premiums (e.g. general medical and dental insurance).

Regarding share-based payment plans (those exclusively for Executive Directors), there were two long-term variable compensation plans in place in 2012:

- (i) The "Performance Share Plan" ("PSP") approved at the General Shareholders' Meeting of June 21, 2006, whose fifth and final phase began in 2010 and which will conclude in July 2013. The shares assigned were as follows: 170,897 shares to Mr. César Alierta Izuel, 128,173 shares to Mr. Julio Linares López, 77,680 shares to Mr. José María Álvarez-Pallete López and 77,680 shares to Mr. Santiago Fernández Valbuena. Delivery of the shares assigned are subject in all cases to meeting the target TSR and the other requirements of the Plan.

Also, it is hereby stated that regarding the fourth phase of this Plan (2009-2012), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to Executive Directors.

- (i) The so-called "Performance & Investment Plan" ("PIP") approved at the General Shareholders' Meeting of May 18, 2011 whose first phase began in 2011 and will end in July 2014, and the second phase began in 2012 and will end in July 2015. It is hereby stated that the number of shares assigned and the maximum possible number of shares to be received by the Directors of Telefónica for discharging executive duties in each phase, if the co-investment

requirement established in the Plan and the maximum target TSR established for each phase are met, are as follows:

**(First phase / 2011-2014)**

Name	Theoretical shares assigned	Maximum number of shares *
Mr. César Alierta Izuel	249,917	390,496
Mr. Julio Linares López	149,950	234,298
Mr. José María Álvarez-Pallete López	79,519	124,249
Mr. Santiago Fernández Valbuena	79,519	124,249

\* Maximum possible number of shares to be received if the co-investment and maximum target TSR are met.

**(Second phase / 2012-2015)**

Name	Theoretical shares assigned	Maximum number of shares *
Mr. César Alierta Izuel	324,417	506,901
Mr. Julio Linares López (1)	13,878	21,685
Mr. José María Álvarez-Pallete López	188,131	293,955
Ms. Eva Castillo Sanz	95,864	149,787
Mr. Santiago Fernández Valbuena	103,223	161,287

(1) The number of shares assigned to Mr. Linares was calculated in proportion to time he discharged executive duties as Chief Operating Officer –COO– (from July 1, 2012 to September 17, 2012) during the second phase of the Plan.

\* Maximum possible number of shares to be received if the “co-investment” and maximum target TSR are met.

In addition, to reinforce Telefónica’s status as a global employer, with a common remuneration culture throughout the Company, to encourage all Group employees to take an equity interest, and to motivate employees and boost their loyalty, at the Company’s General Shareholders’ Meeting of June 23, 2009, shareholders approved the introduction of a Telefónica, S.A. share incentive plan, the “Global Employee Share Plan” (“GESP”) for all employees of the Group worldwide (including executives and Executives Directors).

Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, for a period of up to 12 months (the acquisition period), with this company assuming the obligation of giving participants a certain number of shares free of charge. The maximum sum each employee can assign to this plan is 1,200 euros, while the minimum is 300 euros. Employees who remain at the Telefónica Group and retain their shares for an additional year after the acquisition period (the consolidation period) will be entitled to receive one free share per share acquired and retained until the end of the consolidation period.

During the first phase of this Plan (2010-2011), Directors participating, as they discharged executive duties in the Group, acquired a total of 604 shares (including free shares received under the general terms and conditions of the Plan).

For the second phase of the Plan (2012-2013), approved at the General Shareholders’ Meeting of May 18, 2011, the Executive Directors that decides to take part contributing the maximum (i.e. 100 euros a month, over 12 months), at the date of finalization of these consolidated financial statements, had acquired, under this Plan, a total of 84 shares, entitling them to receive an equivalent number of free shares provided, *inter alia*, that they hold the share acquired throughout the consolidation period.

It should be noted that the external Directors do not receive and did not receive in 2012 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica’s share price.

In addition, the Company does not grant and did not grant in 2012 any advances, loans or credits to the Directors, or to its top executives, thus complying with the requirements of the U.S.A. Sarbanes-Oxley Act, which is applicable to Telefónica as a listed company in that market.

