

Telefónica

AUDIT REPORT, ANNUAL FINANCIAL STATEMENTS, AND
MANAGEMENT REPORT OF TELEFÓNICA, S.A., ALL FOR THE
YEAR ENDED DECEMBER 31, 2011

Audit Report

TELEFÓNICA, S.A.
Financial Statements and Management Report
for the year ended
December 31, 2011

Translation of a report and financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 23)

AUDIT REPORT ON THE FINANCIAL STATEMENTS

To the Shareholders of
Telefónica, S.A.

We have audited the financial statements of Telefónica, S.A., which comprise the balance sheet at December 31, 2011, the income statement, the statement of changes in equity, the cash flow statement, and the notes thereto for the year then ended. The Company's Directors are responsible for the preparation of the financial statements in accordance with the regulatory framework for financial information applicable to the entity in Spain (identified in Note 2.a to the accompanying financial statements), and specifically in accordance with the accounting principles and criteria contained therein. Our responsibility is to express an opinion on the aforementioned financial statements taken as a whole, based upon work performed in accordance with prevailing audit regulation in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the financial statements and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2011 financial statements give a true and fair view, in all material respects, of the equity and financial position of Telefónica, S.A. at December 31, 2011, and of the results of its operations and its cash flow for the year then ended, in conformity with the applicable regulatory framework for financial information in Spain, and specifically the accounting principles and criteria contained therein.

The accompanying 2011 management report contains such explanations as the Directors consider appropriate concerning the situation of the Company, the evolution of its business and other matters; however, it is not an integral part of the financial statements. We have checked that the accounting information included in the aforementioned management report agrees with the 2011 financial statements. Our work as auditors is limited to verifying the management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the Company's accounting records.

ERNST & YOUNG, S.L.



Ignacio Viota del Corte

March 28, 2012

Telefonica

TELEFÓNICA, S.A.

**ANNUAL FINANCIAL STATEMENTS AND MANAGEMENT
REPORT
FOR THE YEAR ENDED DECEMBER 31, 2011**



TELEFÓNICA, S.A.
BALANCE SHEET AT DECEMBER 31
(Millions of euros)

ASSETS	Notes	2011	2010
NON-CURRENT ASSETS			
Intangible assets	5	68	71
Patents, licenses, trademarks, and others		9	4
Software		11	14
Other intangible assets		48	53
Property, plant and equipment	6	338	381
Land and buildings		154	150
Plant and other PP&E items		141	157
Property, plant and equipment under construction and prepayments		43	74
Investment property	7	423	345
Land		65	65
Buildings		358	280
Non-current investments in Group companies and associates	8	79,036	81,726
Equity instruments		77,396	78,870
Loans to Group companies and associates		1,618	2,832
Other financial assets		22	24
Financial investments	9	4,728	3,008
Equity instruments		556	473
Loans to third parties		37	36
Derivatives	16	4,118	2,486
Other financial assets		17	13
Deferred tax assets	17	2,605	2,217
CURRENT ASSETS			
Non-current assets held for sale	8	-	624
Trade and other receivables	10	698	574
Current investments in Group companies and associates	8	3,478	3,335
Loans to Group companies and associates		3,390	3,295
Derivatives	16	57	12
Other financial assets		31	28
Investments	9	394	414
Loans to companies		46	29
Derivatives	16	348	360
Other financial assets		-	25
Accruals		4	6
Cash and cash equivalents		765	416
Cash		765	416
TOTAL ASSETS		92,537	93,117

The accompanying Notes 1 to 23 and Appendix I are an integral part of these balance sheets

Telefonica

TELEFÓNICA, S.A.
BALANCE SHEET AT DECEMBER 31
(Millions of euros)

EQUITY AND LIABILITIES	Notes	2011	2010
EQUITY		26,597	29,400
CAPITAL AND RESERVES		27,212	29,550
Share capital	11	4,564	4,564
Share premium	11	460	460
Reserves	11	22,454	24,710
Legal		984	984
Other reserves		21,470	23,726
Treasury shares and own equity instruments	11	(1,782)	(1,376)
Profit for the year	3	4,910	4,130
Interim dividend	3	(3,394)	(2,938)
UNREALIZED GAINS (LOSSES) RESERVE	11	(615)	(150)
Available-for-sale financial assets		(40)	(5)
Hedging instruments		(575)	(145)
NON-CURRENT LIABILITIES		47,236	43,693
Non-current provisions		42	42
Other provisions		42	42
Non-current borrowings	12	11,339	8,009
Bonds and other marketable debt securities	13	170	148
Bank borrowings	14	9,046	6,822
Derivatives	16	2,033	1,031
Finance leases		86	-
Other debts		4	8
Non-current borrowings from Group companies and associates	15	35,381	34,864
Deferred tax liabilities	17	474	778
CURRENT LIABILITIES		18,704	20,024
Current provisions		65	4
Current borrowings	12	1,033	1,455
Bonds and other marketable debt securities	13	87	104
Bank borrowings	14	742	1,176
Derivatives	16	204	175
Current borrowings from Group companies and associates	15	17,140	16,009
Trade and other payables	18	440	2,522
Accruals		26	34
TOTAL EQUITY AND LIABILITIES		92,537	93,117

The accompanying Notes 1 to 23 and Appendix I are an integral part of these balance sheets.



TELEFÓNICA, S.A.

INCOME STATEMENTS FOR THE YEARS ENDED DECEMBER 31

(Millions of euros)	Notes	2011	2010
Revenue	19	7,952	7,439
Rendering of services to Group companies and associates		707	583
Rendering of services to non-group companies		3	4
Dividends from Group companies and associates		6,967	6,474
Interest income on loans to Group companies and associates		275	378
Impairment and gains (losses) on disposal of financial instruments	19	(1,082)	(1,985)
Impairment losses and other losses	8	(1,606)	(1,985)
Gains (losses) on disposal and other gains and losses		524	-
Other operating income	19	157	103
Non-core and other current operating revenues - Group companies and associates		140	91
Non-core and other current operating revenue - non-group companies		17	12
Employee benefits expense	19	(244)	(193)
Wages, salaries and others		(213)	(165)
Social security costs		(31)	(28)
Other operating expenses		(399)	(687)
External services - Group companies and associates	19	(94)	(85)
External services - non-group companies	19	(296)	(592)
Taxes other than income tax		(9)	(10)
Depreciation and amortization	5, 6 and 7	(72)	(70)
Gains (losses) on disposal of fixed assets		1	(11)
OPERATING PROFIT		6,313	4,596
Finance revenue	19	139	224
From equity investments of third parties		38	37
From marketable securities and other financial instruments		101	187
Finance costs	19	(2,119)	(1,812)
Borrowings from Group companies and associates		(1,872)	(1,791)
Third-party borrowings		(247)	(21)
Change in fair value of financial instruments		(91)	(245)
Trading portfolio and other securities		(11)	(2)
Gain (loss) on available-for-sale financial assets recognized in the period	9	(80)	(243)
Exchange losses	19	(138)	122
Impairment and gains (losses) on disposal of financial instruments with third parties	19	(105)	-
NET FINANCIAL EXPENSE		(2,314)	(1,711)
PROFIT BEFORE TAX		3,999	2,885
Income tax	17	911	1,245
PROFIT FOR THE YEAR		4,910	4,130

The accompanying Notes 1 to 23 and Appendix I are an integral part of these income statements.

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TELEFÓNICA, S.A.

STATEMENTS OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31

A) STATEMENT OF RECOGNIZED INCOME AND EXPENSE

<i>(Millions of euros)</i>	Notes	2011	2010
Profit for the period		4,910	4,130
Total income and expense recognized directly in equity	11	(612)	(44)
From measurement of available-for-sale financial assets		(50)	(120)
From cash flow hedges		(824)	57
Income tax impact		262	19
Total amounts transferred to income statement	11	147	221
From measurement of available-for-sale financial assets		-	243
From cash flow hedges		210	73
Income tax impact		(63)	(95)
TOTAL RECOGNIZED INCOME AND EXPENSE		4,445	4,307

The accompanying Notes 1 to 23 and Appendix I are an integral part of these statements of changes in equity.



TELEFÓNICA, S.A.

B) STATEMENTS OF TOTAL CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31

<i>(Millions of euros)</i>	Share capital	Share premium	Reserves	Treasury shares and own equity investments	Profit for the year	Interim dividend	Net unrealized gains (losses) reserve	TOTAL
Balance at December 31, 2009	4,564	460	20,145	(527)	6,252	(2,277)	(327)	28,290
Total recognized income and expense	-	-	-	-	4,130	-	177	4,307
Transactions with shareholders and owners	-	-	(2,959)	(849)	-	(2,938)	-	(6,746)
Capital decreases	-	-	-	-	-	-	-	-
Dividends paid	-	-	(2,934)	-	-	(2,938)	-	(5,872)
Transactions with treasury shares or own equity instruments (net)	-	-	(25)	(849)	-	-	-	(874)
Other movements	-	-	3,549	-	-	-	-	3,549
Appropriation of prior year profit (loss)	-	-	3,975	-	(6,252)	2,277	-	-
Balance at December 31, 2010	4,564	460	24,710	(1,376)	4,130	(2,938)	(150)	29,400
Total recognized income and expense	-	-	-	-	4,910	-	(465)	4,445
Transactions with shareholders and owners	-	-	(3,455)	(777)	-	(3,394)	-	(7,626)
Capital decreases	-	-	-	-	-	-	-	-
Dividends paid	-	-	(3,458)	-	-	(3,394)	-	(6,852)
Transactions with treasury shares or own equity instruments (net)	-	-	3	(777)	-	-	-	(774)
Other movements	-	-	7	371	-	-	-	378
Appropriation of prior year profit (loss)	-	-	1,192	-	(4,130)	2,938	-	-
Balance at December 31, 2011	4,564	460	22,454	(1,782)	4,910	(3,394)	(615)	26,597

The accompanying Notes 1 to 23 and Appendix I are an integral part of these statements of changes in equity.



TELEFÓNICA, S.A.

CASH FLOW STATEMENTS FOR THE YEARS ENDED DECEMBER 31

<i>(Millions of euros)</i>	Notes	2011	2010
A) CASH FLOWS FROM OPERATING ACTIVITIES		6,423	6,833
Profit before tax		3,999	2,885
Adjustments to profit:		(3,773)	(3,115)
Depreciation and amortization	5, 6 and 7	72	70
Impairment of investments in Group companies and associates	8	1,606	1,985
Impairment of investments in non-group companies		-	-
Change in trade provisions		-	(40)
Gains on the sale of financial assets		(524)	-
Losses on disposal of property, plant and equipment		1	11
Dividends from Group companies and associates	19	(6,967)	(6,474)
Interest income on loans to Group companies and associates	19	(275)	(378)
Net financial expense	19	2,314	1,711
Change in working capital		(108)	310
Trade and other receivables		(51)	53
Other current assets		(16)	(64)
Trade and other payables		(106)	392
Other current liabilities		65	(50)
Other non-current assets and liabilities		-	(21)
Other cash flows from operating activities	21	6,305	6,753
Net interest paid		(1,405)	(1,061)
Dividends received		7,073	6,621
Income tax receipts		637	1,193
B) CASH FLOWS (USED IN)/FROM INVESTING ACTIVITIES		(1,235)	(8,429)
Payments on investments	21	(3,554)	(10,521)
Proceeds from disposals	21	2,319	2,092
C) CASH FLOWS USED IN FINANCING ACTIVITIES		(4,817)	(2,992)
Payments on equity instruments	11	(377)	(883)
Proceeds from financial liabilities	21	2,412	3,763
Debt issues		7,533	14,848
Repayment and redemption of debt		(5,121)	(11,085)
Dividends paid	11	(6,852)	(5,872)
D) NET FOREIGN EXCHANGE DIFFERENCE		(22)	33
E) NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS		349	(4,555)
Cash and cash equivalents at January 1		416	4,971
Cash and cash equivalents at December 31		765	416

Notes 1 to 23 and Appendix I are an integral part of these cash flow statements.

TELEFÓNICA, S.A.

NOTES TO THE FINANCIAL STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2011

(1) INTRODUCTION AND GENERAL INFORMATION

Telefónica, S.A. (“Telefónica” or “the Company”) is a public limited company incorporated for an indefinite period on April 19, 1924, under the corporate name of Compañía Telefónica Nacional de España, S.A. It adopted its present name in April 1998.

The Company’s registered office is at Gran Vía 28, Madrid (Spain), and its Employer Identification Number (CIF) is A-28/015865.

Telefónica’s basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

In keeping with the above, Telefónica is currently the parent company of a group that operates mainly in the telecommunications, media and entertainment industries, providing a wide range of services on the international stage.

The Company is taxed under the general tax regime established by the Spanish State, the Spanish Autonomous Communities and local governments, and files consolidated tax returns with most of the Spanish subsidiaries of its Group under the consolidated tax regime applicable to corporate groups.

(2) BASIS OF PRESENTATION

a) True and fair view

These financial statements have been prepared from Telefónica, S.A.’s accounting records by the Company’s Directors in accordance with the accounting principles and standards contained in the Code of Commerce, developed in the Spanish GAAP in force (2007 Spanish GAAP) and other prevailing legislation at the date of these financial statements, to give a true and fair view of the Company’s equity, financial position, results of operations and of the cash flows obtained and applied in 2011.

The figures in these financial statements are expressed in millions of euros, unless indicated otherwise, and therefore may be rounded. The euro is the Company’s functional currency.

b) Comparison of information

Acquisition of Brasilcel, N.V. and subsequent merger with Telefónica, S.A.

On July 28, 2010 Telefónica, S.A. and Portugal Telecom, SGPS, S.A. reached an agreement for the acquisition by Telefónica, S.A. of 50% of the capital stock of Brasilcel, N.V. (a company in which Portugal Telecom and Telefónica had equal joint interests until that date, and which held approximately 60% of the capital stock of the Brazilian company Vivo Participações, S.A.). The acquisition price for the aforementioned capital stock of Brasilcel, N.V. was 7,500 million euros, of which 2,000 million euros was paid on October 31, 2011 (see Note 18.b). At the time of the acquisition the company announced that it would merge Brasilcel, N.V. into the company as part of the same transaction. This agreement also established inter alia that Portugal Telecom waived the declared dividend payable by Brasilcel, N.V., amounting to 49 million euros and still outstanding, which was recognized as a reduction in the cost of this acquisition. Taking into account the conditions established, the discounted price at which this acquisition was recognized was 7,419 million euros (see Note 8.1).

Subsequently, on September 28, 2010 the two boards of directors approved the merger of Telefónica and Brasilcel, N.V., which was recognized on that date. This merger was entered in the Mercantile Registry on December 21, 2010 and gave rise to a reserve of 3,602 million euros, reduced by 49 million euros corresponding to the aforementioned dividends. The net amount by which Telefónica, S.A.'s equity was affected by this transaction was therefore 3,553 million euros (see Note 11).

In 2011, Telefónica restructured Group entities in Brazil. These transactions are disclosed fully in Note 8.

c) Use of estimates

The financial statements have been prepared using estimates based on historical experience and other factors considered reasonable under the circumstances. The carrying value of assets and liabilities, which is not readily apparent from other sources, was established on the basis of these estimates. The Company periodically reviews these estimates.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date that have a significant risk of causing a material adjustment to the financial statements of the following year are discussed below.

A significant change in the facts and circumstances on which these estimates are based could have an impact on the Company's results and financial position.

Provisions for impairment of investments in Group companies, joint ventures and associates

Investments in group companies, joint ventures and associates are tested for impairment at each year end to determine whether an impairment loss must be recognized in the income statement or a previously recognized impairment loss be reversed. The decision to recognize an impairment loss (or a reversal) involves estimates of the reasons for the potential impairment (or recovery), as well as the timing and amount.

Recoverable amount of investments in group companies, joint ventures and associates is measured as described in Note 4.e.

There is a significant element of judgment involved in the estimates required to determine recoverable amount and the assumptions regarding the performance of these investments, since the timing and scope of future changes in the business are difficult to predict.

Deferred taxes

The Company assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Company's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal projections and are continuously updated to reflect the latest trends.

The appropriate classification of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule. Actual income tax receipts and payments could differ from the estimates made by the Company as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

(3) PROPOSED APPROPRIATION OF PROFIT

Telefónica, S.A. obtained 4,910 million euros of profit in 2011.

Accordingly, the Company's Board of Directors will submit the following proposed appropriation of 2011 profit for approval at the Shareholders' Meeting:

	<i>Millions of euros</i>
Proposed appropriation:	
Profit for the year	4,910
Distribution to:	
Interim dividend (paid in May 2011)	3,394
Goodwill reserve (Note 11.c)	2
Voluntary reserves	1,514

At its meeting of April 12, 2011, the Company's Board of Directors resolved to pay an interim dividend against 2011 profit of a fixed gross 0.75 euros for each of the outstanding shares carrying dividend rights. This dividend was paid in full on May 6, 2011. The total amount paid was 3,394 million euros (see Note 11.1.d).

In accordance with Article 277 of the Spanish Enterprise Law, the following table shows the provisional statement issued by the Directors to substantiate that the Company had sufficient liquidity at that time to distribute this dividend.

	<i>Millions of euros</i>
Liquidity statement at April 12, 2011	
Income from January 1 through March 31, 2011	5,961
Mandatory appropriation to reserves	-
Distributable income	5,961
Proposed interim dividend (maximum amount)	3,423
Cash position at April 12, 2011	
Funds available for distribution	
Cash and cash equivalents	1,670
Unused credit facilities	6,593
Proposed interim dividend (maximum amount)	(3,423)
Difference	4,840

To ensure its liquidity requirements are met throughout the following year, the Company effectively manages its liquidity risks (see Note 16).

