



[*Telefónica's corporate governance principles*]

The basic Telefónica's Corporate Governance principles are contained in the Articles of Association and in the Regulations of its Board of Directors approved on January 29th, 1997 and amended on July 22nd, 1998.

These Regulations determine the Board of Directors' action principles, regulate their organization and functioning and establish their members' code of conduct. It must be highlighted that mainly all the recommendations laid down at that time by the Olivencia Commission were already included in these Regulations. This meant that Corporate Governance principles were brought closer to the Company's memorandum of association, i.e., a significant example of the commitment of the Company to their shareholders.

Although these documents are available via the information provided by the Company to the Comisión Nacional del Mercado de Valores (Securities Markets National Commission, hereinafter, «CNMV»), they will also be available to shareholders, investors and to the public in general on the Company's Website, as stated below.

Regarding those principles inspiring Telefónica's Corporate Governance, these are exactly as established in its Board of Directors' Regulations:

- a. maximization of the Company's value in the interest of shareholders,
- b. the Board of Directors' essential role in the Company's management and administration,
- c. transparency of information in relations with employees, shareholders, investors and clients.

In accordance with the provisions laid down in its Regulations, the Board of Directors will adopt the necessary measures to ensure: (I) the Company's management team pursues the creation of value for shareholders, (II) the management team is effectively under their supervision, (III) that no other person or reduced group of people holds the power of decision or is subject to counterweights or controls, and (IV) that no shareholder receives privileged treatment vis-à-vis the others.

In accordance with these general principles, and in relation to the Company's entrepreneurial and financial strategies, the Board of Directors will ensure:

- a. company planning centres on obtaining long-lasting profits and maximizing long-term cash-flows.
- b. adoption of new investment projects aimed at obtaining an adequate yield.
- c. liquid assets not needed to finance new investment projects or to maintain the Company's financial solidity is distributed among its shareholders.
- d. company transactions are reviewed constantly to optimise their profitability.

These are the Corporate Governance principles that have guided the Board of Directors', its sub-committees' and Telefónica's management team's activity in recent years. Furthermore, the Chairman, César Alierta, expressly renewed them before the shareholders at the last Ordinary General Meeting held on April 12th, 2002. Pursuant to this com-

mitment, and since that date, the Company has adopted a list of measures in terms of Corporate Governance, amongst which we would like to highlight the following:

- **Renewal of the Board of Directors' sub-Committees.** At the meeting held on June 26th, 2002, the Board of Directors approved the re-organization of the Board's Committees, granting the Nominating and Compensation Committee new competencies in terms of Corporate Governance and giving the Human Resources Committee new competencies in the area of Corporate Reputation. In addition, their composition was renewed so from that time they have been almost entirely composed of external or non-executive Board Members.
- **Internal Code of Conduct for Securities Markets Issues.** These Regulations, which will be described in greater detail in chapter VII of this Report, lay down conduct guidelines for the so described affected personnel in matters related to the securities' markets, not only regarding the most stringent respect for current legislation, but also based on ethical criteria and professional liability. These Regulations are already adapted to a great extent to those conduct regulations subsequently stipulated in the «Law 44/2002 of November 22nd: Financial System Reform Measures» («Financial Law»).
- **Regulation regarding the Registration, Communication and Control of Financial-Accounting Information:** At the meeting held on November 28th, 2002, the Board of Directors, in line with their information commitment to the markets, appro-

ved the internal regulation of the Company's internal procedures and control mechanisms related to the preparation of financial-accounting information. They thereby guaranteed the application of homogenous accounting practices and policies within the entire Group and the establishing of periodical assessment on the functioning of this system. This regulation meets the requirements provided by recent legislation published on this matter in the USA.

- **Regulation of informative Statements to the Markets (*Design stage*).** This second internal regulation establishes the basic functioning principles of the Company's informative statement processes and control systems, aimed at guaranteeing priority, quality and control of the information notified to the regulating bodies of the securities' markets and to the market in general. Yet again, it is the consequence of the statutory requirements laid down in the legislations of the different markets where the Company's securities are listed. At the date of this Report, this internal regulation had received a favourable report from the Audit and Control Committee and, likewise, from the Nominating, Compensation and Corporate Governance Committee. However it is still pending approval by the Board of Directors.
- **Board of Directors' Retribution.** The Nominating, Compensation and Corporate Governance Committee decided to assess the Board Members' retribution in accordance with their obligations and engaged an external consultancy in order to prepare a report on this issue to this. Furthermore, in order to provide due transparency to the Board Members' retribution as such, the Com-

pany decided to provide individualised information pursuant to responsibilities or posts of the Board and their sub-Committees.

Finally, the Board of Directors has proposed to the General Shareholders' Meeting that article 28 of the Company's Articles of Association on Board Members' retribution be amended for two reasons: one, to redraft the first section entrusting the General Shareholders' Meeting specifically for setting the maximum retribution amount for the Board; and secondly, to add a new section stipulating how to make the Directors' retribution public in the Annual Report. This measure is described in greater detail in chapter V of this Report.

On the other hand, the drafting of this Corporate Governance Report is yet another initiative worthy of mention, essentially an exercise in the Company's transparency aimed at the markets, in line with recent recommendations by the Aldama Commission. In this sense, the Company's Board of Directors has undertaken to draft an annual report providing the information necessary on Telefónica's Corporate Governance practices and structure, analysed in a single piece of text for the knowledge of its shareholders and investors.

Furthermore, and also in line with the Aldama Commission recommendations, it is also worth highlighting a project to be launched within a section of the Company's Website in the second quarter of the year, exclusively aimed to Corporate Governance issues thus providing shareholders, investors and the general public with easy access to all the relevant information on this

matter.

To conclude, further to the analysis of Corporate Governance practices of all the listed companies within the Telefónica Group during 2002, it is planned to extend the best Corporate Governance practices to all companies belonging to the Group. This will enable the Group to present markets with a commitment as well as homogenous Corporate Governance practices adapted to the structure of the listed companies in each case and the markets where they quote.