**- Note 7 to Section B.1.11**

Sub-section a). "Others" includes: i) 24,748,696 euros in compensation paid to Mr. Julio Linares López on stepping down from his executive duties; and other considerations received for (ii) medical and dental insurance premiums; (iii) compensation for membership in the Company's various regional advisory committees, including the Telefónica Corporate University Advisory Council; and (iv) contributions made by the Telefónica Group to the Pension Plan for Senior Executives (Retirement Plan) on behalf of executive directors.

Subsection b). The "Fixed Payment" includes both the amounts of the salaries received from other Telefónica Group companies by the members of the Board of Directors in their capacity as executives, and the amount received by the members of the Board of Directors as fixed allowance for belonging to the Board of Directors of any of the companies of the Group or of its respective Committees.

**- Note 8 to Section B.1.11**

It is noted that the total amount of the contributions made by the Telefónica Group during 2012 to the Pension Plan for Senior Executives was 2,112,957 euros on behalf of Executive Directors is recorded under the category "Other" in the compensation tables included under points a) and b) of section B.1.11 of the 2012 Annual Corporate Governance Report, as it was done in the Annual Corporate Governance Reports for 2008, 2009, 2010 and 2011.

This is because said Plan is an employee benefit that differs to the general pension plan by which Telefónica remunerates its employees (including executive Directors) which is recorded under the sections on "Pension Funds and Plans" in the aforementioned section B.1.11 of the Annual Corporate Governance Report.

**- Note 9 to Section B.1.12**

"Total remuneration received by senior management" includes the economic valuation of the compensation received under the "Performance Share Plan", as well as contributions made by the Telefónica Group in 2012 to the Pension Plan.

This amount also includes, *inter alia*, 10,893,244 euros corresponding to the amounts received by Mr. Luis Abril Pérez and Mr. Calixto Rios Pérez in termination benefits, as a result of termination of their employment relationship with the Telefónica Group.

In order to ensure maximum transparency in this matter, and in accordance with the information provided in the Notes to the Financial Statements corresponding to the financial year 2012, below we provide the remuneration and benefits received by the Senior Executives of Telefónica, S.A. in the year.

The Executives considered as Senior Executives of the Company in 2012, excluding those that are also members of the Board of Directors, received a total, in 2012, of 24,321,976 euros. It is hereby stated that this amount includes, *inter alia*, 10,893,244 euros corresponding to the amounts received by Mr. Luis Abril Pérez and Mr. Calixto Rios Pérez in termination benefits, as a result of termination of their employment relationship with the Telefónica Group.

In addition, the contributions by the Telefónica Group in 2012 with respect to the Pension Plan for these Executives amounted to 1,392,798 euros. Contribution to the Pension Plan amounted to 48,730 euros and compensation in kind including life and other insurance premiums (e.g. general medical and dental insurance) to 93,460 euros.

Meanwhile, a total of 297,141 shares corresponding to the fifth phase (2010-2013) of the above mentioned "Performance Share Plan" ("PSP") were assigned to the Executives considered as Senior Executives of the Company. Also, it is hereby stated that regarding the fourth phase of this Plan (2009-2012), the general terms for the delivery of shares were not met. Therefore, no shares were delivered to the Executives.

Regarding the “Performance and Investment Plan” (“PIP”) approved at the General Shareholders’ Meeting of May 18, 2011, a total of 422,344 shares were assigned to the Executives considered Senior Executives of the Company in the first phase (2011-2014) and 623,589 shares in the second phase (2012-2015).

Finally, regarding the first phase of the “Global Employee Share Plan” (“GESP”) (2010-2011), Executives participating acquired a total of 872 shares (including free shares received under the general terms and conditions of the Plan).

Regarding the second phase of the Plan (2012-2013), approved at the General Shareholders’ Meeting of May 18, 2011, the Executives taking part and contributing the maximum (i.e. 100 euros a month, over 12 months), at the date of finalization of these consolidated financial statements, had acquired, under this Plan, a total of 110 shares, entitling this Executives to receive an equivalent number of shares free provided, *inter alia*, that they hold the share acquired throughout the consolidation period established in the Plan.

