

07

Degree of compliance with the corporate governance recommendations



07.01 TELEFONICA, S.A.

The following is an analysis of the degree of compliance with the most relevant recommendations on Corporate Governance at an international level, including those made at Spanish level, in the Report published by the “Special Commission to Study an Ethical Code for the Boards of Directors of the companies: Governance of listed companies”, of 26th February 1998 (Olivencia Code) as well as the Report by the “Special Commission to encourage transparency and security on the markets and listed companies”, of 8th January 2003 (Aldama Report).

Principles of Corporate Governance

Existence of internal provisions to regulate the system of corporate governance.

The fundamental rules of corporate governance of Telefónica are set forth in its Articles of Association and in the Regulations of the Board of Directors. The Regulations of the Board of Directors, as fundamental rules for corporate governance of the Company, determine the principles of action of the Board of Directors, regulate its organisation and operation and set the rules of conduct of its members.

The Board of Directors

Express undertaking by the Board of Directors of the general duties of supervision, as an indelegable task, and establishment of a catalogue of matters reserved for its hearing.

The Regulations of the Board of Directors basically configure it as a body to supervise and control the activity of the Company, delegating management of its ordinary business upon the executive bodies (single person or collegiate) and

the management team. Moreover, as established in these Regulations, the Board binds itself to directly exercise certain responsibilities (general strategies, own portfolio policy, implementation and monitoring of internal control systems, etc.)

Composition of the Board of Directors

Operative size of the Board according to the characteristics of the Company.

The Articles of Association of Telefónica foresee that the Board of Directors is comprised of a minimum of five and a maximum of twenty members. The Board of Directors of Telefónica is now comprised of nineteen Directors.

Due to the complexity of the Telefónica Group, the significant number of companies comprising it, the variety of the sectors in which it performs its activities, its multinational nature, as well as its economic and corporate relevance, the size of the Board of Directors is considered adequate and suitable to achieve effective, operational functioning in all cases.

Integration of a reasonable number of independent Directors on the Board.

Majority of Directors external or non executive directors out of the number of executive Directors.

Multinational presence on the Boards of Directors.

Considering the present composition of the present Board of Directors of Telefónica, the principles that govern this composition – established in the Regulations of the Board –, one may conclude that: (a) it has a significant number of independent Directors (eight); (b) the external Directors (proprietary and independent) form an ample majority over the executive ones

(fourteen to five); and, (c) it has a very significant share of independent Directors, who are in majority in relation to the proprietary ones (eight to six).

On the other hand, due to the multinational nature of the Telefónica Group, the Board of Directors of the Company has three foreign Directors.

Operation of the Board

Meetings of the Board: frequency, encouraging participation by all the Directors, care in drafting the minutes and annual evaluation of the efficiency of the Board.

To ensure adequate operation of the Board, its meetings are held at least once a month, according to a pre-set calendar, in which the matters on the Agenda will be analysed and discussed. It will be directly supervised by the Secretary who shall especially ensure that the minutes drafted provide a true record of the matters dealt with and, when appropriate, the resolutions passed.

The Company's CEO

If the Board opts for the formula of accumulating both the Chairman and the CEO positions in a single person, the Company shall adopt the necessary precautions to reduce the risks of concentration of power in a sole person.

The Chairman of the Board of Directors is the CEO of the Company, although according to the terms of the Regulations of the Board of Directors, his actions must comply at all times to the criteria and directives set by the General Shareholders' Meeting and by the Board of Directors and by the Committees reporting to it. Likewise, all resolutions or decisions of

special relevance to the Company must previously be submitted for approval by the Board of Directors or relevant control Committee. Moreover, it is necessary to have the reports and proposals by the different Committees of the Board to pass certain resolutions. It is important to point out that the Chairman does have a deciding vote on the Board of Directors.

Secretary to the Board of Directors

Relevance of the figure of the Secretary to the Board, reinforcing his independence and stability, and emphasising his duty to ensure the formal and material legality of the actions by the Board.