(4) RECOGNITION AND MEASUREMENT ACCOUNTING POLICIES

The main recognition and measurement accounting policies applied in the preparation of the 2011 annual financial statements are the following:

a) Intangible assets

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

The useful lives of intangible assets are assessed individually to be either finite or indefinite. Intangible assets with finite lives are amortized systematically over the useful economic life and assessed for impairment whenever events or changes indicate that their carrying amount may not be recoverable.

Amortization methods and schedules are revised annually at year end and, where appropriate, adjusted prospectively.

Intangible assets include mainly the following:

1. Computer software licenses, which are recorded at cost and amortized on a straight-line basis over their useful lives, generally estimated at three years.
2. Intellectual property, which is recorded at the amounts paid to acquire ownership of or rights to use patents and trademarks and amortized on a straight-line basis over the useful life of the patent or trademark for a period of 3 to 10 years.
3. The goodwill arising from the merger of Telefónica, S.A. and Terra Networks, S.A. carried out in 2005. This is included under "Other intangible assets" at the carrying amount at January 1, 2008 of 33 million euros, calculated in accordance with the former accounting principles, less any accumulated impairment losses. Goodwill is not amortized, but is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable (see Note 4.c).

b) Property, plant and equipment and investment property

Property, plant and equipment is stated at cost, net of accumulated depreciation and any accumulated impairment in value. Land is not depreciated.

Cost includes external costs plus any internal costs comprising warehouse materials used, direct labor costs incurred in installation work and the allocable portion of the indirect costs required for the related investment. Cost includes, where appropriate, the initial estimate of decommissioning, retirement and site reconditioning costs when the Company is under obligation to incur such costs due to the use of the asset.

Costs incurred for expansion, remodeling or improvements which increase the productivity, capacity, or prolong the useful life of the asset are capitalized when the capitalization requirements are met.

Interest and other borrowing costs incurred and directly attributable to the acquisition or construction of assets that require preparation of more than one year for their intended use or sale are capitalized.

Upkeep and maintenance expenses are expensed as incurred.

The Company assesses the need to write down, if appropriate, the carrying amount of each item of property, plant and equipment to its recoverable amount whenever there are indications that the assets' carrying amount exceeds the higher of its fair value less costs to sell or its value in use. The impairment provision is not maintained if the factors giving rise to the impairment disappear (see Note 4.c).

The Company depreciates its property, plant and equipment once the assets are in full working conditions using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

Estimated useful life	Years
Buildings	40
Plant and machinery	3-25
Other plant or equipment, furniture and fixtures	10
Other items of property, plant and equipment	4-10

Assets' estimated residual values and methods and depreciation periods are reviewed, and adjusted if appropriate, prospectively at each financial year end.

Investment property is measured using the same criteria described for land and buildings for own use. Buildings included in investment property are depreciated on a straight-line basis over a period of up to 40 years.

c) Impairment of non-current assets

Non-current assets are assessed at each reporting date for indications of impairment losses. Where such indications exist, or in the case of assets which are subject to an annual impairment test, the Company estimates the asset's recoverable amount as the higher of its fair value less costs to sell and its value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value in the currency in which they will be generated, using a pre-tax discount rate appropriate to that currency and reflecting current market assessments of the time value of money and the risks specific to the asset. The Company translates that present value into its accounting currency at the exchange rate prevailing at the close of the day of calculation of value in use. When the carrying amount of an asset exceeds its recoverable amount, the asset is considered to be impaired. In this case, the carrying amount is written down to recoverable amount and the resulting loss is taken to the income statement. Future depreciation or amortization charges are adjusted for the asset's new carrying amount over its remaining useful life. The Company assesses each asset individually for impairment, unless the asset does not generate cash inflows that are largely independent of those from other assets (or cash-generating units).

The Company bases the calculation of impairment on the business plans of the various cash-generating units to which the assets are allocated. These business plans generally cover a period of three to five years. For periods beyond the strategic plan, an expected constant or decreasing growth rate is applied to the projections based on these plans from the fifth year.

When there are new events or changes in circumstances that indicate that a previously recognized impairment loss no longer exists or has been decreased, a new estimate of the asset's recoverable amount is made. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The reversal is limited to the net carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in the income statement and the depreciation charge is adjusted in future periods to the asset's revised carrying amount.

d) Leases

The determination of whether an arrangement is, or contains, a lease is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the Company to use the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Company. These are classified at the inception of the lease, in accordance with its nature and the associated liability, at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance costs and reduction of the principal of lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are taken to the income statement over the lease term.

e) Financial assets and liabilities

Financial investments

All regular way purchases and sales of financial assets are recognized on the trade date, i.e. the date that the Company commits to purchase or sell the asset. The Company classifies its financial assets into the following categories for initial recognition purposes: financial assets held for trading, other financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, investments in Group companies, joint ventures and associates, and available-for-sale financial assets. When appropriate, the Company re-evaluates the designation at each financial year end.

Financial assets held for trading, i.e., investments made with the aim of realizing short-term profits as a result of price changes, are included in “*Financial assets held for trading*” and presented under current or non-current assets depending on their maturity. Derivatives are classified as held for trading unless they are designated as effective hedging instruments.

“*Investments in group companies, joint ventures and associates*” are classified into a category of the same name and are shown at cost less any impairment loss (see Note 4.c). Group companies are those over which the Company exercises control, either by exercising effective control or by virtue of agreements with the other shareholders. Joint ventures are companies which are jointly controlled with third parties. Associates are companies in which there is significant influence, but not control or joint control with third parties. Telefónica assesses the existence of significant influence not only in terms of percentage ownership but also in qualitative terms such as presence on the board of directors, involvement in decision-making, the exchange of management personnel, and access to technical information.

Financial investments which the Company intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest-rate movements and which have not been included in the preceding categories are classified as *available-for-sale*. These investments are recorded under “Non-current assets,” unless it is probable and feasible that they will be sold within 12 months. Financial assets in this category are measured at fair value. Gains or losses arising from changes in fair value are recognized in equity until the asset is derecognized or impaired, at which time the cumulative gain or loss previously reported in equity is taken to the income statement. Dividends from available-for-sale equity investments are recognized in the income statement once the Company has the right to receive the dividend. Fair value is determined in accordance with the following criteria:

1. Listed securities on active markets: Fair value is considered to be the quoted market price at the closing date.
2. Unlisted securities: Fair value is determined using valuation techniques such as discounted cash flow analysis, option valuation models, or by reference to arm’s length market transactions. When fair value cannot be reliably determined, these investments are carried at cost.

Loans and receivables includes trade or non-trade financial assets, that are neither derivatives nor equity instruments, with fixed or determinable payments and that are not quoted in an active market and not included in any of the preceding classifications. Upon initial recognition, these assets are recognized at fair value which, unless there is evidence to the contrary, is the transaction price, which is equivalent to the fair value of the consideration paid plus directly attributable transaction costs. Following initial recognition, these financial assets are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the loans and receivables are settled or impaired, as well as through the amortization process. Trade receivables are recognized at the original invoice amount. A provision is recorded when there is objective evidence of customer collection risk. The amount of the impairment is calculated as the difference between the carrying amount of the doubtful trade receivables and their recoverable amount. As a general rule, current trade receivables are not discounted, unless the effect of such discount is material.

The Group assesses at each reporting date whether a financial asset is impaired. If there is objective evidence that an impairment loss has been incurred on a financial asset carried at amortized cost, the amount of the loss is measured as the difference between the asset’s carrying amount and its recoverable value, calculated as the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate. If in a subsequent period the impairment loss decreases as a result of a subsequent event, the loss is reversed, with the asset’s amortized cost had no impairment loss been recognized as the upper limit. Such a reversal is recognized in the income statement of that year.

For equity instruments recognized as available-for-sale financial assets, the Company assesses individually for each security whether there is any objective evidence that an asset is impaired as a result of one or more events indicating that the carrying amount of the security will not be recovered. If there is objective evidence that an available-for-sale financial instrument is impaired, the cumulative loss recognized in equity measured as the difference between the acquisition cost (net of any principal payments and amortization made) and the current fair value, less any impairment loss on that

investment previously recognized in the income statement, is removed from equity and recognized in the income statement. If in a subsequent period the fair value of the financial asset increases because of a subsequent event, the impairment loss is reversed through the income statement if the asset is a debt instrument. For equity instruments, the loss is not reversed in the income statement for the period, but rather in equity, as the instrument is measured at its new fair value, with any changes taken to equity.

Recoverable amount for estimating impairment of investments in group companies, joint ventures and associates is the higher of the investment's fair value less costs to sell and the present value of the future cash flows derived from the investment. These cash flows can be calculated by estimating the cash flows to be received from dividends or from the disposal or derecognition of the investment, or the Company's share of the cash flows expected to be generated by the investment (from operations, or the investment's disposal or derecognition).

Financial assets are only fully or partially derecognized when:

1. The rights to receive cash flows from the asset have expired.
2. The Company has transferred its rights to receive cash flows from the asset to a third party and transferred substantially all the risks and rewards of the asset.

Cash and cash equivalents

Cash and cash equivalents included on the balance sheet include cash on hand and at banks, demand deposits and other highly liquid investments with an original maturity of three months or less. These items are stated at historical cost, which does not differ significantly from realizable value.

For the purpose of the cash flow statement, cash and cash equivalents are shown net of any outstanding bank overdrafts.

Issues and interest-bearing debt

These debts are recognized initially at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method. Any difference between the cash received (net of transaction costs) and the repayment value is recognized in the income statement over the life of the debt. Interest-bearing debt is considered non-current when its maturity is over 12 months or the Company has full discretion to defer settlement for at least another 12 months from the reporting date.

Financial liabilities are derecognized when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced with another on substantially different terms, such an exchange is treated as a derecognition of the original liability and the recognition of a new liability, and the difference in their respective carrying amounts is taken to the income statement.

Derivative financial instruments and hedge accounting

Derivative financial instruments are initially recognized at fair value, normally equivalent to cost. Their carrying amounts are subsequently remeasured at fair value.

Derivatives are carried as financial assets when the fair value is positive and as financial liabilities when the fair value is negative. They are classified as current or non-current depending on whether they fall due within less than or after one year, respectively. Derivatives that meet all the criteria for consideration as long-term hedging instruments are recorded as non-current assets when fair value is positive and non-current liabilities when fair value is negative.

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

The Company designates certain derivatives as:

1. Fair value hedges, when hedging the exposure to changes in the fair value of a recognized asset or liability or a firm transaction;
2. Cash flow hedges, when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction; or
3. Hedges of a net investment in a foreign operation.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value or a cash flow hedge.

Changes in fair value of derivatives that qualify as fair value hedges are recognized in the income statement, together with changes in the fair value of the hedged item attributable to the risk hedged.

Changes in the fair value of derivatives that qualify and have been assigned to hedge cash flows, which are highly effective, are recognized in equity. The portion considered ineffective is taken directly to the income statement. Fair value changes from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial measurement of those assets or liabilities. Otherwise, changes in fair value previously recognized in equity are recognized in the income statement in the period in which the hedged transaction affects profit or loss.

An instrument designed to hedge foreign currency exposure on a net investment in a foreign operation is accounted for in a way similar to foreign currency fair value hedges. For these purposes, the net investment in the foreign operation comprises not only the share in the equity of the foreign investment, but also the monetary item receivable or payable, the settlement of which is not expected or likely to take place in the foreseeable future, excluding trade items.

The application of the Company's corporate risk-management policies could result in financial risk-hedging transactions that make economic sense, yet do not comply with the criteria and effectiveness tests required by accounting policies to be treated as hedges. Alternatively, the Company may opt not to apply hedge accounting criteria in certain instances. In these cases, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement.

From inception, the Company formally documents the hedge relationship between the derivative and the hedged item, as well as the associated risk management objectives and strategies. The documentation includes identification of the hedge instrument, the hedged item or transaction and the nature of the risk being hedged. In addition, it states how it will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed, prospectively and retrospectively, both at the inception of the hedge relationship and on a systematic basis throughout the life of the hedge.

Hedge accounting is discontinued whenever the hedging instrument expires or is sold, terminated or settled, the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation. In these instances, gains or losses accumulated in equity are not taken to the income statement until the forecast transaction or commitment affects profit or loss. However, if the hedged transaction is no longer expected to occur, the cumulative gains or losses recognized directly in equity are taken immediately to the income statement.

The fair value of the derivative portfolio includes estimates based on calculations using observable market data, as well as specific pricing and risk-management tools commonly used by financial entities.

f) Treasury shares

Treasury shares are stated at cost and deducted from equity. Any gain or loss obtained on the purchase, sale, issue or cancellation of treasury shares is recognized directly in equity.

Call options on treasury shares to be settled through the physical delivery of a fixed number of shares at a fixed price are considered treasury share instruments. They are stated at the premium paid as a reduction in equity. If the call options are exercised upon maturity, the amount previously recognized is reclassified to treasury shares along with the consideration paid. If the call options are not exercised, their value is recognized directly in equity.

g) Foreign currency transactions

Monetary items denominated in foreign currencies are translated to euros at the exchange rates prevailing on the related transaction date, and are retranslated at the year end to the exchange rates then prevailing.

All realized or unrealized exchange gains or losses are taken to the income statement for the year, with the exception of non-monetary items measured at fair value, provided that they are recognized directly in equity (such as investments in equity instruments classified as available-for-sale financial assets). In these cases, any exchange differences included in gains or losses recognized in equity derived from changes in the value of the non-monetary items measured at fair value are also recognized directly in equity.

h) Provisions

Pensions and other employee obligations

The Company has a defined-contribution pension plan for employees. The obligations are limited to the regular payment of the contributions, which are taken to the income statement as incurred.

Other provisions

Provisions are recognized when the Company has a present obligation (legal or constructive), as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Company expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted, and the corresponding increase in the provision due to the passage of time is recognized as a finance cost.

i) Share-based payments

For equity-settled share option plans, fair value at the grant date is measured by applying statistical techniques or using benchmark securities. The cost is recognized, together with a corresponding increase in equity, over the vesting period. At each subsequent reporting date, the Company reviews its estimate of the number of options it expects to vest, with a corresponding adjustment to equity.

j) Income tax

The income tax expense of each year includes both current and deferred taxes, where applicable.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities.

Deferred income tax is provided using the balance sheet liability method on temporary differences at the reporting date between the tax bases of assets and liabilities and their carrying amounts.

The main temporary differences arise due to discrepancies between the tax bases and accounting amounts of investments in Group companies and associates.

Furthermore, deferred taxes arise from unused tax credits and tax loss carryforwards.

The Company determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability settled, based on tax rates and tax laws that are enacted (or substantively enacted) at the reporting date.

Deferred income tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized.

Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profits will allow the deferred tax asset to be recovered.

Deferred income tax relating to items directly recognized in equity is recognized in equity.

k) Revenue and expenses

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The income obtained by the Company in dividends received from Group companies and associates, and from the interest accrued on loans and credits given to them are included in revenue in compliance with the provisions of consultation No. 2 of BOICAC 79, published on September 30, 2009.

l) Related party transactions

Related party transactions are accounted for in accordance with the criteria described above.

In mergers and spin-offs involving the parent company and its direct or indirect subsidiary, in cases of non-monetary contributions between Group companies, and in cases of dividends in kind, the contributed assets are valued at their pre-transaction carrying amount in the individual financial statements, given that the Telefónica Group does not prepare its consolidated financial statements in accordance with the Standards on Preparing Consolidated Financial Statements (Spanish “NOFCAC”).

In these same operations, companies may also opt to use the consolidated values under International Financial Reporting Standards (IFRS) as adopted by the European Union, providing that the consolidated figures do not differ from those obtained under NOFCAC. Lastly, the Company may also opt to use the values resulting from a reconciliation to NOFCAC. Any accounting difference is taken to reserves.

The effective date of mergers and spin-offs for accounting purposes is taken as the first day of the year in which the merger or spin-off was approved, to the extent that it falls after the companies were incorporated into the group. If one of the companies joins the group in the year of the merger or spin-off, the acquisition date is used for accounting purposes.

m) Financial guarantees

The Company has provided guarantees to a number of subsidiaries to secure their transactions with third parties (see Note 20.a). Where financial guarantees provided have a counterguarantee on the Company’s balance sheet, the value of the counterguarantee is estimated to be equal to the guarantee given, with no additional liability recognized as a result.