**- Note 10 to Section B.1.21**

Although there are no specific powers granted to an independent Director to these effects, the Company considers that this recommendation can be deemed as complied with for the following reasons:

- In accordance with Article 29 of the Regulations of the Board of Directors, all the Directors of the Company, including all independent Directors, may request that a meeting of the Board of Directors be called whenever they consider it necessary, or that the items they deem appropriate be included in the Agenda.
- Furthermore, in accordance with Article 13.3 of said Regulations, the Chairman of the Board of Directors, together with the Chairman of the Nominating, Compensation and Corporate Governance Committee – who shall in all events be an independent Director (Article 22 of the Regulations)- shall be responsible for organizing and coordinating a periodic assessment of the Board.

**- Note 11 to Section B.1.29**

In 2012, the other Board Committees held the following meetings:

- Human Resources and Corporate Reputation and Responsibility Committee: 4
- Regulation Committee: 4
- Service Quality and Customer Service Committee: 4
- International Affairs Committee: 4
- Innovation Committee: 11
- Strategy Committee: 10

**- Note 12 to Section B.1.31**

In accordance with the US securities market regulations, the information contained in the Annual Report on form 20-F (which includes the consolidated Annual Financial Statements of the Telefónica Group), filed with the Securities and Exchange Commission, is certified by the Executive Chairman of the Company and by the Chief Financial Officer – CFO - and Director of Corporate Development. This certification is made after the Financial Statements have been finalized by the Board of Directors of the Company.

**- Note 13 to Section B.1.39**

Financial year 1983 was the first audited by an external auditor. Prior to that, the financial statements were revised by chartered accountants ('censores de cuentas'). Therefore, 1983 is the base year taken for calculating the percentage in the case of audits of the Individual Annual Accounts of Telefónica, S.A. and 1991 is the date taken for the calculation of the percentage in the case of the Consolidated Annual Accounts, as 1991 was the first year in which the Telefónica Group prepared Consolidated Annual Accounts.

**- Note 14 to Section B.1.40**

The equity holding of the Director Mr. Isidro Fainé Casas in Telecom Italia, S.p.A., is of the total amount of shares of this company.

The director Ms. Eva Castillo Sanz directly holds 10,000 shares in the Group company, Telefónica Deutschland Holding, A.G. (0.001% of its share capital), in which she holds the post of Chairwoman of the Supervisory Board.

**- Note 15 to Section C.2.]**

The transactions included under "Commitments Undertaken" in amounts of 5,718 and 12,905,663 euros with Banco Bilbao Vizcaya Argentaria, S.A. and 53 and 2,661,335 euros with Caja de Ahorros y Pensiones de Barcelona, "la Caixa", entail transactions with derivatives.

You may include in this section any other information, clarification or observation related to the above sections of this report.

Specifically indicate whether the company is subject to corporate governance legislation from a country other than Spain and, if so, include the compulsory information to be provided when different to that required by this report.

## **II. ADDITIONAL DISCLOSURES REQUIRED UNDER ARTICLE 61 BIS OF THE SPANISH SECURITIES MARKET LAW**

Disclosure requirements under Article 61 bis of the Spanish Securities Market Law are as follows:

**Securities that are admitted to trading on a regulated market in a Member State, where appropriate with an indication of the different classes of shares and, for each class, the rights and obligations attaching to it.**

Not applicable.

**Any restrictions on the transfer of securities and any restrictions on voting rights.**

Nothing in the Company By-Laws imposes any restriction or limitation on the free transfer of Telefónica shares.

According to Article 21 of the Company's Bylaws, no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own. This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

The 10 per cent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

In relation to the above and in accordance with the provisions of article 527 of the Corporate Enterprises Act, any clauses in the bylaws of listed corporations that directly or indirectly restrict the number of shares that may be cast by a single shareholder, the companies belonging to the same group or by any parties acting together with the aforementioned, will be rendered null and void when, subsequent to a takeover bid, the buyer has a stake equal to or over 70% of share capital which confers voting rights, unless the buyer was not subject to neutralization measures to prevent a takeover bid or had not adapted these measures accordingly.