The Secretary to the Board has Director status, in order to reinforce his authority on the Board. Pursuant to the terms of the Regulations of the Board, the Secretary has the essential mission of caring in all cases for the formal and material legality of the actions by the Board and to guarantee that its procedures and rules of governance are respected.

The Executive Committee

Existence of an Executive Committee with a similar composition to that of the Board and relations between both based on a principle of transparency.

The relations between the Board of Directors of Telefónica and its Executive Committee are based on a principle of transparency, so the Board has full knowledge of the matters dealt with and the decisions made by this Committee. According to this, those matters are always included as a point on the Agenda to be dealt with at the next meeting of the Board of Directors.

The Board of Directors sub-committees

Existence of Board sub-committees comprised exclusively by external Directors, in particular, with responsibility on audit and control matters, and on matters related to appointments and compensation.

The Board of Directors of Telefónica has the sub-committees recommended by the Olivencia Code: an Audit and Control Committee, and a Nominating, Compensation and Corporate Governance Committee, with the competencies that Code attributes them. Also according to this one, these Committees are comprised exclusively of external Directors.

Besides, the Board of Directors considered it convenient to constitute three additional sub-committees: the Regulation Committee, the Human Resources and Corporate Reputation Committee, and the Service Quality and Customer Service Committee. Moreover, in 2003, at its meeting on 26th February, the Board of Directors of the Company resolved to create a sixth Committee, the International Affairs Committee.

Thus, on the date of issue of this Report, there are six Board sub-committees in the Company.

The Directors

Measures to guarantee that the Directors have the necessary information in time and form.

The Company takes the necessary measures to ensure that the Directors have sufficient information enough time in advance, specifically elaborated and aimed at preparing the sessions of the Board and its Committees, without any excuse for non fulfilment, based on the importance or reserved nature of the

information – apart from absolutely exceptional circumstances.

Formal, transparent procedure to select Directors, based on a proposal by the Appointments Committee.

The proposals of appointments of Directors always comply with the terms of the Regulations of the Board and are preceded by the relevant favourable report by the Nominating, Compensation and Corporate Governance Committee.

Existence of regulations that establish the obligation of the Directors to decide in cases that may negatively affect the operation of the Board or the credit and reputation of the Company. Establishment of an upper age to hold office as a Director.

The Regulations of the Board make it obligatory for Directors to resign in cases that may negatively affect the operation of the Board or the credit and reputation of the Company. On the other hand, pursuant to the Regulations of the Board, the Directors must hand in their resignation and formalise the relevant resignation when they reach the age of seventy (70). Executive Directors shall resign from executive office at the age of sixty five (65), although they may remain as Directors, if the Board so decides.

Regulation of the obligations arising from the general duties of diligence and loyalty of the Directors considering, in particular, the situation of conflict of interest, the duty of confidentiality, taking advantage of business opportunities and the use of corporate assets.

According to the recommendations made in the Olivencia Code and in the Aldama Report, the Regulations of the Board provide a specific title for this, formed by twelve articles, to describe the range of rights and obligations of the Directors. This title details the details that arise from the obligations of diligence and loyalty of the Directors, considering, in particular, the situation of conflicts of interest, the duty of confidentiality, in particular, the situation of conflicts of interest, the duty of confidentiality, taking advantage of business opportunities and use of corporate assets.

Recognition of the rights of Directors to obtain information and establishment of channels to exercise them.

The Regulations of the Board formally recognise the rights of all Directors to gather and obtain the necessary information and advice to fulfil their duties of supervision, and establish the appropriate channels to exercise that right, enabling even resorting to external experts under special circumstances.

The Director compensation policy is adequate and fits the criteria of moderation, which must be proposed, evaluated and reviewed by the Compensation Committee, and detailed, individual information must be provided.

As to the policy of retribution of the Directors, it is proposed, evaluated and reviewed by the Nominating, Compensation and Corporate Governance Committee, and complies with criteria of moderation. The Company provides annual information on the compensation received by the holders of offices or posts on the Board. Moreover, in line with the Aldama Report, the external Directors shall not participate in any

compensation scheme linked to the listed value of the shares.

Measures to extend the duties of loyalty to the significant shareholders and top management.