Guarantees provided for which there is no item on the Company’s balance sheet acting as a counterguarantee are initially measured at fair value which, unless there is evidence

to the contrary, is the same as the premium received plus the present value of any premiums receivable. After initial recognition, these are subsequently measured at the higher of:

- i) the amount in accordance with rules for measuring provisions and contingencies; and
- ii) the amount initially recognized less, when applicable, any amounts taken to the income statement corresponding to accrued income.

n) Non-current assets held for sale

Non-current assets (and certain groups of assets and liabilities defined as disposal groups) are classified as *held for sale* when their carrying amounts will be recovered primarily through their sale, which is considered to be highly probable. Non-current assets (and disposal groups) held for sale are accounted for at the lower of their carrying amount and fair value less cost to sell, and are recognized on a separate line of the balance sheet.

o) Consolidated data

As required under prevailing legislation, the Company has prepared separate consolidated annual financial statements, drawn up in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union. The balances of the main headings of the Telefónica Group's consolidated financial statements for 2011 and 2010 are as follows:

Item (millions of euros)	2011	2010
Total assets	129,623	129,775
Equity:		
Attributable to equity holders of the parent	21,636	24,452
Attributable to minority interests	5,747	7,232
Revenue from operations	62,837	60,737
Profit for the year:		
Attributable to equity holders of the parent	5,403	10,167
Attributable to minority interests	784	(95)

(5) INTANGIBLE ASSETS

The movements in the items composing intangible assets and the related accumulated amortization in 2011 and 2010 are as follows:

(Millions of euros) 2011	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	311	5	(11)	15	320
Patents, licenses, trademarks, and others	22	2	-	5	29
Software	176	3	(11)	5	173
Other intangible assets	113	-	-	5	118
ACCUMULATED AMORTIZATION	(240)	(22)	10	-	(252)
Patents, licenses, trademarks, and others	(18)	(2)	-	-	(20)
Software	(162)	(10)	10	-	(162)
Other intangible assets	(60)	(10)	-	-	(70)
Net carrying amount	71	(17)	(1)	15	68

<i>(Millions of euros)</i> 2010	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INTANGIBLE ASSETS, GROSS	346	6	(42)	1	311
Patents, licenses, trademarks, and others	62	2	(42)	-	22
Software	171	4	-	1	176
Other intangible assets	113	-	-	-	113
ACCUMULATED AMORTIZATION	(217)	(25)	2	-	(240)
Patents, licenses, trademarks, and others	(17)	(3)	2	-	(18)
Software	(152)	(10)	-	-	(162)
Other intangible assets	(48)	(12)	-	-	(60)
Net carrying amount	129	(19)	(40)	1	71

Disposals in 2011 relate to sales of software, at carrying amount, to other Telefónica Group companies.

In 2010 the rights to operate and commercialize the Altamira Platform were sold to a company outside the Telefónica Group. The carrying amount of this asset was 40 million euros on the sale date.

At December 31, 2011 commitments exist to acquire intangible assets amounting to 1.1 million euros (0.3 million euros at December 31, 2010). Future finance lease commitments are also disclosed in Note 19.5.

At December 31, 2011 and 2010, the Company had 190 million euros and 167 million euros, respectively, of fully amortized intangible assets.

(6) PROPERTY, PLANT AND EQUIPMENT

The movements in the items composing property, plant and equipment and the related accumulated depreciation in 2011 and 2010 are as follows:

<i>(Millions of euros)</i> 2011	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	598	12	(1)	(15)	594
Land and buildings	219	1	-	8	228
Plant and other PP&E items	305	9	(1)	10	323
Property, plant and equipment under construction and prepayments	74	2	-	(33)	43
ACCUMULATED DEPRECIATION	(217)	(40)	1	-	(256)
Buildings	(69)	(5)	-	-	(74)
Plant and other PP&E items	(148)	(35)	1	-	(182)
Net carrying amount	381	(28)	-	(15)	338

<i>(Millions of euros)</i> 2010	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
PROPERTY, PLANT AND EQUIPMENT, GROSS	591	33	-	(26)	598
Land and buildings	243	-	-	(24)	219
Plant and other PP&E items	294	2	-	9	305
Property, plant and equipment under construction and prepayments	54	31	-	(11)	74
ACCUMULATED DEPRECIATION	(180)	(37)	-	-	(217)
Buildings	(65)	(4)	-	-	(69)
Plant and other PP&E items	(115)	(33)	-	-	(148)
Net carrying amount	411	(4)	-	(26)	381

Firm commitments to acquire property, plant and equipment at December 31, 2011 and 2010 amounted to 0.4 million euros and 0.3 million euros, respectively.

In 2011 and 2010, no interest or other borrowing costs incurred in the construction of property, plant and equipment were capitalized.

At December 31, 2011 and 2010, the Company had 36 million euros and 21 million euros, respectively, of fully depreciated items of property, plant and equipment.

Telefónica, S.A. has taken out insurance policies with appropriate limits to cover the potential risks which could affect its property, plant and equipment.

“Property, plant and equipment” includes the net carrying amount of the land and buildings occupied by Telefónica, S.A. at its Distrito Telefónica headquarters, amounting to 73 million euros and 95 million euros at the 2011 and 2010 year-ends, respectively. Also included is the net carrying amount of the remaining assets (mainly plant and property) related to the operational headquarters built in the Las Tablas district, called “Distrito Telefónica,” of 114 million euros at December 31, 2011 and 134 million euros at December 31, 2010.

(7) INVESTMENT PROPERTIES

The movements in the items composing investment properties in 2011 and 2010 and the related accumulated depreciation are as follows:

<i>(Millions of euros)</i> 2011	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	386	88	-	-	474
Land	65	-	-	-	65
Buildings	321	88	-	-	409
ACCUMULATED DEPRECIATION	(41)	(10)	-	-	(51)
Buildings	(41)	(10)	-	-	(51)
Net carrying amount	345	78	-	-	423

<i>(Millions of euros)</i> 2010	Opening balance	Additions and allowances	Disposals	Transfers	Closing balance
INVESTMENT PROPERTIES, GROSS	361	-	-	25	386
Land	65	-	-	-	65
Buildings	296	-	-	25	321
ACCUMULATED DEPRECIATION	(33)	(8)	-	-	(41)
Buildings	(33)	(8)	-	-	(41)
Net carrying amount	328	(8)	-	25	345

In January 2011, the Telefónica Group moved its offices to the recently completed Diagonal 00 building, its new corporate headquarters in Barcelona. In the view of the terms of the contract, the Company has determined that the building satisfies the requirements for recognition as an asset acquired under a finance lease; it is accordingly shown under “Additions” in the above table at the present value of the rental payments, 88 million euros. 100% of this space is rented to Telefónica Group companies under 15-year non-cancellable lease contracts that can be renewed for up to 50 years at the discretion of Telefónica.

“Investment properties” mainly includes the value of land and buildings leased by Telefónica, S.A. to other Group companies at the Distrito Telefónica head offices in Madrid and Telefónica’s new headquarters in Barcelona, Diagonal 00.

The Company has buildings with a total area of 367,167 square meters leased to several Telefónica Group and other companies, equivalent to an occupancy rate of 93.3% of the buildings it has earmarked for lease. In 2010, it had a total of 361,475 square meters leased, equivalent to an occupancy rate of 92.97% of the buildings earmarked for lease.

Total income from leased buildings in 2011 (see Note 19.1) amounted to 52 million euros (43 million euros in 2010). Future minimum rentals receivable under non-cancellable leases are as follows:

<i>(Millions of euros)</i>	2011		2010	
	Future minimum recoveries	Present value	Future minimum recoveries	Present value
Up to one year	51		50	
Between one and five years	121		-	
Over 5 years	5		-	
Total	177	151	50	48

All lease contracts held with subsidiaries occupying Distrito Telefónica premises expired in 2010. These contracts were renewed in 2011, for a non-cancellable period of three years. The figures for 2011 also reflect non-cancellable lease revenue from Diagonal 00, the contracts for which expire in 2016.

The main contracts in which Telefónica, S.A. acts as lessee are described in Note 19.5.

(8) INVESTMENTS IN GROUP COMPANIES AND ASSOCIATES

- 8.1 The movements in the items composing investments in Group companies, joint ventures and associates in 2011 and 2010 are as follows:

(Millions of euros) 2011	Opening balance	Additions	Disposals	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Non-current:									
-Equity instruments (Net) (1):	78,870	(1,148)	(404)	123	-	(113)	68	77,396	139,678
Equity instruments (Cost)	86,824	458	(404)	123	-	(113)	68	86,956	
- Impairment losses	(7,954)	(1,606)	-	-	-	-	-	(9,560)	
- Loans to Group companies and associates	2,832	149	(31)	(1,322)	(10)	-	-	1,618	1,681
-Other financial assets	24	25	-	(27)	-	-	-	22	22
Total non-current investment in Group companies and associates	81,726	(974)	(435)	(1,226)	(10)	(113)	68	79,036	141,381
Current:									
- Loans to Group companies and associates	3,295	750	(1,856)	1,322	(121)	-	-	3,390	3,467
- Derivatives	12	57	(12)	-	-	-	-	57	57
- Other financial assets	28	9	(33)	27	-	-	-	31	31
Total current investments in Group companies and associates	3,335	816	(1,901)	1,349	(121)	-	-	3,478	3,555

(Millions of euros) 2010	Opening balance	Additions	Disposals	Business combinations	Transfers	Exchange losses	Dividends	Hedges of a net investment	Closing balance	Fair value
Non-current:										
-Equity instruments (Net) (1):	66,542	9,219	-	3,505	(610)	-	(21)	235	78,870	146,118
Equity instruments (Cost)	72,535	11,204	(5)	3,505	(629)	-	(21)	235	86,824	
- Impairment losses	(5,993)	(1,985)	5	-	19	-	-	-	(7,954)	
- Loans to Group companies and associates	4,000	769	(30)	-	(2,116)	209	-	-	2,832	2,832
-Other financial assets	23	24	-	-	(23)	-	-	-	24	24
Total non-current investment in Group companies and associates	70,565	10,012	(30)	3,505	(2,749)	209	(21)	235	81,726	148,974
Current:										
- Loans to Group companies and associates	3,141	1,115	(3,095)	-	2,116	18	-	-	3,295	3,295
- Derivatives	29	12	(29)	-	-	-	-	-	12	12
- Other financial assets	29	23	(47)	-	23	-	-	-	28	28
Total current investments in Group companies and associates	3,199	1,150	(3,171)	-	2,139	18	-	-	3,335	3,335

(1) Fair value at December 31, 2011 and 2010 of Group companies and associates quoted in an active market (Telefónica de Perú, S.A.A. and Telefónica Czech Republic, a.s. in 2010, and, additionally in 2011, Telefónica Brasil, S.A.) was calculated taking the listing of the investments on the last day of the year; the rest of the shareholdings are stated at the value of discounted cash flows based on those entities' business plans.

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders' Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders' Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participações, Ltda., valued at 13,021 million euros (see Note 8.c), subsequent to the liquidation by absorption of Portelcom Participações, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participações, Ltda.

The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders' Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders' Meeting held on the same date.

Following the share exchange, a partial contribution was made to Sao Paulo Telecomunicações (SPT), leaving the direct stake in Telesp at 24.68%. As all the aforementioned transactions were performed at the carrying amounts, they are not reflected in the table of movements for 2011.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders' Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

In 2011, "*Transfers*" primarily reflected capitalization on June 15, 2011 and September 12, 2011 of accrued interest receivable on loans granted to Telefónica Móviles México, S.A. de C.V., amounting to 32 million euros (541 million Mexican pesos) and 30 million euros (524 million Mexican pesos), respectively.

In January and October 2011, invoices issued in 2010 and 2011 to Telcel, C.A. were contributed to Latin American Cellular Holding, S.A., so that the latter could offset these collection rights against the loan it had received from the former. These invoices amounted to 61 million euros, as reflected under "*Transfers*."

In both 2011 and 2010, movement in "*Transfers*" under "Loans to Group companies and associates" primarily relates to the reclassification from long-term to short-term, in accordance with the loan maturity schedule.

The column headed "*Dividends*" sets out the amounts of dividends paid out by Group companies and associates in respect of earnings generated prior to the effective date of the corresponding shareholding. In 2011, these figures relate chiefly to SPT (107 million euros).

On June 23, 2010 Telefónica S.A. reduced its ownership interest in Portugal Telecom by 6.49%, resulting in cash inflow of 512 million euros from the sale of these shares. In addition, Telefónica entered into three equity swap contracts for Portugal Telecom shares with a number of financial institutions, subject to net settlement, which grant Telefónica the equivalent total return of the investment. At that time, this investment, previously recognized under "Investments in associates," was reclassified to "Non-current assets held for sale". At December 31, 2010 Telefónica, S.A. held a 2.02% interest in Portugal Telecom, which was also reclassified to this heading. Both movements were included under "*Transfers*" in the table of movements for 2010.

In 2011, equity swap contracts were partially cancelled through the sale of 33 million shares in Portugal Telecom, generating gains of 13 million euros. These gains were recognized under the income statement caption "Gains (losses) on disposal and other gains and losses". Given that the listed price of these shares dropped considerably in the

second half of the year, the Company made a financial provision amounting to 135 million euros, recognized under the income statement caption “Impairment and gains (losses) on disposal of financial instruments” (see Note 19.10). In October 2011, in view of the adverse outlook published for this stock by financial analysts, the Company decided to extend the equity swap contracts and reclassified the net carrying amount of the direct stake in Portugal Telecom (which continued to be 2.02%) and the shares allocated to the equity swap contracts, a total amount for direct and indirect stake of 235 million euros to “Available-for-sale assets” within the caption “Non-current financial investments,” until it could design an appropriate divestment policy in view of market value trends for this investee (see Note 9).

The impact in 2011 of hedges of net investments in foreign operations amounted to a gain of 68 million euros (235 million euros in 2010).

In 2011 and 2010, Telefónica, S.A. bought and sold the following shareholdings:

a) Acquisitions of investments and capital increases:

Companies	Millions of euros	
	2011	2010
Subsidiaries:		
Casiopea Re, S.A.	80	-
Telefónica Global Technology, S.A.U.	38	-
Telefónica Móviles México, S.A. de C.V.	176	-
Telefónica de Costa Rica, S.A.	127	-
Brasilcel, N.V.	-	7,419
Telfin Ireland, Ltd.	-	3,410
Telefónica Europe, Ltd.	-	35
Others	37	340
Total subsidiaries	458	11,204

2011

On June 27, 2011, Telefónica, S.A. performed a capital increase of 1,285 million Mexican pesos (76 million euros) at its subsidiary Telefónica Móviles México, S.A. de C.V. In October 2011, several more capital increases were carried out, totaling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

On October 31, 2011, Telefónica, S.A. injected a further 38 million euros of equity in its subsidiary Telefónica Global Technology, S.A.U.

2010

On February 10, 2010 Irish company Telfin Ireland Limited was incorporated by means of a 919 million euro contribution by Telefonica, S.A. (its sole shareholder). On April 28, 2010, Telefónica, S.A. injected a further 243 million euros of equity into this company. Then on May 21, 2010, Telefónica, S.A. injected a further 1,379 million euros and on June 24, 2010 another 869 million euros. These funds were used by Telfin Ireland, Ltd. to finance other Group companies in transactions performed during 2010.

On July 28, 2010, Telefónica and Portugal Telecom signed an agreement for the acquisition by Telefónica of 50% of the capital stock of Brasilcel (company then jointly owned in equal shares by Telefónica and Portugal Telecom; the joint venture in its turn owned shares representing, approximately, 60% of the capital stock of Brazilian company Vivo Participações, S.A.). The acquisition price for the aforementioned capital stock of Brasilcel was 7,500 million euros, of which 4,500 million euros was paid at the closing of the transaction on September 27, 2010, 1,000 million euros on December 30, 2010, and the remaining 2,000 million euros on October 31, 2011.

b) Disposals of investments and capital decreases:

Companies	Millions of euros	
	2011	2010
Subsidiaries:		
Telefónica Móviles Argentina Holding, S.A.	285	-
Atento Inversiones y Teleservicios, S.A.	116	-
Others	3	5
Total subsidiaries	404	5

2011

In January 2011, Telefónica, S.A. sold a 25% stake in Telefónica Móviles Argentina Holding, S.A. to Telefónica Internacional, S.A.U., at market value as determined in an independent expert report. This sale generated gains of 511 million euros, recognized under “Gains (losses) on disposal and other gains and losses” in the accompanying income statement (see Note 19.9).

On March 31, 2011, Atento Inversiones y Teleservicios, S.A. resolved to pay out 150 million euros to its sole shareholder, Telefónica, S.A. 116 million euros of that amount related to a reduction in the share premium, recognized as a return of contributions and thus stated as a disposal in the table of movements for the year. The remainder, 34 million euros, was recognized in the income statement as income from dividends.

2010

In January 2010, Mobipay Internacional was liquidated. Full provision had been made for the investment in this company of 5 million euros.

c) Business combinations

2011

No business combinations were carried out in 2011.

2010

On September 27, 2010 the corresponding boards of directors agreed to start the take-over of Brasilcel, N.V. by Telefónica, which was completed on December 21, 2010 after being entered in the Madrid Mercantile Registry.

Brasilcel, N.V. had the following merger balance sheet:

<i>(Millions of euros)</i>	
Investments in Group companies	4,574
Other assets	103
Total assets	4,677
Liabilities and equity	4,677

As a result of this transaction, Telefónica, S.A. acquired direct investments in Vivo Participações, S.A. (35.89%), Portelcom Participações, S.A. (84.78%), PTelecom Brasil, S.A. (100%), and increased its stake in Telefónica Brasil Sul Celular Participações, Ltda. to 74.39%. The total direct and indirect stake in Vivo Participações held by Telefónica, S.A. at December 31, 2010 amounted to approximately 60%. The gross value of these stakes amounts to 13,021 million euros which, less the acquisition cost of Brasilcel, N.V., amounts to 3,505 million euros, as shown in the “Business combinations” column of the table showing investments in Group companies and associates in 2010.

8.2 Assessment of impairment of investments in group companies, joint ventures and associates

At each year end, the Company re-estimates the future cash flows derived from its investments in Group companies and associates. The estimate is made based on the discounted cash flows to be received from each subsidiary in its functional currency, net of the liabilities associated with each investment (mainly net borrowings and provisions) and translated to euros at the official closing rate of each currency at December 31, 2011 and 2010.

As a result of these re-estimations and the effect of the net investment hedge in 2011, an impairment provision of 1,606 million euros was recognized. This amount reflects the net effect of the following: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year.

In 2010, the Company recognized write-downs of its shareholding in Telefónica Europe, plc. amounting to 1,985 million euros, of which 124 million euros related to the effect of net investment hedges.