**Rules governing the amendment of the article of association.**

The procedure for amending the Bylaws is regulated by sections 285 et seq. of the consolidated text of the Corporate Enterprises Act, according to which changes in the Company's By-Laws must be decided by the Shareholders' Meeting with the majorities stipulated in sections 194 and 201 of the abovementioned Act. Also, the directors shall draft and put at the disposal of the shareholders, the requested report with the wording of the proposed amendment in full justifying the proposal. Article 14 of the By-Laws and article 5 of the Regulations for the General Shareholders' Meeting expressly include, among the powers of shareholders acting at a General Shareholders' Meeting, that of amending the By-Laws.

Article 21 of the Regulations for the General Shareholders' Meeting regulates the voting procedure for the proposals, stating that, in the case of amendments to the By-Laws, when a single item on the agenda includes different matters, such matters shall be separately submitted to a vote.

**Significant agreements to which the company is a party and which take effect, alter or terminate upon a change of control of the company following a takeover bid and the effects thereof.**

The Company has no significant agreements outstanding that would take effect, alter or terminate in the event of a change of control following a Takeover Bid.

**Agreements between the Company and its board members and executives or employees providing for compensation if they are made redundant without valid reason following a takeover bid.**

In general, the contracts of Executive Directors and some managers of the executive team include a clause giving them the right to receive the economic compensation indicated below in the event that their employment relationship is ended for reasons attributable to the Company and/or due to objective reasons such as a change of control in the Company. However, if the employment relationship is terminated for a breach attributable to the executive director or executive, he/she will not be entitled to any compensation whatsoever. That notwithstanding, in certain cases the severance benefit to be received by the Executive Director or Executive, according to their contract, does not meet these general criteria, but rather are based on other circumstances of a personal or professional nature or on the time when the contract was signed. The agreed economic compensation for the termination of the employment relationship, where applicable, consists of a maximum of three times annual salary plus another year based on length of service at the Company. The annual salary on which the indemnity is based is the last fixed salary and the arithmetical mean of the sum of the last two payments received by contract.

Meanwhile, contracts that tie employees to the Company under a common employment relationship do not include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labor legislation. This notwithstanding, contracts of some Company employees, depending on their level and seniority, as well as their personal or professional circumstances or when they signed their contracts, establish their right to receive compensation in the same cases as in the preceding paragraph, generally consisting of a year and a half of salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two variable payments received by contract.

**A description of the main characteristics of the internal control and risk management systems with regard to statutory financial reporting.**

**A. The entity's control environment**

**A.1**

The Board of Telefónica, S.A. (hereinafter Telefónica) assumes the ultimate responsibility of ensuring that an adequate and effective internal control over financial reporting system (ICFRS) exists and is updated.

Pursuant to Law and the Company's By-laws, the Board of Directors is the Company's most senior governing body and representative, and is therefore authorized within the corporate purpose laid down in the By-laws, to perform all acts and legal transactions of administration and disposal, by any legal title, except those reserved by Law or the Company's By-laws for the shareholders in a General Meeting.

Without prejudice to the aforementioned, the Board of Directors basically consists of a supervisory and control body, while the executive bodies and management team are responsible for the day-to-day management of the Company's businesses.

The Regulations of the Board of Directors state that the primary duty of the Audit and Control Committee shall be to support the Board of Directors in its supervisory duties. Specifically, it shall have at least the following powers and duties:

- To supervise the process of preparing and submitting financial information. In this regard, to supervise the process of preparation and the integrity of the financial information related to the Company and the Group, reviewing compliance with the regulatory requirements, the proper determination of the scope of consolidation, and the correct application of the accounting standards.
- To supervise the effectiveness of the Company's internal control system and risk management systems, and to discuss with the auditors significant weaknesses in the internal control system detected during the audit. With respect thereto, it shall be responsible for proposing to the Board of Directors a risk control and management policy, which shall identify at least the following types of risk (operational, technological, financial, legal and reputational) which the company faces; the level of risk which the company deems acceptable; the measures for mitigating the impact of the identified risks should they materialize; and the control and information systems to be employed to control and manage said risks.
- Establish and maintain appropriate relations with the External Auditor to receive information on those matters that may jeopardize the independence thereof, for consideration by the Audit and Control Committee, and any other related to the development of the audit process, as well as any other communications provided for in audit legislation and technical standards of audit.
- Issue annually, prior to the issuance of the audit report, a report that will express an opinion on the independence of the External Auditor
- To supervise internal audit and, in particular: to ensure the independence and efficiency of the internal audit function; to receive periodic information on its activities; and to verify that the senior executive officers take into account the conclusions and recommendations of its reports.