Lastly, the duties of loyalty to the significant shareholders is extended, foreseeing that the Board reserves the right to examine and authorise any transaction between the Company and any of its significant shareholders. Under no circumstances will the transaction be approved without a prior report by the Nominating, Compensation and Corporate Governance Committee evaluating the operation from the point of view of equal treatment of the shareholders and their conditions, which must be those of the market. On the other hand, and in line with the Aldama Report, the Company has extended the obligations arising from the duty to loyalty of the top management, through what is set forth in the Internal Rules of Conduct in matters of conflict of interest.

Relations of the Board with the markets

Quick, precise, reliable information for the markets, and establishment to that end of procedures and controls for communication of the information within the Company.

Periodic financial information prepared according to the same principles and professional practices as the annual accounts and verified by the Audit Committee.

Duty of information and transparency, (especially in matters of corporate governance).

The Regulations of the Board assign several articles to regulating the channels through which relations are established between the

Board of Directors and the shareholders of the Company so it may thus ensure the greatest possible transparency in those relations.

Beyond the requisites set in the by-laws in force, the Board of Directors of Telefónica, has committed itself to providing the markets with precise, reliable information. In particular, the periodic financial information of the Company, just as expressly recorded in the Regulations of the Board, is prepared according to the same principles and professional practices as the annual accounts, and before being disclosed, is verified by the Audit and Control Committee, according to the functions that Committee is attributed.

Moreover, in line with the recommendations of the Aldama Report, the Company provides the market all the information that may be considered relevant to the investors, in a symmetrical, equitable manner. According to the obligations established under the new Financial Act, the Company issues communications of relevant information to the National Stock Exchange Commission, prior to its diffusion by any other means, as soon as the fact is known, or as soon as the decision has been taken, or the agreement or contract is signed with the third parties concerned. The Company ensures that its communication of relevant information is true, clear and complete at all times.

In matters of transparency in corporate governance, and in line with the recommendations put forward in the Aldama Report, as during last financial year 2002, Telefónica has prepared a specific Report on corporate governance. In the same line, the Company has set up a web page on Corporate Governance, that includes, among others, the

content suggested by the Aldama Report (Articles of Association, internal regulations of the Company, periodic financial information, composition of the Board of Directors and its sub-committees, etc.).

Relations of the Board with the external auditors

Establishment of measures to monitor the independence of the external auditors.

Through the Audit and Control Committee, the Board of Directors has established a stable, professional relation with the Accounts Auditor to the company, with strict respect for its independence, in addition to fulfil the recommendations to that end in the Olivencia Code. According to this, the Audit and Control Committee monitors situations that may be a risk to the independence of the External Auditors of the Company and, specifically, supervises the percentage of fees it is paid in relation to the total revenue of the audit firm.

Lastly, it reports on the Company annual report, pursuant to the legal requisites in force, on the fees paid to the External Auditor to the Company including those related to non-audit services.

In fulfilment of the legal requisites established by the United States by-laws on this matter, and in line with the Aldama Report, the audit and related services provided by the External Auditor to the Company must have prior approval by the Audit y Control Committee.

The General Shareholders' Meeting

Measures that make the mechanism to delegate votes more transparent and encourage communication by the Company with the shareholder.

In order to provide for and make it possible for any shareholder to exercise the right to information, the proposals of resolutions submitted for approval by the Meeting and the documents and required reports related to them are made available to the shareholders, on the terms and conditions of the Stock Company Act, from when the announcements calling the Meeting are published.

Likewise, the Company attends, as far as possible, to requests for information related to matters included on the Agenda of the General Shareholders' Meeting that are raised by any shareholder, in the days prior to holding the Meeting, as at the actual Meeting, the agenda of which expressly includes a turn for the shareholders to speak, during which all the shareholders attending the Meeting who so wish may express themselves, and their interventions will always be replied to by the Chairman of the Company.

As to the right to attend and vote at the General Shareholders' Meeting, the Company facilitates exercise of those rights as much as possible, always within the framework set in the applicable laws in force and the Articles of Association, especially that of representation of shareholders at the General Shareholders' Meeting, which may be granted in favour of any person, although not a shareholder.