8.3 The detail of subsidiaries and associates is shown in Appendix I.

8.4 Transactions protected for tax purposes

Transactions carried out in 2011 that are considered protected for tax purposes, as defined in Articles 83 or 94, as applicable, of Chapter VII of Title VII of Legislative Royal Decree 4/2004 of March 5 approving the Revised Spanish Corporate Income Tax Law, are detailed in the following paragraphs. Transactions protected for tax purposes carried out in prior years are disclosed in the annual financial statements for those years.

The main operation of this type which took place in 2011 between subsidiaries belonging to the tax Group headed by Telefónica, S.A. is the following:

On September 26, 2011 the Luxembourg-based company Casiopea Re, S.A., a wholly-owned subsidiary of Telefónica S.A., signed a public deed whereby its entire shareholding in the Spanish company Pléyade Peninsular Correduría de Seguros y Reaseguros (an 83.33% stake) was spun off to Telefónica Finanzas S.A.U., a Spanish company fully owned by Telefónica S.A. The spin-off was completed with the corresponding share capital increase in Telefónica Finanzas S.A.U., fully subscribed by Telefónica, S.A.

8.5 The breakdown and maturity of loans to Group companies and associates in 2011 and 2010 are follows:

2011 Company (millions of euros)	2012	2013	2014	2015	2016	2017 and subsequent years	Final balance, current and non-current
Telefónica de España, S.A.U.	1,036	-	-	-	-	-	1,036
Telefónica Móviles México, S.A. de C.V.	1,298	-	-	-	-	-	1,298
Telefónica de Contenidos, S.A.U.	2	1,142	-	79	-	-	1,223
Telefónica Móviles Argentina, S.A.	8	5	-	-	-	-	13
Telefónica Global Technology, S.A.U.	5	5	5	1	13	75	104
Telco, S.p.A.	614	-	-	-	-	-	614
Telefónica Emisiones, S.A.U.	4	117	42	-	-	-	163
Others	423	26	22	27	7	52	557
Total	3,390	1,295	69	107	20	127	5,008

2010 Company (millions of euros)	2011	2012	2013	2014	2015	2016 and subsequent years	Final balance, current and non-current
Telefónica de España, S.A.U.	1,079	698	-	-	-	-	1,777
Telefónica Móviles España, S.A.U.	236	-	-	-	-	-	236
Telefónica Móviles México, S.A. de C.V.	1,697	-	-	-	-	-	1,697
Telefónica de Contenidos, S.A.U.	28	-	1,142	-	79	-	1,249
Telefónica Móviles Argentina, S.A.	8	8	5	-	-	-	21
Inversiones Telefónica Móviles Holding, Ltd.	50	-	-	-	-	-	50
Telefónica Global Technology, S.A.U.	4	5	5	5	2	66	87
Telco, S.p.A.	14	600	-	-	-	-	614
Telefónica Internacional, S.A.U.	56	-	-	-	-	-	56
Others	123	24	86	14	16	77	340
Total	3,295	1,335	1,238	19	97	143	6,127

The main loans granted to Group companies are described below:

- Financing granted to Telefónica de España, S.A.U. consists mainly of a loan dated January 4, 1999 resulting from the company's spin-off from Telefónica, that bears interest at 6.80% and had an outstanding short-term balance of 698 million euros at December 31, 2011. The short-term amount includes accrued interest receivable of 6 million euros (11 million euros in 2010).

On December 29, 2011 Telefónica, S.A. acquired two buildings from Telefónica de España, S.A.U., the market value of which amounted to 51 million euros (see Note

18.a, Donation to the Telefónica Foundation). The balance payable on this acquisition was recorded as a decrease in the aforementioned financing and will be allocated in three equal installments upon the next loan maturities. The first installment was reduced through a payment at December 31, 2011, resulting in an outstanding balance payable of 34 million. This amount has been applied as a reduction in the balance payable in 2012, shown in the above table.

The Company also has tax receivables from this subsidiary amounting to 366 million euros, in connection with the consolidated tax group.

- At December 31, 2009, the total drawn amount on the credit facilities extended to Telefónica Móviles México, S.A. de C.V. (the principal of the loans) came to 27,912 million Mexican pesos, or 1,494 million euros. One of the lines of credit of 4,519 million Mexican pesos (279 million euros) matured in 2010 and was offset by a payable Telefónica had with Telfisa Global, B.V. for the same amount in euros. No cash flow therefore occurred in relation to this repayment. The movement was recognized as a disposal in the 2010 table of movements.

On September 23, 2010, an additional loan of 269 million euros was extended to Telefónica Móviles México, S.A. de C.V., maturing in March 2011, to cover the financing requirements of the subsidiary during the second half of 2010. On March 23, 2011, this loan was repaid, decreasing the balance Telefónica, S.A. had payable to Telfisa Global, B.V. for the same amount in euros.

In 2011 the Company capitalized accrued interest receivable amounting to 1,065 million Mexican pesos, equivalent to 62 million euros.

At December 31, 2011 and 2010 the balance of the two outstanding loans amounted to 23,393 million Mexican pesos, equivalent to 1,298 million euros in 2011 (1,418 million euros in 2010).

At December 31, 2011 there was no accrued interest receivable on the aforementioned loans extended to Telefónica Móviles México, S.A. de C.V. Accrued interest receivable on these loans at December 31, 2010 amounted to 11 million euros.

- Financing granted to Telefónica de Contenidos, S.A.U. comprises a 1,142 million euro participating loan, extended in 2003 and fully drawn down at December 31, 2011 and 2010, which bears interest based on Telefónica de Contenidos, S.A.U.'s business performance. In addition, in 2005 Telefónica, S.A. granted a new participating loan of 79 million euros maturing in 2015. This second loan was also fully drawn down at December 31, 2011 and 2010. The current portion of this loan in 2010 included accrued interest receivable of 11 million euros. No interest receivable is outstanding in respect of 2011.

The Company also has tax receivables from this subsidiary amounting to 2 million euros, in connection with the consolidated tax group.

- On January 11, 2010, Telco, S.p.A. ("Telco") arranged a 1,300 million euro loan with Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A., Société Générale, S.p.A. and Unicredito, S.p.A. maturing on May 31, 2012, part of which is secured with Telecom Italia, S.p.A. shares. The lending banks granted Telco shareholders a call option on the Telecom Italia, S.p.A. shares that they may be entitled to receive as a result of the potential execution of the pledge.

In line with the commitments assumed by Telco shareholders, on December 22, 2009, the rest of Telco's financing needs with respect to debt maturities were met with a bridge loan granted by shareholders Telefónica, Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for approximately 902 million euros, and a bank bridge loan granted by Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for the remaining 398 million euros.

The financing from the bridge loans was substituted with a bond subscribed by Telco's shareholder groups, on a pro-rate basis in accordance with their interests in the company, on February 19, 2010 (maturing on June 8, 2012) for 1,300 million euros, of which 600 million euros corresponded to Telefónica, accruing interest at a fixed rate of 4%. At the 2011 year end, this bond had generated accrued interest receivable of 14 million euros (14 million euros at December 31, 2010).

- A floating-rate loan linked to three-month Euribor was granted to Telefónica Internacional, S.A.U. on April 15, 2008 for 1,000 million euros, maturing in April 2011. At that time, the loan was raised to 1,300 million euros, maturing on April 14, 2012. No amounts were drawn as at December 31, 2011 or 2010, although 700 million euros were drawn down in the course of 2011 and repaid prior to the year-end (see Note 21).
- In January 2010, a 19 million euro loan was extended to Telefónica Global Technology, S.A. (hereinafter TGT), which matures in 2015 and accrues interest at a variable rate linked to the six-month Euribor. At December 31, 2011 a total of 15 million euros had been drawn down on this loan (18 million euros at December 31, 2010).

On September 10, 2010, Telefónica, S.A. extended a 111 million euro participating floating-rate Euribor-linked loan to TGT, maturing in 2020. This loan accrues interest based on the performance of the company. At December 31, 2011 and 2010, 68 million euros was drawn down on this loan.

In October 2011, Telefónica, S.A. extended another Euribor-linked variable-interest participating loan, for 59 million euros, maturing in 2019. This loan accrues interest based on the performance of the company. At December 31, 2011, 21 million euros was drawn down on this loan.

- At December 31, 2011 and 2010, financing granted to Telefónica Móviles Argentina, S.A. comprised a 47 million US dollar loan granted in July 2006, on which 15 million US dollars (13 million euros) were drawn down at the 2011 year end.
- Financing granted to Inversiones Telefónica Móviles Holding, Ltd. was arranged on November 4, 2008 as a result of the loan assigned by Telefónica Internacional Chile, S.A. to Telefónica, S.A. for 284 million euros. Upon maturity of this loan in 2010, it was extended to July 26, 2011. The balance was therefore recognized as a current loan in the 2010 table, for the amount drawn down (50 million euros). This amount was repaid on maturity.
- In the second half of 2010, Telefónica, S.A. acquired bonds issued by Telefónica Emisiones, S.A.U. amounting to 56 million euros. The bond acquisition policy for this subsidiary was carried on in 2011, reaching a total of 159 million euros.

Other accrued interest payable amounts to 4 million euros.

- Disposals of current credit facilities to group companies and associates includes the cancellation of balances receivable from subsidiaries on account of their membership of Telefónica, S.A.'s tax group against debts held by these same subsidiaries totalling 703 million euros (2010: 1,166 million euros).
- "Additions" also include 665 million euros (703 million euros in 2010) for credits arising in connection with the taxation of Telefónica, S.A. as the head of the tax group pursuant to the consolidated tax regime applicable to corporate groups (see Note 17), mainly 264 million euros to Telefónica Móviles España, S.A.U. (236 million euros in 2010) and 366 million euros to Telefónica de España, S.A.U. (371 million euros in 2010). There is no balance receivable from Telefónica Internacional, S.A.U. in 2011 (56 million euros in 2010). All these amounts mature in the short term.

"Loans to Group companies and associates" includes accrued interest receivable at December 31, 2011 amounting to 27 million euros (51 million euros in 2010).

8.6 Other financial assets with Group companies and associates

This includes rights to collect amounts from other Group companies related to share-based payment plans involving Telefónica, S.A. shares offered by subsidiaries to their employees maturing in 2012, 2013 and 2014 (see Note 19.3).

(9) FINANCIAL INVESTMENTS

9.1. The breakdown of “Financial investments” at December 31, 2011 and 2010 is as follows:

2011 <i>(Millions of euros)</i>	ASSETS AT FAIR VALUE							ASSETS AT AMORTIZED COST				TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
	Available-for- sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Measurement hierarchy			Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value		
					Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data						
Non-current financial investments	556	1,574	2,544	4,674	556	4,118	-	37	17	54	54	4,728	4,728
Equity instruments	556	-	-	556	556	-	-	-	-	-	-	556	556
Derivatives (Note 16)	-	1,574	2,544	4,118	-	4,118	-	-	-	-	-	4,118	4,118
Loans to third parties and other financial assets	-	-	-	-	-	-	-	37	17	54	54	54	54
Current financial investments	-	159	189	348	-	348	-	46	-	46	46	394	394
Loans to third parties	-	-	-	-	-	-	-	46	-	46	46	46	46
Derivatives (Note 16)	-	159	189	348	-	348	-	-	-	-	-	348	348
Total financial investments	556	1,733	2,733	5,022	556	4,466	-	83	17	100	100	5,122	5,122

2010 <i>(Millions of euros)</i>	ASSETS AT FAIR VALUE							ASSETS AT AMORTIZED COST				TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE
	Available-for- sale financial assets	Financial assets held for trading	Hedges	Subtotal assets at fair value	Measurement hierarchy			Loans and receivables	Other financial assets	Subtotal assets at amortized cost	Subtotal liabilities at fair value		
					Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on observable market data						
Non-current financial investments	473	936	1,550	2,959	473	2,486	-	36	13	49	49	3,008	3,008
Equity instruments	473	-	-	473	473	-	-	-	-	-	-	473	473
Derivatives (Note 16)	-	936	1,550	2,486	-	2,486	-	-	-	-	-	2,486	2,486
Loans to third parties and other financial assets	-	-	-	-	-	-	-	36	13	49	49	49	49
Current financial investments	-	170	190	360	-	360	-	29	25	54	54	414	414
Loans to third parties	-	-	-	-	-	-	-	29	25	54	54	54	54
Derivatives (Note 16)	-	170	190	360	-	360	-	-	-	-	-	360	360
Total financial investments	473	1,106	1,740	3,319	473	2,846	-	65	38	103	103	3,422	3,422

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

9.2 Held-for-trading financial assets and hedges.

These two categories include the fair value of outstanding derivative financial instruments at December 31, 2011 and 2010 (see Note 16).

9.3 Available-for-sale financial assets.

This category mainly includes the fair value of investments in listed companies (equity instruments). The movement of items composing this category at December 31, 2011 and 2010 are as follows:

December 31, 2011						
(Millions of euros)	Opening balance	Additions	Disposals	Other movements	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	418	-	-	(11)	(80)	327
Portugal Telecom, S.G.P.S., S.A.	-	-	(10)	235	(32)	193
Other companies	55	-	(1)	-	(18)	36
Total	473	-	(11)	224	(130)	556

December 31, 2010				
(Millions of euros)	Opening balance	Additions	Fair value adjustments	Closing balance
Banco Bilbao Vizcaya Argentaria, S.A.	468	49	(99)	418
Amper, S.A.	11	-	(6)	5
Zon Multimedia Serviços de Telecomunicações e Multimedia, SGPS, S.A.	65	-	(15)	50
Total	544	49	(120)	473

In view of the ongoing drop in the price of Portugal Telecom, SGPS, S.A. shares, in October 2011 the Company reclassified the carrying amount of its stake in that investee from "Non-current assets held for sale" to "Available-for-sale financial assets" (see Note 8). Consequently, since that month, changes in the market value of these shares have been reflected under equity (32 million euros, net of the tax effect). In December 2011, the Company sold 1.9 million shares, reflected under "Disposals" in the table of movements.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under "Gain (loss) on available-for-sale financial assets recognized in the period", with no impact on the statement of recognized income and expenses.

The amount shown under “Additions” in 2010 reflected the capital increase performed on November 30, 2010, in which Telefónica, S.A. acquired 7,359,889 new shares in the investee.

In 2010, Telefónica, S.A. transferred the stake in Banco Bilbao Vizcaya Argentaria, S.A. of 191 million euros and in Zon Multimedia Serviços de Telecomunicações e Multimedia, S.G.P.S., S.A. of 52 million euros from equity to net financial expense. These transfers were recognized in “Gain (loss) on available-for-sale financial assets recognized in the period”.

At December 31, 2011 Telefónica, S.A.’s investment in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), held since 2000, represents 0.90% of that company’s share capital.

9.4 Other financial assets and loans to third parties

The breakdown of investments included in this category at December 31, 2011 and 2010 is as follows:

<i>(Millions of euros)</i>	2011	2010
Other non-current financial assets		
Loans to third parties	37	36
Prepayments	2	1
Guarantees given	15	12
Other current financial assets:		
Loans to third parties	46	29
Guarantees given	-	25
Total	100	103

9.4.1 Loans to third parties

Non-current loans to third parties includes the cost of the financial instrument arranged in 2011 to partially cover share-based payment schemes involving Telefónica, S.A. shares (Manager and Senior Executive Options Remuneration Plan - Performance & Investment Plan (PIP)) for 37 million euros (see Note 19.3).

The value of the financial instrument arranged in 2010 partly to cover the fourth phase of share-based payment schemes involving Telefónica, S.A. shares, which in 2010 was recorded as non-current, was reclassified to current at December 31, 2011 owing to its falling due in June 2012 (36 million euros).

9.4.2 Guarantees given

Non-current loans to third parties primarily includes guarantees received from tenants of buildings owned by Telefónica, S.A., to be returned in a period of over 12 months.

In 2010 non-current loans to third parties included the remaining guarantee deposit provided to Ipse 2000 S.p.A., for 25 million euros. This amount was released and collected by the Company in 2011 (see Note 20.c).

(10) TRADE AND OTHER RECEIVABLES

The breakdown of “Trade and other receivables” at December 31, 2011 and 2010 is as follows:

<i>(Millions of euros)</i>	2011	2010
Trade receivables	24	39
Trade receivables from Group companies and associates	453	388
Other receivables	21	20
Employee benefits payable	2	2
Tax receivables (Note 17)	198	125
Total	698	574

“Trade receivables from Group companies and associates” mainly includes amounts receivable from subsidiaries for the impact of the rights to use the Telefónica brand and the monthly office rental fees (see Note 7).

“Trade receivables” and “Trade receivables from Group companies and associates” include balances in foreign currency equivalent to 134 million euros (91 million euros at year end 2010). In December 2011, there were receivables in US dollars equivalent to 104 million euros and Czech crowns equivalent to 30 million euros. In December 2010, there were receivables in US dollars equivalent to 57 million euros and Czech crowns equivalent to 34 million euros.

These balances gave rise to exchange losses in the income statement of approximately 8 million euros in 2011 (9 million euros of exchange gains in 2010).

(11) EQUITY

11.1 Capital and reserves

a) Share capital

At December 31, 2011, Telefónica, S.A.’s share capital amounted to 4,563,996,485 euros and consisted of 4,563,996,485 fully paid ordinary shares of a single series, per value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system (“Continuous Market”), where they form part of the Ibex 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Buenos Aires and Lima Stock Exchanges.

With respect to authorizations given regarding share capital, on May 18, 2011, authorization was given at the Annual Shareholders’ Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company’s needs, to increase the Company’s capital, at one or several times, within a maximum period of five years from that date, under the terms of Article 297.1.b) of the Spanish Enterprise Law up to a maximum increase of 2,281,998,242.50 euros, equivalent to half of Telefónica, S.A.’s share capital at that date, by issuing and placing new shares, be they ordinary, preference, redeemable, non-voting or of any other type permitted by the Law, with a fixed or variable premium, and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed. The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Article 506 of the Spanish Enterprises Act.