The Audit and Control Committee shall meet monthly and as often as appropriate.

In order to carry out this supervisory function, the Audit and Control Committee is assisted by the Internal Audit department which periodically submits its activities report to the Committee.

## **A.2**

The different areas and functional units of the Telefónica Group play a key role in ICFR as they are responsible for preparing, maintaining and updating the different procedures that govern their operations and identify the tasks to be carried out, as well as the persons in charge of the same.

The Board of Directors is responsible for designing and reviewing the Company's organizational structure, ensuring there is an adequate separation of functions and that satisfactory coordinating mechanisms among the different areas are established.

Use of the Telefónica Group's economic-financial IT system is regulated through several manuals, instructions and internal rules and regulations, the most noteworthy of which are as follows:

**Accounting Policies and Measurement Criteria Manual**, designed to unify and standardize the accounting criteria and policies used by all the Group companies to ensure Telefónica operates as a consolidated and uniform group.

**Instructions for closing and external audits**, published annually to establish the procedures and schedule all Telefónica Group companies and their auditors must follow when reporting financial and accounting information in order

to elaborate the consolidated financial information of the Group by the Financial Consolidation Department to comply with Telefónica, S.A.'s legal and reporting requirements in Spain and the other countries in which its shares are listed.

**Annual calendar of financial accounting information**, applicable to all Telefónica Group companies to establish the monthly accounting-financial reporting dates at the start of each period.

The regulations also define and delimit responsibilities at each level of the organization regarding the reliability of the information published.

With regard to the principles which guide the Company's actions, we would note that in December 2006, the Telefónica Group approved a **code of conduct and business ethics**, "The Telefónica Business Principles," which are applicable to all Group employees and all organizational levels (management and non-management). The Business Principles are available on the Telefónica Group intranet and there are procedures in place to update, monitor and disseminate these throughout the Telefónica Group. They expressly mention issues regarding recording transactions and preparation of financial information.

A specially-designed committee is responsible for monitoring these Business Principles. This Committee meets periodically and comprises representatives from Telefónica's Human Resources, Reputation, General Secretariat and Group Internal Audit departments, as well as representatives from each of the geographical areas in which Telefónica is present.

As part of its remit, this Committee coordinates the activities of the various business areas, with particular emphasis on monitoring the actions inherent in the Business Principles. For example, as the Internal Audit area is involved, it is able to answer potential queries regarding the need to carry out specific actions should notifications of failure to comply with the Business Principles be received. Also, through this Committee, its members agree on ways to help disseminate the Business Principles to the Group, as well as monitoring communication and training initiatives in this matter. For this last initiative, and as part of the on-line training platform, there is a specific course on these principles. By taking part in this abovementioned course, employees pledge to adhere to these business principles.

Also, since April 2004 the Telefónica Group has a **complaints channel** which can be accessed directly via the Telefónica intranet. This was approved by the Audit and Control Committee and Group employees were notified according to the established procedures. This complaints channel allows all Telefónica Group employees to report, anonymously if chosen, two types of irregularities:

- *Any irregularities* detected in the internal control system, accounting or the audit of the financial statements. These are reported directly to the Secretary of the Telefónica Audit and Control Committee.
- *Other irregularities*, including those related to the Business Principles. These complaints are reported either to the Business Principles office or the Internal Audit Department.

The Telefónica Audit and Control Committee receives all complaints regarding internal controls, accounting or the audit of the financial statements. All complaints of this nature will be treated and resolved by the Committee appropriately.

Telefónica, S.A. also has "Internal Code of Conduct for Securities Markets Issues" setting out the general guidelines and principles of conduct for the persons involved in securities and financial instrument transactions.

With regard to employee training in financial and control issues, we would note that in 2007 the **Telefónica Corporate University** (Universitas Telefónica) was opened to help contribute to the Telefónica Group's advancement through lifelong learning. All the University's training programs are based on developing the corporate culture, the business strategy and management and leadership skills. Personnel involved in preparing and reviewing financial information are also offered refresher courses in this area.