According to the demands of the Spanish mercantile laws, the documentation related to the points on the Agenda are available to all the shareholders at the Company registered office, and they may apply to have it sent to them free of charge. The same information is also available to all shareholders on the Company web page.

07.02 OTHER COMPANIES IN THE TELEFÓNICA GROUP

In addition to Telefónica, the company that heads the Group, the shares of which are listed on 9 different markets, the Telefónica Group is formed by another 21 listed companies, some of which, in addition to being present on the local stock exchanges, are listed in the United States.

The following is a list of the listed companies of the Telefónica Group, showing the markets on which its shares are traded (*see Table 7, Other Companies in the Telefónica Group*).

The corporation has encouraged the adoption of the best Corporate Governance practices within the Group, regardless of the specific requisites on each market. Thus, all the listed companies in the Telefónica Group now have common minimum standards for corporate governance that are fulfilled across the board (*see Table 8, Common corporate governance minimum standards*).

TABLE 7
OTHER COMPANIES IN THE TELEFÓNICA GROUP

Company	Local Market	United States
Spain		
Telefónica Móviles, S.A.	Spain	NYSE
Terra Networks, S.A.	Spain	NASDAQ
Telefónica Publicidad e Información, S.A	Spain	
Argentina		
Telefónica de Argentina, S.A.	Buenos Aires	NYSE
Telefónica Móviles Argentina, S.A.	Buenos Aires	
Telefónica Holding de Argentina, S.A.	Buenos Aires	
Compañía Internacional de Telecomunicaciones, S.A.	Buenos Aires	
Telefónica Data Argentina, S.A.	Buenos Aires	
Brazil		
Tele Sudeste Celular Participações, S.A.	Sao Paulo	NYSE
Tele Leste Celular Participações, S.A.	Sao Paulo	NYSE
Celular CRT Participações, S.A.	Sao Paulo	
Telesp Celular Participações, S.A.	Sao Paulo	NYSE
Tele Centro Oeste Celular Participações, S.A.	Sao Paulo	NYSE
Telecomunicações de Sao Paulo, S.A.	Sao Paulo	NYSE
Telefónica Data Brasil Holding, S.A.	Sao Paulo	
Chile		
Compañía de Telecomunicaciones de Chile, S.A.	Santiago de Chile	NYSE
Compañía de Teléfonos de Chile Transmisiones Regionales, S.A.	Santiago de Chile	
Peru		
Telefónica Móviles Perú Holding, S.A.A	Lima	
Telefónica Data Perú Holding, S.A.A	Lima	
Telefónica de Perú, S.A.A	Lima	NYSE
El Salvador		
Telefónica el Salvador	El Salvador	

TABLE 8
COMMON CORPORATE GOVERNANCE MINIMUM STANDARDS

Composition of the Board of Directors

Majority of external or non executive Directors in relation to executive Directors.

Existence of a reasonable number of independent Directors on the Board.

Operation of the Board of Directors.

Existence of operating rules of the Board ("Reglamento del Consejo" in Spain).

Calendar. Minimum number of meetings.

Regulation of the rights and obligations of the Directors⁵.

Board of Directors sub-committees.

Existence of an Audit and Control Committee.

Existence of a Nominating, Compensation and Corporate Governance Committee⁶.

Comprised exclusively of non executive Directors.

Transparency.

Shareholder customer service.

Information on corporate governance provided annually in an Annual Report or Specific Report.

Web Page on Corporate Governance (including Relevant Facts)⁷.

Others.

Control systems for the financial-accounting information.

Internal Code of Conduct for Securities Markets Issues.

⁽⁵⁾ Regulation contained either in an internal rule of the Company, or in the local by-laws.

⁽⁶⁾ All the Spanish listed companies in the Group have this Committee. This practice will gradually be spread to other companies in the Group, according to the specific characteristics of each of them.

⁽⁷⁾ In the case of the Spanish listed companies in the Group, the content in matters of corporate governance in these pages is adapted to the requirements of Ministerial Order 3722/2003, of 26th December, on the annual report on corporate governance and other instruments providing information on listed stock companies and other entities.