In addition, at the June 2, 2010 Shareholders' Meeting, authorization was given for the Board of Directors to issue fixed-income securities and preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, plain or, in the case of debentures and bonds, convertible into shares of the Company and/or exchangeable for shares of any of the Group companies. They may also be preferred shares. The total maximum amount of the securities issued agreed under this authorization is 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. As at December 31, 2011, the Board of Directors had exercised these powers, approving two programs for the issuance of corporate promissory notes in 2011 and 2012.

In addition, on June 2, 2010, shareholders voted to authorize the acquisition by the Board of Directors of treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders' Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

At December 31, 2011 and 2010, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/11	84,209,363	15.68	13.39	1,127	1.84508%

(1) Millions of euros

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/10	55,188,046	17.01	16.97	937	1.20920%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2010 and 2011 is as follows:

	Number of shares
Treasury shares at 12/31/09	6,329,530
Acquisitions	52,650,000
Disposals	(827,047)
Delivery PSP Phase II (Note 19.3)	(2,964,437)
Treasury shares at 12/31/10	55,188,046
Acquisitions	55,979,952
Disposals	(24,058,446)
Delivery PSP Phase III (Note 19.3)	(2,900,189)
Treasury shares at 12/31/11	84,209,363

Furthermore, at December 31, 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A. (16,896 treasury shares held by Telefónica Móviles Argentina, S.A. at December 31, 2010).

The amount paid to acquire treasury shares in 2011 and 2010 was 822 million euros and 897 million euros, respectively.

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP) (see Note 19.3), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the Plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally delivered (32.6 million euros).

On June 30, 2010, subsequent to the maturing of the second phase of the Performance Share Plan (PSP) (see Note 19.3) a total of 2,964,437 treasury shares were delivered at a price of 16.93 euros per share (50.1 million euros).

Expanding on the existing strategic alliance, 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. In 2011, Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 2011 282.063.000 shares of China Unicom amounted to 358 millions euros. 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.

Treasury shares sold in 2011 and 2010 amounted to 445 million euros and 14 million euros, respectively. The sales for 2011 included 371 million euros in respect of the Strategic Partnership Agreement with China Unicom, referred to above.

At the date of authorization for issue of these financial statements, Telefónica held 234 million call options on treasury shares subject to physical settlement (190 million and 160 million options on treasury shares at December 31, 2011 and 2010, respectively).

The Company also holds a derivative on approximately 26 million Telefónica shares, subject to net settlement, recognized under “Derivative financial liabilities” (current) on the balance sheet.

b) Legal reserve

According to the text of the Spanish Enterprise Law, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2011, the Company had duly set aside this reserve.

c) Other reserves

“Other reserves” includes:

- The “Revaluation reserve” which arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7. The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to

increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, at the end of 2011, an amount of 15 million euros corresponding to revaluations reserves subsequently considered unrestricted has been reclassified to "Other reserves." In 2010, an amount of 16 million euros was reclassified in this connection. The balance of this reserve at December 31, 2011 and 2010 was 126 million and 141 million euros, respectively.

- Reserve for cancelled share capital:
In accordance with Article 335.c) of the Spanish Enterprise Law and to render null and void the right of opposition provided for in Article 334 of the same Law, whenever the Company decreases capital it records a reserve for cancelled share capital for an amount equal to the par value of the cancelled shares, which can only be used if the same requirements as those applicable to the reduction of share capital are met. The cumulative amount of the reserve for cancelled share capital at December 31, 2011 and 2010 was 498 million euros.
- Pursuant to the provisions of Royal Decree 1514/2007, since 2008, after the distribution of profits for each year, the Company sets aside a non-distributable reserve of 1.7 million euros for goodwill amortization. The balance of this reserve at December 31, 2011 was 5 million euros. The proposed appropriation of 2011 profit (see Note 3) includes an allocation of 1.7 million euros to this restricted reserve.
- In addition to the restricted reserves explained above, "Other reserves" includes unrestricted reserves from gains obtained by the Company in prior years.
- On September 27, 2010, subsequent to the merger approved by the competent company organs, the merger between Telefónica, S.A. and Brasilcel, N.V. was recognized, and inscribed thereafter on December 21, 2010 in the Madrid Mercantile Registry. This merger generated a distributable reserve of 3,602 million euros, reduced by 49 million euros corresponding to the dividends of Brasilcel, N.V. (see Note 2.b).

d) Dividends

Dividends paid in 2011

At its meeting of April 12, 2011, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2010 profit of a fixed gross 0.75 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 6, 2011. The total amount paid was 3,394 million euros.

In addition, approval was given at the General Shareholders' Meeting on May 18, 2011 to pay a gross 0.77 dividend per share outstanding carrying dividend rights with a charge to unrestricted reserves. This dividend was paid in full on November 7, 2011, and the total amount paid was 3,458 million euros.

Dividends paid in 2010

At its meeting of April 28, 2010, Telefónica, S.A.'s Board of Directors resolved to pay an interim dividend against 2010 profit of a fixed gross 0.65 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 11, 2010, and the total amount paid was 2,938 million euros.

In addition, approval was given at the General Shareholders' Meeting on June 2nd, 2010 to pay a gross 0.65 dividend per share outstanding carrying dividend rights with a charge to unrestricted reserves. This dividend was paid in full on November 8, 2010, and the total amount paid was 2,934 million euros.

11.2 Unrealized gains (losses) reserve

The movements in the items composing "Unrealized gains (losses) reserve" in 2011 and 2010 are as follows:

<i>(Millions of euros)</i> 2011	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	(5)	(50)	15	-	-	(40)
Cash flow hedges (Note 16)	(145)	(824)	247	210	(63)	(575)
Total	(150)	(874)	262	210	(63)	(615)

<i>(Millions of euros)</i> 2010	Opening balance	Valuation at market value	Tax effect of additions	Amounts transferred to income statement	Tax effect of transfers	Closing balance
Available-for-sale financial assets (Note 9.3)	(91)	(120)	36	243	(73)	(5)
Cash flow hedges (Note 16)	(236)	57	(17)	73	(22)	(145)
Total	(327)	(63)	19	316	(95)	(150)

(12) FINANCIAL LIABILITIES

The breakdown of "Financial liabilities" at December 31, 2011 and 2010 is as follows:

2011		LIABILITIES AT FAIR VALUE									
			Subtotal financial liabilities at fair value	Measurement hierarchy			LIABILITIES AT AMORTIZED COST		TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE	
				Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Subtotal liabilities at fair value			
<i>(Millions of euros)</i>											
Financial liabilities held for trading	Hedges										
Non-current financial liabilities	1,123	910	2,033	-	2,033	-	44,687	41,038	46,720	43,071	
Payable to Group companies and associates	-	-	-	-	-	-	35,381	33,465	35,381	33,465	
Bank borrowings	-	-	-	-	-	-	9,046	7,374	9,046	7,374	
Bonds and other marketable debt securities	-	-	-	-	-	-	170	109	170	109	
Derivatives (Note 16)	1,123	910	2,033	-	2,033	-	-	-	2,033	2,033	
Other financial liabilities	-	-	-	-	-	-	90	90	90	90	
Current financial liabilities	183	21	204	-	204	-	17,969	17,078	18,173	17,282	
Payable to Group companies and associates	-	-	-	-	-	-	17,140	16,270	17,140	16,270	
Bank borrowings	-	-	-	-	-	-	742	721	742	721	
Bonds and other marketable debt securities	-	-	-	-	-	-	87	87	87	87	
Derivatives (Note 16)	183	21	204	-	204	-	-	-	204	204	
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	
Total financial liabilities	1,306	931	2,237	-	2,237	-	62,656	58,116	64,893	60,353	

2010		LIABILITIES AT FAIR VALUE									
			Subtotal financial liabilities at fair value	Measurement hierarchy			LIABILITIES AT AMORTIZED COST		TOTAL CARRYING AMOUNT	TOTAL FAIR VALUE	
				Level 1: quoted prices	Level 2: Estimates based on other directly observable market inputs	Level 3: Estimates not based on other directly observable market data	Trade and other payables	Subtotal liabilities at fair value			
<i>(Millions of euros)</i>											
Financial liabilities held for trading	Hedges										
Non-current financial liabilities	630	401	1,031	-	1,031	-	41,842	41,539	42,873	42,570	
Payable to Group companies and associates	-	-	-	-	-	-	34,864	34,969	34,864	34,969	
Bank borrowings	-	-	-	-	-	-	6,822	6,446	6,822	6,446	
Bonds and other marketable debt securities	-	-	-	-	-	-	148	116	148	116	
Derivatives (Note 16)	630	401	1,031	-	1,031	-	-	-	1,031	1,031	
Other financial liabilities	-	-	-	-	-	-	8	8	8	8	
Current financial liabilities	109	66	175	-	175	-	17,289	18,128	17,464	18,303	
Payable to Group companies and associates	-	-	-	-	-	-	16,009	16,866	16,009	16,866	
Bank borrowings	-	-	-	-	-	-	1,176	1,157	1,176	1,157	
Bonds and other marketable debt securities	-	-	-	-	-	-	104	105	104	105	
Derivatives (Note 16)	109	66	175	-	175	-	-	-	175	175	
Other financial liabilities	-	-	-	-	-	-	-	-	-	-	
Total financial liabilities	739	467	1,206	-	1,206	-	59,131	59,667	60,337	60,873	

Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

The calculation of the fair values of the Company's financial debt instruments required an estimate for each currency of a credit spread curve using the prices of the Company's bonds and credit derivatives.

(13) BONDS AND OTHER MARKETABLE DEBT SECURITIES

13.1 The balances and movements in issues of debentures, bonds and commercial paper at December 31, 2011 and 2010 are as follows:

<i>(Millions of euros)</i> 2011	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	148	104	252
Additions	-	44	44
Depreciation and amortization	-	(62)	(62)
Revaluation and other movements	22	1	23
Closing balance	170	87	257
Details of maturities:			
Non-current	170	-	170
Current	-	87	87

<i>(Millions of euros)</i> 2010	Non-convertible debentures and bonds	Other marketable debt securities	Total
Opening balance	159	368	527
Depreciation and amortization	(19)	(272)	(291)
Revaluation and other movements	8	8	16
Closing balance	148	104	252
Details of maturities:			
Non-current	148	-	148
Current	-	104	104

Maturities of the nominal amounts of debenture and bond issues at December 31, 2011 and 2010 are as follows:

2011			Maturity						Subsequent years	TOTAL
Name	Interest rate	% interest rate	2012	2013	2014	2015	2016			
DEBENTURES AND BONDS:										
JULY 99	ZERO COUPON (**)	6.39%	-	-	-	-	-	-	64	64
MARCH 00	FLOATING	3.831% (*)	-	-	-	50	-	-	-	50
Total issues			-	-	-	50	-	-	64	114

2010			Maturity					Subsequent years	TOTAL	
Name	Interest rate	% interest rate	2011	2012	2013	2014	2015			
DEBENTURES AND BONDS:										
JULY 99	ZERO COUPON (**)	6.39%	-	-	-	-	-	-	61	61
MARCH 00	FLOATING	3.994% (*)	-	-	-	-	50	-	-	50
Total issues			-	-	-	-	50	-	61	111

(*) The applicable interest rate (floating, set annually) is the sterling 10-year swap rate multiplied by 1.0225.

(**) Issues of zero-coupon debentures and bonds are shown in the table above at amortized cost.

- 13.2 The detail of the maturities and redemption values of zero-coupon debentures and bonds at December 31, 2011 and 2010 is as follows:

Issue	Redemption date	Redemption rate	Redemption value
DEBENTURES AND BONDS:			
JULY 99	07/21/2029	637.639%	191
Total			191

The remaining debentures and bonds have been measured at amortized cost at the year end.

- 13.3 At December 31, 2011, Telefónica, S.A. had a corporate promissory note program registered with the CNMV, with the following features:

Amount (millions of euros)	Placement system	Nominal amount of the Promissory notes	Terms of the Promissory notes	Placement
500 million; can be increased to 2,000 million	Auctions	1,000 euros	1, 2, 3, 6, 12, 18 and 25 months	Competitive auctions at least once a month
	Tailored	100,000 euros	Between 7 and 750 days	Specific transactions

At December 31, 2011 the outstanding balance on this promissory note program was 87 million euros (42 million euros in 2010).

- 13.4 The average interest rate during 2011 on debentures and bonds outstanding during the year was 4.74% (5.68% in 2010) and the average interest rate on corporate promissory notes was 1.88% (0.685% in 2010).

(14) INTEREST-BEARING DEBT AND DERIVATIVES

- 14.1 The balances at December 31, 2011 and 2010 are as follows:

Item (millions of euros)	December 31, 2011		
	Current	Non-current	Total
Loans with financial entities	742	9,046	9,788
Derivative financial liabilities (Note 16)	204	2,033	2,237
Total	946	11,079	12,025

Item (millions of euros)	December 31, 2010		
	Current	Non-current	Total
Loans with financial entities	1,176	6,822	7,998
Derivative financial liabilities (Note 16)	175	1,031	1,206
Total	1,351	7,853	9,204

- 14.2 The nominal values of the main interest-bearing debts at December 31, 2011 and 2010 are as follows:

Description	December 31, 2011					
	Value date	Maturity date	Currency	Limit at 12/31/11	Balance (million currency)	Balance (million euros)
€8bn syndicated loan	07/28/10	07/28/16	EUR	8,000	8,000	8,000
Syndicated loan savings banks	04/21/06	04/21/17	EUR	700	700	700
ECAS/EKN loan	02/12/10	11/30/19	USD	472	335	259

Description	December 31, 2010					
	Value date	Maturity date	Currency	Limit at 12/31/10	Balance (million currency)	Balance (million euros)
€8bn syndicated loan	07/28/10	07/28/15	EUR	8,000	6,000	6,000
Syndicated loan savings banks	04/21/06	04/21/17	EUR	700	700	700
€6bn syndicated loan	06/28/05	06/28/11	EUR	650	300	300

14.3 Maturities of balances at December 31, 2011 and 2010 are as follows:

Item (millions of euros)	December 31, 2011						Closing balance
	Maturity						
	2012	2013	2014	2015	2016	Subsequent years	
Loans with financial entities	742	930	1,836	2,989	2,245	1,046	9,788
Derivative financial liabilities (Note 16)	204	61	106	287	192	1,387	2,237
Total	946	991	1,942	3,276	2,437	2,433	12,025

Item (millions of euros)	December 31, 2010						Closing balance
	Maturity						
	2011	2012	2013	2014	2015	Subsequent years	
Loans with financial entities	1,176	35	2,967	5	2,979	836	7,998
Derivative financial liabilities (Note 16)	175	103	69	95	214	550	1,206
Total	1,351	138	3,036	100	3,193	1,386	9,204

14.4 On June 28, 2010, Telefónica, S.A. obtained a syndicated line of credit with a group of national and international banks for up to a maximum of 8,000 million euros. The line of credit has two tranches: the first for up to 5,000 million euros and a term of three years, and the second for up to 3,000 million euros, structured as a revolving credit facility with a five-year term. On May 12, 2011 Telefónica, S.A. signed an amendment whereby it was agreed that of the 5,000 million euros that would initially mature in July 2013, 2,000 million euros would be extended for another year, i.e. until July 2014, and another 2,000 million for a further three years, i.e. until July 2016. At December 31, 2011 the outstanding balance drawn down on this line of credit amounted to 8,000 million euros (6,000 million euros at December 31, 2010).

On May 3, 2011, Telefónica, S.A. entered into a long-term line of credit facility for an aggregate amount of 376 million US dollars at a fixed rate with the guarantee of the Finnish Export Credits Guarantee Board (Finnvera). This line of credit is structured into four tranches: a tranche of 94 US dollars maturing on January 30, 2020, another of 90 million US dollars maturing on July 30, 2020, a third of 94 million US dollars maturing on January 30, 2021, and a fourth of 98 million US dollars maturing on July 30, 2021. No amounts had been drawn down on this credit facility at December 31, 2011.

On February 12, 2010, Telefónica, S.A. signed a long-term line of credit of 472 million US dollars at a fixed rate and guaranteed by the Swedish Export Credits Guarantee Board (EKN). This credit facility is divided into three tranches: a tranche of 232 US dollars maturing on November 30, 2018, another of 164 million US dollars maturing on April 30, 2019, and a third of 76 million US dollars maturing on November 30, 2019. During the year, it repaid 218 million US dollars of the first tranche and 154 million US dollars of

the second, although since this facility has a repayment schedule at December 31, 2011, the outstanding balance amounted to 335 million US dollars (equivalent to 259 million euros).

On April 21, 2006, Telefónica S.A. arranged a 700 million euro syndicated loan, denominated in euros and bearing interest linked to Euribor. In 2011 and 2010, there were no movements in this loan, which will be repaid in two equal installments, in April 2015 and 2017, respectively.

On June 28, 2011, the syndicated loan facility arranged by Telefónica, S.A. on June 28, 2005 for 6,000 million euros matured as scheduled. The outstanding balance prior to maturity was 300 million euros.

In addition, Telefónica signed three equity swap contracts with different financial entities in June 2010. These swaps are based on the share price of Portugal Telecom and are settled net, thereby obtaining the same economic returns. The amount received from these contracts is 541 million euros, recognized as current interest-bearing debts. These contracts were partially cancelled in 2011 through the sale of 33 million shares. The remaining outstanding balance stands at 155 million euros.