Likewise, the Telefónica Accounting Policies Department offers training plans and seminars to all personnel working in the Group's financial areas and other pertinent areas (Tax, M&A, etc.), with the aim of informing them of any accounting or financial changes which are applicable to their job of preparing consolidated financial information.

Finance personnel also attend technical sessions run by external consultancy firms and covering developments in accounting.

Finally, the Telefónica Group also has an on-line training platform which includes a finance school providing specific training and refresher courses on financial information, as well as an internal control school providing instruction on auditing, internal control and risk management.

## **B. Risk assessment in financial reporting**

Given the vast number of processes involved in financial reporting at the Telefónica Group, a model has been developed to select the most significant processes by applying a so-called Scope Definition Model. This model is applied to the financial information reported by subsidiaries or companies managed by Telefónica. The model selects the accounts with the largest balance or difference and identifies the processes used to generate this information. Once the processes have been identified, the risks inherent in the processes affecting financial reporting are analyzed. This identification procedure covers all the financial reporting objectives of existence and occurrence, completeness, valuation, presentation, disclosure and fraud. Risk identification is carried out on an annual basis.

Telefónica also has a Risk Management Model covering four key areas of risk:

- Business risks
- Operational risks
- Global risks
- Financial risks

Financial risks include risks associated with the accuracy, completeness and publication of reporting information.

In the process of identifying the consolidation scope, the Telefónica Consolidation Department periodically monitors the changes in the Group's scope.

## **C. Control activities**

On March 26, 2003 the Telefónica Board approved the "Regulations governing disclosure and reporting to the markets". These regulate the basic principles of operation of the financial disclosure control processes and systems which guarantee that all relevant consolidated financial information is communicated to the company's senior executives and its management team, assigning to the Internal Audit the duty of periodically assessing the functioning of these processes and systems.

Each quarter the Finance Department submits the periodic financial information to the Audit and Control Committee, highlighting the main events and accounting criteria applied and clarifying any major events which occurred during the period.

Likewise, the Telefónica Group has documented financial processes in place which stipulate common criteria for preparing financial information in all Group companies, as well as any outsourced activities.

The Company follows documented procedures for preparing consolidated financial information whereby those employees responsible for the different areas are able to verify this information. In this regard, there is a Coordination and Control Committee comprising employees responsible for these areas. They are able to submit the results of their reviews in order to correctly prepare the financial information presented to the Company's bodies (Audit and Control Committee and, if applicable, the Board of Directors).

Also, and pursuant to the internal regulations, the Executive Chairmen and the Finance Directors must submit a certificate to the Corporate Finance Department stating that they have reviewed the financial information being presented, that the financial statements give a true and fair view, in all material respects, of the financial position, results and cash position, and that there are no significant risks to the business or unhedged risks which may have a material impact on the Company's equity and financial position.

In relation to the accounting close, the Consolidation and Accounting Policies Department issues instructions setting out the calendar and contents for the financial reporting period for the preparation of the consolidated annual financial statements. These instructions are mandatory for all Telefónica consolidation subgroups and subsidiaries.

The Corporate Finance Department reviews the key judgments, estimates, valuations and forecasts to identify critical accounting policies that require the use of estimates and value judgments. In these cases, the Corporate Finance Department also establishes the necessary operational co-ordination actions with the rest of the Telefónica Group units

for their specific areas of activity and knowledge before presenting them to the Audit and Control Committee. The most relevant are dealt with by the Audit and Control Committee. Senior management defines the format for presenting the annual financial statements prior to approval by the Board.

The critical processes involved in financial reporting at the Telefónica Group, as well as its controls, are evaluated by the internal audit function, which looks at the degree of documentation and revision, as well as its operation. In order to establish an adequate evaluation process, the Telefónica Group has three general levels, which are applied according to the type of controls, the level of risk of the processes or the activities being evaluated: General Evaluation Model, Self-Appraisal Questionnaires (to determine the degree of internal control in all Group companies, even those which are considered less significant in terms of their contribution to the consolidated financial figures) and Focused Tests (a tool used to evaluate the general controls of the ICFR).

The General Evaluation Model follows the same working scheme for each company listed on a foreign exchange: critical accounts are defined based on their materiality; the processes and systems associated with the critical accounts are identified; the risks and controls inherent in financial reporting associated with these processes are identified; the controls are evaluated; audit testing is carried out and should any incidences in the effectiveness of them be detected, recommendations are proposed to guarantee the correct functioning of ICFR.

The Global IT systems department of the Telefónica Group is responsible for the IT systems at all the Group's businesses. One of its many and various duties is to define and implement policies and security standards for applications and infrastructures (in conjunction with the Security and Networks departments), which includes IT aspects of the internal control model.

In the Telefónica Group the Internal Audit is charged with monitoring the general controls over the IT systems. The processes for controlling the IT systems are grouped into 22 general control objectives, which in turn are grouped together in the following four categories: **Physical security** (security at the data processing center and facilities, information backup, contingency plans, information recovery in the event of disasters and business continuity at the different data processing centers and IT facilities); **Logistics security** (program access control, user applications and data handling control, productive database data access control, and appropriate separation of duties); **Systems development** (methodology for developing and maintaining systems, controls inherent in an application, methodological steps for applications, project start-up); and **Systems operation** (non-programmed tasks, application testing, interruption monitoring, and incident management).

When a process or part of a process concerning financial information is outsourced, suppliers are requested to present the ISAE 3402 certificate or controls are established within these processes to ensure they function correctly.

When Telefónica or any of its subsidiaries engage the services of an independent expert whose findings may materially affect the consolidated financial statements, as part of the selection process the competence, training, credentials and independence of the third party is verified directly by the area contracting the service and, if applicable, the procurement department. The finance department has control activities in place to guarantee the validity of the data, the methods used and the reasonableness of the assumptions used by the third party.

Likewise, there is an internal procedure for engaging independent experts which requires specific levels of approval.

#### **D. Information and Communication**

The Consolidation and Accounting Policies Department of Telefónica is charged with defining and updating the accounting policies used for preparing the consolidated financial information.

Thus, this area publishes IFRS (International Financial Reporting Standards) information bulletins summarizing the main changes to accounting methodology, as well as clarifications on various other related issues.

Also, the Telefónica Group has an Accounting Policies Manual which is updated periodically. The objectives of this manual are: to align the corporate accounting principles and policies with IFRS; to maintain accounting principles and policies which ensure that the information is comparable within the Group and offers optimum management of the source of information; to improve the quality of the accounting information of the various Group companies and of the Consolidated Group by disclosing, agreeing and introducing accounting principles which are unique to the Group; and to facilitate the accounting integration of acquired and newly-created companies into the Group's accounting system by means of a reference manual.

This Manual is mandatory for all companies belonging to the Telefónica Group, and shall be applied to their reporting methods when preparing the consolidated financial statements.

There is also a **Compliance Manual for Consolidation Reporting**, which includes specific instructions on preparing the disclosures which comprise the reporting for the consolidation of the Telefónica Group's financial statements and the preparation of consolidated financial information.

Likewise, the Telefónica Group uses a specific IT tool for the reporting of the individual financial statements at its various subsidiaries, as well as the necessary notes and disclosures for preparing the consolidated annual financial statements. This tool is used to carry out the consolidation process and its subsequent analysis. The system is managed centrally and uses the same accounts plan.

## **E. Monitoring**

Telefónica is listed on the New York Stock Exchange and is therefore subject to the regulatory requirements established by the US authorities applicable to all companies trading on this exchange.

Among these requirements is the "Sarbanes-Oxley Act" and, specifically, Section 404 which stipulates that all listed companies must evaluate on an annual basis the effectiveness of its ICFR procedures and structure.

As noted above, the Telefónica Group has an Internal Audit function which reports hierarchically (to the General Secretariat and the Board) and functionally (to the Audit and Control Committee). Its activities include ensuring compliance with applicable laws, internal regulations and the principles of the Group's Code of Ethics; safeguarding the equity's assets, the efficiency and effectiveness of operations, the reliability of the information, controlled transparency with third parties and safeguarding the image of the Telefónica Group.

The Audit and Control Committee also provides support in monitoring the correct functioning of the ICFR system. The system is monitored twice a year in order to offer a preliminary assessment to help resolve any major incidences in advance by establishing the corresponding action plans for the managers in charge.

In 2012, the Audit and Control Committee was informed of the findings of the ICFRS review which directly affected 19 companies, 266 material accounting items, 588 critical processes and 205 IT systems, with a total of 4,854 control activities reviewed.