14.5 Average interest on loans and borrowings

The average interest rate in 2011 on loans and borrowings denominated in euros was 2.376% and on foreign-currency loans and receivables it was 3.354%.

The average interest rate in 2010 on loans and borrowings denominated in euros was 1.17% and on foreign-currency loans and receivables it was 3.86%.

14.6 Unused credit facilities

The balances of “Loans and borrowings” relate only to amounts drawn down.

At 31 December 2011 and 2010, Telefónica had undrawn credit facilities amounting to 6,764 million and 8,670 million euros, respectively.

Financing arranged by Telefónica, S.A. at December 31, 2011 and 2010 is not subject to compliance with any financial covenants.

(15) PAYABLE TO GROUP COMPANIES AND ASSOCIATES

15.1 The breakdown at December 31, 2011 and 2010 is as follows:

December 31, 2011			
(Millions of euros)	Non-current	Current	Total
Loans	34,855	16,993	51,848
Trade payables to Group companies and associates	-	129	129
Derivatives (Note 16)	-	14	14
Payable to subsidiaries due to taxation on a consolidated basis	526	4	530
Total	35,381	17,140	52,521

December 31, 2010			
(Millions of euros)	Non-current	Current	Total
Loans	34,520	15,800	50,320
Trade payables to Group companies and associates	-	132	132
Derivatives (Note 16)	6	20	26
Payable to subsidiaries due to taxation on a consolidated basis	338	57	395
Total	34,864	16,009	50,873

The maturity of these loans at the 2011 and 2010 year ends is as follows:

December 31, 2011							
Company (millions of euros)	2012	2013	2014	2015	2016	2017 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	1,343	3,445	4,370	3,504	6,315	13,101	32,078
Telefónica Europe, B.V.	6,478	1,957	14	-	-	1,599	10,048
Telfisa Global, B.V.	2,332	-	-	-	-	-	2,332
Telefónica Finanzas, S.A.U.	6,830	-	-	476	74	-	7,380
Others	10	-	-	-	-	-	10
Total	16,993	5,402	4,384	3,980	6,389	14,700	51,848

December 31, 2010							
Company (millions of euros)	2011	2012	2013	2014	2015	2016 and subsequent years	Final balance, current and non-current
Telefónica Emisiones, S.A.U.	3,713	634	3,452	4,395	3,428	13,802	29,424
Telefónica Europe, B.V.	1,804	4,708	1,996	-	-	1,555	10,063
Telfisa Global, B.V.	1,812	-	-	-	-	-	1,812
Telefónica Finanzas, S.A.U.	8,461	-	-	-	475	75	9,011
Others	10	-	-	-	-	-	10
Total	15,800	5,342	5,448	4,395	3,903	15,432	50,320

The carrying amount of financing raised by Telefónica, S.A. through its subsidiary Telefónica Europe, B.V. at December 31, 2011 was 10,048 million euros (10,063 million euros at the 2010 year end). This financing entails a number of loans paying market rates of interest calculated on a Euribor plus spread basis. The average interest rate in 2011 was 3.52% (3.94% in 2010).

This financing mainly derives from the syndicated multicurrency loan arranged between Telefónica Europe, B.V. and a group of financial institutions for an amount of up to 18,500 million pounds sterling on October 31, 2005 to fund the acquisition of O2, Plc., which at December 14, 2006 was reduced to 7,000 million pounds sterling, while the maturity was extended from 2008 to 2013. At December 31, 2011, the balance outstanding on this loan was 2,965 million euros (2,945 million euros at 2010 year end).

The carrying amount of financing raised by Telefónica, S.A. through Telefónica Emisiones, S.A.U. at December 31, 2011 was 32,078 million euros (29,424 million euros in 2010). This financing is arranged as loans from these companies on the same terms as those of the issuance programs. The average interest rate in 2011 was 5.06% (5.06% in 2010). The financing arranged includes, as a related cost, the fees or premiums taken to the income statement for the period corresponding to the financing based on the corresponding effective interest rates. Telefónica Emisiones, S.A.U. raised financing in 2011 mainly by tapping the European and US capital markets, issuing the following bonds totaling 4,495 million euros (5,484 million euros in 2010):

Description	Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
<i>EMTN bonds</i>	02-07-2011	02-07-2017	1,200,000,000	EUR	4.750%
	03-21-2011	02-07-2017	100,000,000	EUR	4.750%
	11-03-2011	02-03-2016	1,000,000,000	EUR	4.967%
	11-04-2011	11-04-2016	7,000,000,000	JPY	2.8247%
<i>SHELF bond</i>	02-16-2011	02-16-2016	1,250,000,000	USD	3.992%
	02-16-2011	02-16-2021	1,500,000,000	USD	5.462%

Part of the amount owed by Telefónica, S.A. to Telefónica Emisiones, S.A.U. and to Telefónica Europe, B.V. includes restatements to amortized cost at December 31, 2011 and 2010 as a result of fair value interest rate and exchange rate hedges.

Meanwhile, at December 31, 2011, Telefónica, S.A. had raised financing from Telefónica Finanzas, S.A.U., in charge of the integrated cash management of the companies comprising the Telefónica Group in Spain, amounting to 7,380 million euros (9,011 million euros at December 31, 2010) in a series of loans bearing interest at market rates.

Telfisa Global, B.V. centralizes and handles cash management and flows for the Telefónica Group in Latin America, the United States and Europe. The balance payable to this subsidiary is formalized through several Deposit Agreements accruing interest at market rates and amounting to 2,332 million euros in 2011 and 1,812 million euros in 2010.

“Loans to Group companies” under current assets includes accrued interest receivable at December 31, 2011 amounting to 829 million euros (776 million euros in 2010).

- 15.2 The balance of “Payable to subsidiaries due to taxation on a consolidated basis” was 530 million euros and 395 million euros at December 31, 2011 and 2010, respectively. This basically includes payables to Group companies for their contribution of taxable income (tax losses) to the tax group headed by Telefónica, S.A. (see Note 17). The current- or non-current classification is based on the Company’s projection of maturities.

The main amounts are those relating to Telefónica Internacional, S.A.U. for 283 million euros (147 million euros in 2010), Telefónica Móviles España, S.A.U. for 130 million euros (128 million euros in 2010) and Telefónica de España, S.A.U. for 32 million euros (20 million euros in 2010).

(16) DERIVATIVE FINANCIAL INSTRUMENTS AND RISK MANAGEMENT POLICIES

a) Derivative financial instruments

During 2011, the Group continued to use derivatives to limit interest and exchange rate risk on otherwise unhedged positions, and to adapt its debt structure to market conditions.

At December 31, 2011, the total outstanding balance of derivatives transactions was 141,155 million euros (102,008 million euros at December 31, 2010), of which 119,772 million euros related to interest rate risk and 21,383 to foreign currency risk. In 2010 81,470 million euros related to interest rate risk and 20,538 million euros to foreign currency risk.

It should be noted that at December 31, 2011, Telefónica, S.A. was not a party to any transaction with financial institutions to hedge interest-rate risk for other Telefónica Group companies; however, it was a party to transactions worth 696 million euros to hedge exchange rate risk in behalf of other Group companies. In 2010, trades of this nature amounted to 38 million euros for interest rate risk and 987 million euros for exchange rate risk. These external trades are matched by intra-group hedges with identical terms and maturities between Telefónica, S.A. and Group companies, and therefore involve no risk for the Company. External derivatives not backed by identical intragroup transactions consist of hedges on net investment and future acquisitions that, by their nature, cannot be transferred to Group companies and/or transactions to hedge

financing raised by Telefónica, S.A. as parent company of the Telefónica Group, which are transferred to Group subsidiaries in the form of financing rather than via derivative transactions.

The breakdown of Telefónica, S.A.'s interest-rate and exchange-rate derivatives at December 31, 2011, their notional amounts at year end and the expected maturity schedule is as follows:

2011					
Type of risk <i>Millions of euros</i>	Value in Euros	Telefónica receives		Telefónica pays	
		Carrying	Currency	Carrying	Currency
Euro interest rate swaps	92,082				
<i>Fixed to fixed</i>	2,078	2,078	EUR	2,078	EUR
<i>Fixed to floating</i>	21,812	21,812	EUR	21,812	EUR
<i>Floating to fixed</i>	63,977	63,977	EUR	63,977	EUR
<i>Floating to floating</i>	4,215	4,215	EUR	4,215	EUR
Foreign currency interest rate swaps	19,971				
<i>Fixed to floating</i>					
GBP/GBP	2,412	2,015	GBP	2,015	GBP
JPY/JPY	220	22,000	JPY	22,000	JPY
USD/USD	14,385	18,612	USD	18,612	USD
<i>Floating to fixed</i>					
GBP/GBP	909	760	GBP	760	GBP
USD/USD	2,045	2,446	USD	2,446	USD
Exchange rate swaps	12,422				
<i>Fixed to fixed</i>					
EUR/BRL	331	318	EUR	804	BRL
EUR/CLP	131	112	EUR	87,800	CLP
EUR/CZK	606	631	EUR	15,641	CZK
<i>Fixed to floating</i>					
MAD/EUR	88	1,000	MAD	88	EUR
JPY/EUR	95	15,000	JPY	95	EUR
<i>Floating to fixed</i>					
EUR/MAD	90	90	EUR	1,000	MAD
<i>Floating to floating</i>					
EUR/CZK	319	322	EUR	8,228	CZK
EUR/GBP	484	588	EUR	405	GBP
JPY/EUR	244	37,000	JPY	244	EUR
USD/EUR	10,034	13,482	USD	10,034	EUR
Forwards	6,820				
ARS/USD	-	2	ARS	1	USD
CLP/EUR	147	101,490	CLP	147	EUR
CZK/EUR	5	125	CZK	5	EUR
EUR/BRL	18	17	EUR	44	BRL
EUR/CZK	556	567	EUR	14,335	CZK
EUR/GBP	941	933	EUR	786	GBP
EUR/MXN	2	2	EUR	35	MXN
EUR/USD	1,690	1,625	EUR	2,186	USD
GBP/EUR	2,447	2,094	GBP	2,447	EUR
GBP/USD	17	14	GBP	22	USD
USD/ARS	1	1	USD	6	ARS
USD/BRL	168	224	USD	408	BRL
USD/CLP	11	14	USD	7,183	CLP
USD/COP	1	1	USD	2,756	COP
USD/EUR	763	1,014	USD	763	EUR
USD/GBP	53	69	USD	44	GBP
USD/PEN	-	-	USD	1	PEN
Spot	1				
MXN/EUR	1	17	MXN	1	EUR
USD/EUR	-	-	USD	-	EUR
Subtotal	131,296				

<i>(Millions of euros)</i> Notional amounts of structured products with options	Value in euros	Notional	Currency
<i>Interest rate options</i>	7,719		
Swaptions	850	850	EUR
Caps & Floors	6,869	6,869	EUR
USD	54	69	USD
EUR	4,900	4,900	EUR
GBP	1,915	2,293	GBP
<i>Currency options</i>	2,140		
USD/EUR	2,140	2,769	USD
Subtotal	9,859		
TOTAL	141,155		

The breakdown by average maturity is as follows:

<i>(Millions of euros)</i> Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	536	56	280	-	200
Loans	37,993	22,567	1,794	3,430	10,202
In national currency	33,911	21,447	1,400	2,950	8,114
In foreign currencies	4,082	1,120	394	480	2,088
Debentures and bonds	80,299	16,439	13,181	23,220	27,459
In national currency	34,446	7,014	7,951	9,145	10,336
In foreign currencies	45,853	9,425	5,230	14,075	17,123
Otros subyacentes*	22,327	8,979	5,343	2,499	5,506
Swaps	10,767	1,045	4,871	1,999	2,852
Swaptions	850	850	-	-	-
Currency options	2,140	283	138	160	1,559
Forwards	6,820	6,801	19	-	-
IRS	1,750	-	315	340	1,095
Total	141,155	48,041	20,598	29,149	43,367

* Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

The breakdown of Telefónica, S.A.'s derivatives in 2010, their fair value at year end and the expected maturity schedule is as follows:

2010					
Type of risk <i>Millions of euros</i>	Value in Euros	Telefónica receives		Telefónica pays	
		Carrying	Currency	Carrying	Currency
Euro interest rate swaps	56,424				
<i>Fixed to fixed</i>	55	55	EUR	55	EUR
<i>Fixed to floating</i>	18,290	18,290	EUR	18,290	EUR
<i>Floating to fixed</i>	37,987	37,984	EUR	37,984	EUR
<i>Floating to floating</i>	92	92	EUR	92	EUR
Foreign currency interest rate swaps	17,325				
<i>Fixed to floating</i>	14,261				
GBP/GBP	1,801	1,550	GBP	1,550	GBP
JPY/JPY	138	15,000	JPY	15,000	JPY
USD/USD	12,322	16,465	USD	16,465	USD
<i>Floating to fixed</i>	3,064	-		-	
GBP/GBP	1,098	945	GBP	945	GBP
USD/USD	1,966	2,628	USD	2,628	USD
Exchange rate swaps	11,122				
<i>Fixed to fixed</i>	621				
EUR/BRL	129	107	EUR	288	BRL
EUR/CLP	140	112	EUR	87,800	CLP
EUR/CZK	352	352	EUR	8,818	CZK
<i>Fixed to floating</i>	183				
JPY/EUR	95	15,000	JPY	95	EUR
MAD/EUR	88	1,000	MAD	88	EUR
<i>Floating to fixed</i>	143				
EUR/MAD	89	90	EUR	1,000	MAD
USD/ARS	54	90	USD	285	ARS
<i>Floating to floating</i>	10,175				
EUR/CZK	328	322	EUR	8,228	CZK
EUR/GBP	1,098	1,373	EUR	945	GBP
JPY/EUR	178	30,000	JPY	178	EUR
USD/EUR	8,571	11,395	USD	8,570	EUR
Forwards	7,375				
EUR/BRL	12	11	EUR	27	BRL
EUR/CZK	697	705	EUR	17,457	CZK
EUR/GBP	961	984	EUR	828	GBP
EUR/MXN	2	2	EUR	36	MXN
EUR/USD	1,576	1,571	EUR	2,106	USD
GBP/EUR	2,247	1,927	GBP	2,246	EUR
GBP/USD	26	23	GBP	35	USD
USD/BRL	144	185	USD	320	BRL
USD/CLP	-	1	USD	274	CLP
USD/COP	-	-	USD	246	COP
USD/EUR	818	1,094	USD	818	EUR
USD/GBP	70	94	USD	60	GBP
USD/MXN	548	727	USD	9,039	MXN
MXN/USD	274	4,519	MXN	366	USD
Spot	1				
MXN/EUR	1	23	MXN	1	EUR
Subtotal	92,247				

<i>(Millions of euros)</i>			
Notional amounts of structured products with options	Value in euros	Notional	Currency
Interest rate options Caps & Floors	7,721		
USD	62	83	USD
EUR	5,800	5,800	EUR
GBP	1,859	1,600	GBP
Currency options	2,040		
USD/EUR	2,040	2,725	USD
Subtotal	9,761		
TOTAL	102,008		

The breakdown by average maturity is as follows:

<i>(Millions of euros)</i> Hedged underlying item	Notional	Up to 1 year	From 1 to 3 years	From 3 to 5 years	Over 5 years
With underlying instrument					
Promissory notes	587	51	56	280	200
Loans	26,170	11,469	6,350	2,586	5,765
In national currency	23,485	11,394	5,177	2,400	4,514
In foreign currencies	2,685	75	1,173	186	1,251
Debentures and bonds					
MtM	55,231	10,662	5,423	11,195	27,951
In national currency	22,080	4,666	2,092	6,791	8,531
In foreign currencies	33,151	5,996	3,331	4,404	19,420
Without underlying*	20,020	8,795	3,212	3,685	4,328
Swaps	10,615	1,297	3,024	3,524	2,770
Spots	1	1	-	-	-
Currency options	2,040	183	138	161	1,558
Forwards	7,364	7,314	50	-	-
Total	102,008	30,977	15,041	17,746	38,244

* Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and provisions for restructuring plans.

The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

The fair value of Telefónica, S.A.'s derivatives portfolio with external counterparties at December 31, 2011 was equivalent to a net asset of 2,229 million euros (net asset of 1,626 million euros in 2010).

b) Risk management policy

Telefónica, S.A. is exposed to various financial market risks as a result of: (i) its ordinary business activity, (ii) debt incurred to finance its business, (iii) its investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting Telefónica are as follows:

1. Exchange rate risk

Foreign currency risk primarily arises in connection with: (i) Telefónica's international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom and the Czech Republic), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.

2. Interest rate risk

Interest rate risk arises primarily in connection with changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of liabilities at fixed interest rates.

3. Share price risk

Share price risk arises primarily from changes in the value of the equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the

value of derivatives associated with such investments, from changes in the value of treasury shares and from equity derivatives.

Telefónica, S.A. is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, Telefónica is exposed to country risk (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica, S.A. operates, especially in Latin America.

Telefónica, S.A. actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and investments. In this way, Telefónica attempts to protect its solvency, facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understanding its debt position. Net debt and net financial debt take into account the impact of the Group's cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of liquidity.

Exchange rate risk

The fundamental objective of the exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by the businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of debt denominated in such currencies. The degree of exchange rate hedging employed varies depending on the type of investment.

At December 31, 2011, net debt in Latin American currencies was equivalent to approximately 7,953 million euros. However, the Latin American currencies in which this debt is denominated is not distributed in proportion to the cash flows generated in each currency. The future effectiveness of the strategy described above as a hedge of exchange rate risks therefore depends on which currencies depreciate relative to euro.