In order to assess the status of the general controls at Telefónica, "Focused Tests" have been carried out to analyze the controls established by the Company's management which are more closely associated with the general control environment and apply to all of the Company's processes. A total of 25 control objectives were reviewed.

Also, Self-Appraisal Questionnaires have been filled out by the employees in charge of the 268 Group companies certifying their assessment of a series of issues related to internal control in their area of responsibility.

The results of the final appraisal were presented at the February 2012 meeting of the Audit and Control Committee. No material weaknesses or significant shortcomings in the ICFR structure and procedures were identified.

Each year the External Auditor issues its own opinion on the effectiveness of ICFR. At the date of this report, the External Auditor has not notified the Audit and Control Committee of the existence of any control shortcomings which constitute material weaknesses or significant deficiencies.

Furthermore, the External Auditor participates regularly in the Audit and Control Committee meetings, when called to do so by the Committee, to explain and clarify different aspects of the audit reports and other aspects of its work.

## **F. External auditor review**

The attached information on ICFR has been submitted to review by the External Auditor, whose report is attached as an appendix to this document.

This Appendix to the Telefónica, S.A. 2012 Annual Report on Corporate Governance was originally prepared in Spanish. In the event of a discrepancy, the Spanish-language prevails.

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*Translation of an auditor's report and description of the Internal Control over Financial Reporting System (SCIIF in Spanish) originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails*

## AUDITOR'S REPORT ON THE DESCRIPTION OF THE INTERNAL CONTROL OVER FINANCIAL REPORTING SYSTEM (SCIIF IN SPANISH)

To the Board of Directors of  
Telefónica, S.A., engaged by the management:

We have examined the accompanying description of the Internal Control over Financial Reporting System (SCIIF in Spanish) of Telefónica, S.A. (the Parent Company) and its subsidiaries (the Group), which is included in Section II of the Appendix to the Annual Corporate Governance Report for the year ended December 31, 2012, in the "Description of the main characteristics of the internal control and risk management systems with regard to statutory financial reporting." This examination has included the evaluation of the effectiveness of Internal Control on the Financial Reporting System regarding the financial information included in the Group's consolidated financial statements at December 31, 2012, prepared in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group. This system is based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report "Internal Control - Integrated Framework."

Telefónica, S.A.'s management is responsible for maintaining effective internal control over financial reporting included in the consolidated financial statements, and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on the aforementioned effectiveness of internal control over financial reporting, based on the work we have performed in accordance with the requirements of the Standard ISAE 3000 "Assurance Engagement Other than Audits or Reviews of Historical Financial Information" issued by the International Auditing and Assurance Standards Board (IAASB) of the International Federation of Accountants (IFAC) for the issuance of reports to obtain reasonable assurance.

The work performed to obtain reasonable assurance includes obtaining an understanding of the internal control over financial reporting system regarding the financial information included in the consolidated financial statements, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we consider necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, fraud or illegal acts. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Telefónica, S.A. and subsidiaries maintained, in all material respects, effective internal control over financial reporting regarding the financial information included in the consolidated financial statements as of December 31, 2012, based on the criteria and policies defined by the Parent Company's management in accordance with the guidelines established by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in its report "Internal Control - Integrated Framework." We also have checked that the disclosures included in the accompanying description of the Internal Control over Financial Reporting System (SCIIF in Spanish) at December 31, 2012 comply, in all material respects, with the requirements of Securities Market Law 24/1988 of July 28, as amended by Law 2/2011, of March 4, on Sustainable Economy, and meets the minimum content required by the Draft Circular published on October 26, 2011 by the National Securities Market.

The examination indicated in the preceding paragraphs is not subject to the Consolidated Spanish Audit Law, approved by Royal Legislative Decree 1/2011 of July 1, so we do not express an audit opinion in the terms provided for in the aforementioned Law.

In addition to the aforementioned examination, we have audited, in accordance with prevailing audit regulations in Spain, the consolidated financial statements of Telefónica, S.A. and its subsidiaries at December 31, 2012, prepared by the Parent Company's Directors in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group, and our report dated March 20, 2013 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.



Ignacio Viota del Corte

March 20, 2013