The Telefónica Group aims to protect itself against declines in Latin American currencies relative to the euro affecting asset values through the use of dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

Telefónica's target is to preserve the same ratio of sterling-denominated net debt to OIBDA as the ratio of net debt to OIBDA for Telefónica as a whole so as to limit sensitivity to the sterling to euro and sterling to Czech crown exchange rates. This objective is similar to that described for the investment in the UK: the amount of Czech

crown-denominated debt is proportional to the OIBDA of the “Telefónica Europa” business unit in the Czech Republic. Czech crown-denominated net debt at December 31, 2011 was 1.7 times OIBDA in Czech crown (1.6 times in 2010) on a consolidated basis and 2.55 times (2.3 times in 2010) on a proportional basis. Both were below the Telefónica Group’s net debt to OIBDA ratio in 2011.

The Telefónica Group also manages exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether there are open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

As Telefónica’s direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2011 were constant during 2012 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that consolidated exchange losses recorded for 2012 would be 111 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to a decrease in finance costs of 89 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

Interest rate risk

The Telefónica Group’s financial expenses are exposed to changes in interest rates. In 2011, the rates applied to the largest amount of short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest-rate options.

Telefónica analyzes its exposure to changes in interest rates at the Telefónica Group level. The table illustrates the sensitivity of finance costs and the balance sheet to variability in interest rates at Group and Telefónica, S.A. level.

To calculate the sensitivity of the income statement, a 100 basis point rise in interest rates in all currencies in which there are financial positions at December 31, 2011 has been assumed, as well as a 100 basis point decrease in all currencies except the US dollar and pound sterling, in order to avoid negative rates. The constant position equivalent to that prevailing at the end of 2011 has also been assumed.

To calculate the sensitivity of equity to variability in interest rates, a 100 basis point increase in interest rates in all currencies and terms in which there are financial positions at December 31, 2011 was assumed, as well as a 100 basis point decrease in all currencies and terms. Cash flow hedge positions were also considered as they are, in the main, the only positions where changes in market value due to interest-rate fluctuations are recognized in equity.

	Impact on consolidated result (*)	Impact on Telefónica SA individual income statement (*)	Impact on consolidated equity	Impact on Telefónica SA individual equity
+100bp	(141)	(32)	779	779
-100bp	147	39	(849)	(849)

(*) Impact on results of 100 bp change in all currencies, except the pound sterling and the dollar.

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

According to the Telefónica, S.A. share option plan, Performance Share Plan (PSP) and the Performance & Investment Plan (PIP) (see Note 19), the shares to be delivered to employees under such plan may be either the parent company treasury shares, acquired by them or any of its Group companies; or newly issued shares. The possibility of delivering shares to beneficiaries of the plan in the future, in accordance with relative total shareholders' return, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each phase, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each phase if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for ordinary shareholders as a result of the higher number of shares delivered under such plan outstanding.

To reduce the risk associated with variations in share price under these plans, Telefónica has acquired financial instruments that replicate the risk profile of some of the shares deliverable under the plan as explained in Note 19.

During 2010, an incentive plan for Group employees to purchase Telefónica shares, approved at the Ordinary General Shareholders' Meeting of 2009, was initiated. The cost of this plan will not exceed 50 million euros, as agreed in the aforementioned Ordinary General Shareholders' Meeting (see Note 19 for further details).

In addition, the Group may use part of the treasury shares of Telefónica, S.A. held at December 31, 2011 to cover shares deliverable under the PSP or the PIP. The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A.'s share price.

Liquidity risk

The Telefónica Group seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The Telefónica Group's average maturity of net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle is considered as a guideline when managing debt and access to credit markets, but not a rigid requirement. When calculating the average maturity for the net financial debt and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities,

and extension options on some financing facilities may be considered as exercised, for calculation purposes.

2. The Telefónica Group must be able to pay all commitments over the next 12 months without accessing new borrowing or tapping the capital markets (although drawing upon firm credit lines arranged with banks), assuming budget projections are met.

Country risk

The Telefónica Group managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in the Telefónica Group's Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

As a general rule, the Telefónica Group trades in derivatives with creditworthy counterparties. Therefore, Telefónica, S.A. generally trades with credit entities whose "senior debt" ratings are of at least "A". In Spain, where most of the Group's derivatives portfolio is held, there are netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. In addition, since Lehman went bankrupt, the credit ratings of rating agencies has proved to be less effective as a credit risk management tool. Therefore, the 5-year CDS (Credit Default Swap) of credit institutions has been added. This way, the CDS of all the counterparties with which Telefónica S.A. operates is monitored at all times in order to assess the maximum allowable CDS for operating at any given time. Transactions are generally only carried out with counterparties whose CDS is below the threshold.

For other subsidiaries, particularly those in Latin America, given the stable sovereign rating provides a ceiling and is below A, trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, the Telefónica Group places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually. Counterparties are chosen according to criteria of liquidity, solvency and diversification based on the conditions of the market and countries where the Group operates. The general framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); (ii) the maximum tenor of the investment, set at 180 days; and (iii) the instruments in which the surpluses may be invested (money-market instruments).

The Telefónica Group considers managing commercial credit risk as crucial to meeting its sustainable business and customer base growth targets in a manner that is consistent with its risk-management policy.

This is based on continuous monitoring of the risk assumed and the resources necessary to optimize the risk-reward ratio in its operations. Particular attention is given to those clients that could cause a material impact on the Group's consolidated financial

statements for which, depending on the segment and type of relation, hedging instruments or collateral may be required to mitigate exposure to credit risk.

All Group companies adopt policies, procedures, authorization guidelines, and homogeneous management practices, in consideration of the particularities of each market and best international practices, and incorporating this commercial credit risk management model into the Group's decision making processes, both from a strategic and day to day operating perspective, which risk assessment guides the commercial offering available for the various credit profiles.

Telefónica's maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 8 and 9) and the guarantees given by Telefónica.

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2011, these guarantees amounted to approximately 239 million euros.

Capital management

Telefónica's corporate finance department, which is in charge of Telefónica's capital management, takes into consideration several factors when determining Telefónica's capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC. Telefónica also uses a net financial debt ratio below 2.35x OIBDA in the medium term (excluding items of a non-recurring or exceptional nature), enabling to obtain and maintain the desired credit rating over the medium term, and with which the Telefónica Group can match the potential cash flow generation with the alternative uses that could arise at all times.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, or the volatility in cash flow generation, when determining the Telefónica Group's financial structure.

Derivatives policy

Telefónica's derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.
- Matching the company contracting the derivative and the company that owns the underlying.
- Ability to measure the derivative's fair value using the valuation systems available to the Telefónica Group.
- Sale of options only when there is an underlying exposure.
- Hedge accounting

Hedges can be of three types:

- Fair value hedges

- Cash flow hedges, which can be set at any value of the risk to be hedged (primarily interest rate and foreign currency) or for a defined range through options.
- Hedges of net investment in a foreign operation.

Hedges can comprise a combination of different derivatives. There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our share capital. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model.

Risk management guidelines are issued by the Corporate Finance Department. This department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

In 2011, the Company recognized a loss of 0.3 million euros for the ineffective part of cash flow hedges (3.8 million euros in 2010).

The breakdown of the Company's derivatives with counterparties not belonging to the Telefónica Group at December 31, 2011 and December 31, 2010 by type of hedge, their fair value at year end and the expected maturity schedule is as follows:

2011 Derivatives	<i>(Millions of euros)</i>					
	Fair value (**)	Notional amount MATURITIES (*)				
		2012	2013	2014	Subsequent years	Total
Interest rate hedges	(58)	(1,536)	793	(824)	8,232	6,665
Cash flow hedges	880	(1,040)	1,189	(350)	10,992	10,791
Fair value hedges	(938)	(496)	(396)	(474)	(2,760)	(4,126)
Exchange rate hedges	(947)	194	239	-	6,482	6,915
Cash flow hedges	(947)	194	239	-	6,482	6,915
Fair value hedges	-	-	-	-	-	-
Interest and exchange rate hedges	(656)	(44)	1,154	72	2,099	3,281
Cash flow hedges	(656)	(44)	1,154	72	2,099	3,281
Fair value hedges	-	-	-	-	-	-
Hedge of net investment	(141)	(546)	(160)	(230)	(1,152)	(2,088)
Derivatives not designated as hedges	(427)	8,209	(441)	(194)	(1,576)	5,998
Interest rate	(234)	7,855	(579)	(144)	(2,404)	4,728
Exchange rate	(208)	445	138	(50)	828	1,361
Interest and exchange rate	15	(91)	-	-	-	(91)

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

2010	<i>(Millions of euros)</i>					
	Fair value (**)	Notional amount MATURITIES (*)				
		2011	2012	2013	Subsequent years	Total
Derivatives						
Interest rate hedges	(353)	(5,998)	60	(2,084)	7,170	(852)
Cash flow hedges	267	(3,652)	556	(438)	8,487	4,953
Fair value hedges	(620)	(2,346)	(496)	(1,646)	(1,317)	(5,805)
Exchange rate hedges	(409)	854	112	577	4,323	5,866
Cash flow hedges	(409)	854	112	577	4,323	5,866
Fair value hedges	-	-	-	-	-	-
Interest and exchange rate hedges	(223)	27	130	926	2,004	3,087
Cash flow hedges	(223)	27	130	926	2,004	3,087
Fair value hedges	-	-	-	-	-	-
Hedge of net investment	(288)	(1,770)	-	(160)	(980)	(2,910)
Derivatives not designated as hedges	(367)	4,453	316	(289)	(478)	4,002
Interest rate	(238)	4,415	426	(427)	(1,316)	3,098
Exchange rate	(115)	106	(109)	138	838	973
Interest and exchange rate	(14)	(68)	(1)	-	-	(69)

(*) For interest rate hedges, the positive amount is in terms of fixed "payment." For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

(17) INCOME TAX

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated tax group in 2011 comprised 48 companies. Included during the year were Wayra Investigación y Desarrollo, S.L.U., Movistar Loyalty, S.L., and Telefónica Digital Holding, S.L. All three companies were incorporated in 2011. Venturini, S.A. ceased forming part of the consolidated tax group in 2011, having been sold during the year.

Tax balances are as follows:

<i>(Millions of euros)</i>	2011	2010
Tax receivables:	2,803	2,342
<i>Deferred tax assets:</i>	<i>2,605</i>	<i>2,217</i>
Impuestos diferidos deducibles frente Hacienda Pública	124	140
Other temporary differences, assets	1,641	1,569
Long-term tax loss carryforwards	723	443
Deductions	117	65
<i>Current tax receivables (Note 10):</i>	<i>198</i>	<i>125</i>
Withholdings	52	42
Corporate income tax payable	120	66
VAT and Canary Islands general indirect tax refundable	26	17
Tax payable:	521	824
<i>Deferred tax liabilities:</i>	<i>474</i>	<i>778</i>
Deferred income tax (expense)	164	10
Other temporary differences, liabilities	310	768
<i>Current payables to public administrations (Note 18):</i>	<i>47</i>	<i>46</i>
Personal income tax withholdings	4	5
Corporate income tax payable	14	18
Withholding on investment income, VAT and other	28	10
Social security	1	13

The tax group had unused tax loss carryforwards at December 31, 2011 amounting to 4,575 million euros. These losses must be applied within 18 years.

Of this amount, 2,410 million euros gave rise to a tax credit recognized on the balance sheet in the amount of 723 million euros (443 million euros in 2010), of which 982 million euros (226 million euros in 2010) were generated by Telefónica, S.A. itself, net of the rest of the amount, which corresponded to other companies in the tax group.

Unused tax loss carryforwards relate mainly to a negative adjustment made to the taxable base for corporate income tax at Telefónica Móviles, S.A. (now Telefónica, S.A.) in 2002, amounting to 2,137 million euros and resulting from the transfer of certain holdings acquired in previous years where the market value differed from the book value at which they were recognized.

The challenging of this adjustment, which was related to the tax inspection of financial years 2001 to 2004, completed in 2008, has not had an impact on the Company's financial statements. However, the use by the Group of the tax loss carryforward is subject to a successful appeal before the Courts against the assessments arising from this inspection.

As head of the Telefónica Tax Group, in 2011 Telefónica, S.A. made no payments on account of 2011 income tax. In 2010, payments on account of the year totalled 729 million euros.

17.1 Movement in deferred tax assets and liabilities

The balances and movements in “Deferred tax assets” and “Deferred tax liabilities” for Telefónica, S.A. at December 31, 2011 and 2010 are as follows:

<i>2011</i> <i>(Millions of euros)</i>	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	443	1,709	65	2,217	778
Arising in the year	756	446	11	1,213	280
Reversal	-	(358)	-	(358)	(604)
Transfers to the tax group's net position	(476)	(32)	41	(467)	5
Other movements	-	-	-	-	15
Closing balance	723	1,765	117	2,605	474

<i>2010</i> <i>(Millions of euros)</i>	Tax credits	Temporary differences, assets	Deductions	Total deferred tax assets	Deferred tax liabilities
Opening balance	443	454	200	1,097	37
Arising in the year	-	728	40	768	19
Reversal	-	(80)	-	(80)	(15)
Transfers to the tax group's net position	-	-	(258)	(258)	-
Other movements	-	607	83	690	737
Closing balance	443	1,709	65	2,217	778

The main items for which Telefónica, S.A. recognizes temporary differences in assets and liabilities are the tax effects of impairment losses on some of its assets, principally investments in subsidiaries (see Note 8).

Deferred tax liabilities include 17 million euros corresponding to the tax amortization of goodwill generated on acquiring stakes in the Brazilian subsidiaries of Brasilcel, N.V. (see Note 8.1 c). No impact has been recognized in profit and loss, pending the final decisions on the court and administrative proceedings relating to this matter, which at year-end remained open.

In accordance with article 12.3 of the revised Spanish Income Tax Law (“TRLIS”), as well as with transitional provision 29 of that law, a positive adjustment of 248 million euros was provisionally included in the Company’s taxable income declared at 2010 year end, in connection with the decline in value of investees. Finally, using the subsidiaries’ definitive accounting records, 309 million euros was included in the income tax return. At December 31, 2011 2,489 million euros is pending inclusion for reversal of the adjustment in future periods. In 2010, the variation in equity of investees for which a provision was made amounts to 2,589 million euros.

In addition, at the 2011 year end, a decrease of 551 million euros was provisionally incorporated in the Company’s taxable income in connection with impairment of investees for tax purposes.

At December 31, 2011 3,040 million euros is pending inclusion for reversal of the adjustment in future periods.

In 2011, the variation in equity of investees for which a provision was made amounts to 13,771 million euros, primarily in respect of Brazilian companies.

17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable.

The calculation of the income tax expense and income tax payable for 2011 and 2010 is as follows.

<i>(Millions of euros)</i>	2011	2010
Accounting profit before tax	3,999	2,885
Permanent differences	(7,177)	(6,598)
Permanent differences arising from the first-time application of PGC 2007	-	210
Temporary differences:	658	2,060
Arising in the year	1,846	2,008
Arising in prior years	(1,188)	52
Tax result	(2,520)	(1,443)
Gross tax payable	(756)	(433)
Tax credits capitalized	(11)	(40)
Corporate income tax refundable	(767)	(473)
Temporary differences for tax valuation	(351)	(618)
Tax effect of first-time application of PGC 2007	-	(63)
Diferencias temporarias derivadas del proceso de consolidación fiscal	153	-
Other effects	16	(100)
Corporate income tax accrued in Spain	(949)	(1,254)
Foreign taxes	38	9
Income tax	(911)	(1,245)
Current income tax	(718)	(487)
Deferred income tax	(193)	(758)

The permanent differences relate mainly to changes in investment write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, and to dividends received from Tax Group companies or foreign companies that meet certain requirements.

In addition, they include as a permanent difference the decrease in income tax expense derived from the tax amortization of financial goodwill for foreign shareholding acquisitions made before December 21, 2007. In 2011 and 2010, this income item came to 28 million euros and 139 million euros, respectively. This impact has been lessened as a result of the entry into force of Law 9/2011, which reduced the deductible portion of goodwill amortization under article 12.5 LIS (Corporate Income Tax Act) from 5% to 1% for 2011, 2012 and 2013. The effect is temporary: the 4% not amortized over those three years (12% in total) will be recovered by extending the deduction period from the original 20 years to 22.5 years.

Temporary differences mainly comprise adjustments on eliminating the tax base of impairment provisions and reversals of investment write-downs that are not tax deductible under article 12.3 of the Income Tax Law (LIS).

In 2011 and 2010, the Company capitalized 11 million euros and 40 million euros, respectively, of tax credits. The cumulative amount at year end principally reflects tax deductions for export activities and donations to non-profit organizations (approximately 117 million euros). Given that the tax balance was a negative balance in 2011, no deductions were offset during the year.

17.3 Tax inspections and tax-related lawsuits

On September 25, 2002, tax inspections commenced at several companies included in tax group 24/90, of which Telefónica is the parent company for the years from 1998 to 2000.

The tax assessments related to this review, which included settlement agreements and imposed fines on Telefónica, were signed by the company in disagreement in October 2004 and July 2005. The total amount of these assessments was 140 million euros, corresponding to subsidiaries of the Fiscal Group.

In April 2007, Telefónica filed an administrative appeal before the National Court of Justice requesting not only the avoid of the liquidation but also the consideration of another favourable aspects that were not observed by the inspection. Throughout the process, the Company requested that the execution of the settlements and penalties appealed be suspended by providing the appropriate guarantees. On February 22, 2010, Telefónica received the notification of the ruling by the National Court of Justice dated February 4, 2010, in which it partially accepted the Company's allegations, and cancelled the imposition of penalties. On May 18, 2010, Telefónica, S.A. filed an appeal and the National Court of Justice gave Telefónica, S.A. leave to proceed with its appeal and ruled on April 5, 2010 to refer the case to the Supreme Court. In addition, on June 4, 2010, the Tax Authorities filed an appeal before the Supreme Court against one of the rulings of the National Court of Justice partially accepting Telefónica's allegations. In January 2011, Telefónica submitted a brief of opposition against that appeal.

In addition, a new tax inspection for the period 2001 to 2004 commenced in June 2006 and concluded in July 2008. The Tax Group's income tax and in addition to the above, the inspection has not accepted additional adjustments to the tax amounts considered by Telefónica which amounts to 2,137 million euros (note that consolidated financial statements are not affected by this challenging). Approximately 346 million of additional deductions related to its exporting activity were not accepted y the Tax Authorities either.

In keeping with the above, the Tax Authorities solved the contentious by commencing a new tax liquidation. Telefónica, filed an administrative appeal before the Central Administrative Economic Court, which on September 10, 2009 ruled against the interests of the Company. Telefónica filed an administrative appeal before the National Court of Justice. On April, 2010 the Company filed the claim and on April, 2010, Telefónica presented in writing its conclusions..

Additionally, in June 2010, new inspections of various companies in the 24/90 Tax Group, of which Telefónica, S.A. is the parent, were initiated. The taxes subject to review were corporate income tax for the years 2005 to 2007, VAT, tax withholdings and payments on account in respect of personal income tax, tax on investment income, property tax and non-resident income tax for the years 2006 to 2007.

Therefore, including the years under inspection, Telefónica, S.A. has all taxes since 2005 open to inspection.

In relation to the sale by Terra Networks, S.A. (now Telefónica, S.A.) of it stake in Lycos, Inc. in 2004, the Company began the necessary procedures to enable it to recognize a higher tax loss of up to 7,418 million euros as a consequence of measuring the market value of Lycos, Inc. shares received at acquisition value for tax purposes,

rather than the book value at which they were recorded, in conformity with Article 159 of the Spanish Corporation Law. However, no accounting adjustments have been recorded until the Company receives a definitive ruling on this procedure.

At 2011 year end, it is not expected that the final outcome of these assessments, lawsuits, and inspections in progress or pending for years open to inspection will require any additional significant liabilities to be recognized in Telefónica, S.A.'s financial statements.

(18) TRADE AND OTHER PAYABLES

The breakdown of "Trade and other payables" is as follows:

<i>(Millions of euros)</i>	2011	2010
Suppliers	322	411
Other payables	71	2,065
Current income tax liabilities (Note 17)	14	18
Other payables to public administrations (Note 17)	33	28
Total	440	2,522

a) Trade payables

In performance of Telefónica's irrevocable undertaking of 2010 to give Fundación Telefónica a total of 280 million euros, in 2011 the Company made cash payments in the amount of 60 million euros and, in addition, contributed real estate previously purchased from Telefónica de España, S.A.U. (see Note 8) at its arm's length value of 51 million euros.

Information on deferred payments to third parties. (Third additional provision, "Information requirement" of Law 15/2010 of 5 July).

Telefónica, S.A. has adapted its internal processes and payment schedules to the provisions of Law 15/2010, establishing measures against late payment in commercial transactions. Engagement conditions with commercial suppliers in 2011 included payment periods of up to 85 days, as laid down in said law.

For reasons of efficiency and in line with general practice in the business, the Company has set payment schedules, whereby payments are made on set days. Invoices falling due between two payment days are settled on the following payment date in the schedule. This is not deemed to be a deferred payment.

Information on contracts entered into after Law 15/2010 took effect that exceed the maximum period established in this law is shown in the table below.

Payments to Spanish suppliers in 2011 surpassing the legal limit were due to circumstances or incidents beyond the payment policies, mainly the closing of agreements with suppliers over the delivery of goods or the rendering of services, or occasional processing issues.

Millions of euros	2011	
	Amount	%
Payments made on time	254	93
Other	19	7
Total payments to commercial suppliers	273	100
Weighted average maturity exceeded (days)	52	
Deferrals at year-end that exceed the limit	2	

At the date of authorization for issue of these financial statements, Telefónica had processed the outstanding payments, except in cases where an agreement with suppliers was being handled.

b) Sundry creditors

In 2010 this line included 1,977 million euros corresponding to the value of the final payable to Portugal Telecom (2,000 million euros) for the acquisition of 50% of Brasilcel, N.V. (see Note 8.1). This debt was repaid upon maturity.

(19) REVENUE AND EXPENSES

19.1 Revenue

a) Rendering of services

In 2008, Telefónica, S.A. arranged contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2011 and 2010, "Rendering of services to Group companies" included 618 million euros and 518 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts to provide management support services to Telefónica de España, S.A.U, Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2011 and 2010 amounted to 25 million euros and 13 million euros, in each case, recognized under "Services rendered to Group companies and associates."

Operating revenues also include property rental income amounting to 52 million euros in 2011 and 43 million euros in 2010, mainly from the lease of office space in Distrito Telefónica to several Telefónica Group companies (see Note 7).

b) Dividends from Group companies and associates

The detail of the main amounts recognized in 2011 and 2010 is as follows:

<i>(Millions of euros)</i>	2011	2010
Telefónica Móviles España, S.A.U.	1,980	2,190
Telefónica de España, S.A.U.	2,430	2,827
Telefónica Europe, plc.	715	708
Vivo Participações, Ltda. and subsidiaries	553	47
Telefónica Czech Republic, a.s.	365	331
Latin American Cellular Holding, B.V.	218	65
Brasilcel, N.V.	-	82
Portugal Telecom	-	44
Telecomunicações de Sao Paulo	235	-
Sao Paulo Telecomunicações	91	-
Telefónica Móviles Argentina, S.A. y		
Telefónica Móviles Argentina Holding, S.A.	179	39
Other companies	201	141
Total	6,967	6,474

c) Interest income on loans to Group companies and associates

This heading includes the return obtained on loans made to subsidiaries to carry out their business (see Note 8.5). The breakdown of the main amounts is as follows:

<i>(Millions of euros)</i>	2011	2010
Telefónica Móviles México, S.A. de C.V.	145	188
Telefónica de España, S.A.U.	83	130
Other companies	47	60
Total	275	378

19.2 “Non-core and other current operating revenues – Group companies” relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion. The amount includes billings to Telefónica Móviles España, S.A.U., which amounted to 26 million euros and 30 million euros in 2011 and 2010, respectively, and to Telefónica de España, S.A.U., for 48 million euros in 2011 and 28 million euros in 2010.

19.3 Personnel expenses and employee benefits

The breakdown of “Personnel expenses” is as follows:

<i>(Millions of euros)</i>	2011	2010
Wages, salaries and other personnel expenses	213	165
Pension plans (Note 4.h)	12	10
Social security costs	19	18
Total	244	193

In 2011 “Wages, salaries and other personnel expenses” includes 61 million euros for estimated obligations arising from the collective labor force reduction program approved in Telefónica de España, S.A.U. and expected to be passed on to Telefónica, S.A., and for the estimated cost of certain voluntary redundancies approved in 2011 and carried out in early 2012. A balancing entry for this expense was made under “Current provisions”. In addition to these pending costs, the Company has recognized 10 million euros in connection with severance payments for terminations in 2011.

Telefónica has reached an agreement with its staff to provide an Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, of November 29, approving the revised Pension Plans and Funds Law. The features of this Plan are as follows:

- Defined contribution of 4.51% of the participating employees’ base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.
- Mandatory contribution by participants of a minimum of 2.2% of their base salary.
- Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary, Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2011, 1,717 employees had signed up for the plan (1,536 employees in 2010). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 4 million euros in each of 2011 and 2010.

In 2006, a Pension Plan for Senior Executives, wholly funded by the Company, was created and complements the previous plan and involves additional defined contributions

at a certain percentage of the executive's fixed remuneration, based on professional category, plus some extraordinary contributions depending on the circumstances of each executive, payable in accordance with the terms of the Plan.

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 8.2 million euros in 2011 (6.2 million euros in 2010).

In 2010, some executives left this Plan, leading to the recovery of part of the initial extraordinary contributions amounting to 2 million euros.

No provision was made for this plan as it has been fully externalized.

The share-based payment plans are the following:

Telefónica, S.A. share plan: "Performance Share Plan" (PSP).

At the General Shareholders' Meeting of Telefónica, S.A. on June 21, 2006, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies. Under this plan, selected participants who met the qualifying requirements were given a certain number of Telefónica, S.A. shares as a form of variable compensation.

The Plan was initially intended to last seven years. It is divided into five phases, each three years long, beginning on July 1 (the "Start Date") and ending on June 30 three years later (the "End Date"). At the start of each phase the number of shares to be awarded to Plan beneficiaries is determined based on their success in meeting targets set. The shares are delivered, assuming targets are met, at the End Date of each phase. Each phase is independent from the others. The first started on July 1, 2006 (with shares to be delivered in July 2009) and the fifth phase began on July 1, 2010 (with any shares earned being delivered from July 1, 2013).

Award of the shares is subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the three-year duration of each phase, subject to certain special conditions related to departures.
- The actual number of shares awarded at the end of each phase will depend on success in meeting targets and the maximum number of shares assigned to each executive. Success is measured by comparing the total shareholder return (TSR), which includes both share price and dividends offered by Telefónica shares, with the TSRs offered by a basket of listed telecoms companies that comprise the comparison group. Each employee who is a member of the plan is assigned at the start of each phase a maximum number of shares. The actual number of shares awarded at the end of the phase is calculated by multiplying this maximum number by a percentage reflecting their success at the date in question. This will be 100% if the TSR of Telefónica is equal to or better than that of the third quartile of the Comparison Group and 30% if Telefónica's TSR is in line with the average. The percentage rises linearly for all points between these two benchmarks. If the TSR is below average no shares are awarded.

June 30, 2010 marked the end of the second phase of this plan, which entailed the following maximum number of shares allocated:

	Number of shares	Unit fair value	End date
2 nd phase July 1, 2007	5,556,234	7.70	June 30, 2010

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

	Number of shares	Unit fair value	End date
2 nd phase July 1, 2007	1,102,711	7.70	June 30, 2010

With the maturity of the second phase of the plan on June 30, 2010 a total of 2,964,437 shares (corresponding to a total of 4,091,071 gross shares less a withholding of 1,132,804 shares at the choice of employees) were delivered to Telefónica Group directors included in the second phase. The shares delivered were deducted from the Company's treasury shares in 2010 (see Note 11.1.a). The total net shares delivered to Telefónica, S.A. managers and executives were 816,893.

The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 7.7 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under "Reserves" for an amount of 15 million euros in 2010.

June 30, 2011 marked the end of the third phase of this plan, which entailed the following maximum number of shares allocated

	Number of shares	Unit fair value	End date
3 rd phase July 1, 2008	5,286,980	8.39	June 30, 2011

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

	Number of shares	Unit fair value	End date
3 rd phase July 1, 2008	1,248,067	8.39	June 30, 2011

With the maturity of the third phase of the plan on June 30, 2011 a total of 2,900,189 shares (corresponding to a total of 4,166,304 gross shares less a withholding of 1,266,115 shares at the choice of employees) were delivered to Telefónica Group Directors. The shares delivered were deducted from the Company's treasury shares in 2011 (see Note 11.1.a). The total net shares delivered to Telefónica, S.A. managers and executives were 922,266.

The third phase of the Plan was partially covered through two financial instruments relating to 2,446,104 shares at a cost of 10.18 euros per share. The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 8.39 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under “Reserves” for an amount of 19 million euros in 2011.

The maximum numbers of shares allotted at the beginning of each phase, and during each of the two phases that were outstanding at December 31, 2011, for the Telefónica Group as a whole, were as follows:

	No. of shares assigned	No. of shares outstanding at Dec 31, 2011	Unit fair value	End date
4th phase July 1, 2009	6,356,597	5,407,401	8.41	June 30, 2012
5th phase July 1, 2010	5,025,657	4,684,289	9.08	June 30, 2013

Of the total number of shares allotted and outstanding at year-end, those corresponding to Telefónica, S.A. employees, by phase, are as follows:

	No. of shares assigned	No. of shares outstanding at Dec 31, 2011	Unit fair value	End date
4th phase July 1, 2009	1,555,382	1,528,883	8.41	June 30, 2012
5th phase July 1, 2010	1,249,407	1,296,953	9.08	June 30, 2013

This plan is equity-settled via the delivery of shares to the executives, with a balancing entry for the 15 million euros of employee benefits expense recorded in 2011 (11 million euros in 2010) in equity, net of the related tax effect.

The cost of the shares granted to employees of Group subsidiaries is recognized under “Reserves” and amounted to 53 million euros in 2011 (52 million euros in 2010). As Telefónica, S.A. will reinvoice these amounts to its subsidiaries at the maturity of the phases, the related receivable is recognized under “Other non-current financial assets (phase V) and “Other current financial assets” (phase IV) (see Note 8.6).

For the fourth phase of the Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument was 36 million euros, equivalent to 8.41 euros per option (see Note 9.4.1).

Telefónica, S.A. share plan: “Global Employee Share Plan” (GESP)

At the June 23, 2009 General Shareholders' Meeting of Telefónica, S.A. , the shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees of the Telefónica Group worldwide, with certain exceptions. Under this plan, participants who met the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, with this company assuming the obligation of giving participants a certain number of Telefónica, S.A. shares free of charge.

The initial duration of the plan is intended to be two years. Employees subscribed to the plan can acquire Telefónica, S.A. shares through monthly installments of up to 100 euros (or the local currency equivalent), up to a maximum of 1,200 euros over a twelve-month period of (acquisition period). The delivery of shares will occur, where applicable, when the plan is consolidated, as of September 1, 2012, subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the two-year duration of the plan (consolidation period), subject to certain special conditions related to departures.
- The actual number of shares to be delivered at the end of the consolidation period will depend on the number of shares acquired and retained by each employee. Each employee who is a member of the plan, has remained a Group employee, and has retained the shares acquired for an additional twelve-month period after the acquisition date, will be entitled to receive one free share per share acquired and retained at the end of the consolidation period.

The acquisition period started in August 2010, and at December 31, 2011, 37,230 Telefónica Group employees were members of this plan (41,152 in 2010). This plan will be equity-settled via the delivery of shares to the employees. Accordingly, a balancing entry for the employee benefits expenses was made in equity. In 2011, Telefónica, S.A. recognized an expense of 316 thousand euros for this item in its income statement (158 thousand euros in 2010).

Long-term incentive plan based on Telefónica, S.A. shares: “Performance and Investment Plan”

At the General Shareholders' Meeting held on May 18, 2011, a new long-term share-based incentive plan called “Performance and Investment Plan” (the “Plan” or “PIP”) was approved for Telefónica Group directors and executive officers. This plan will take effect following completion of the Performance Share Plan.

Under this Plan, a certain number of shares of Telefónica, S.A. will be delivered to plan participants selected by the Company who decide to participate on compliance with stated requirements and conditions.

The Plan lasts five years and is divided into three independent three-year phases (i.e. delivery of the shares for each three-year phase three years after the start date). The first phase began on July 1, 2011 (with the delivery of the related shares from July 1, 2014). The second phase will begin on July 1, 2012 (with delivery of the related shares from July 1, 2015). The third phase will begin on July 1, 2013 (with delivery of the related shares from July 1, 2016).

The specific number of Telefónica, S.A. shares deliverable within the maximum amount established to each member at the end of each phase will be contingent and based on the Total Shareholder Return (“TSR”) of Telefónica, S.A. shares (from the reference value)

throughout the duration of each phase compared to the TSRs of the companies included in the Dow Jones Global Sector Titans Telecommunications Index. For the purposes of this Plan, these companies make up the comparison group (“Comparison Group”).

The TSR is the indicator used to determine the Telefónica Group’s medium- and long-term value generation, measuring the return on investment for each shareholder. For the purposes of this Plan, the return on investment of each phase is defined as the sum of the increase or decrease in the Telefónica, S.A. share price and dividends or other similar items received by the shareholder during the phase in question.

At the beginning of each phase, each Participant is allocated a notional number of shares. The number of shares to be delivered under the Plan is expected to range from:

- 30% of the number of notional shares if Telefónica, S.A.’s TSR is at least equal to the Comparison Group’s median, and
- 100% if Telefónica, S.A.’s TSR is within the third quartile or higher than the Comparison Group’s. The percentage is calculated using linear interpolation when it falls between the median and third quartile.
- No shares will be delivered if Telefónica, S.A.’s TSR is below the Comparison Group’s median.

The Plan includes an additional condition regarding compliance by all or part of the Participants with a target investment and holding period of Telefónica, S.A. shares through each phase (“Co-Investment”), to be determined for each participant, as appropriate, by the Board of Directors based on a report by the Nominating, Compensation and Corporate Governance Committee. Participants meeting the co-investment requirement will receive an additional number of shares, provided the rest of the requirements established in the Plan are met.

In addition, and independently of any other conditions or requirements that may be established, each in order to be entitled to receive the corresponding shares, each Participant must be a Telefónica Group employee at the delivery date for each phase, except in special cases as deemed appropriate. Shares will be delivered at the end of each phase (i.e., in 2014, 2015, and 2016, respectively). The specific delivery date will be determined by the Board of Directors or the committee or individual entrusted by the Board to do so.

The shares to be delivered to Participants, subject to compliance with the pertinent legal requirements in this connection, may be either (a) treasury shares in Telefónica, S.A. acquired by Telefónica, S.A. itself or by any of the Telefónica Group companies; or (b) newly-issued shares.

The first allocation of shares under this plan was made on July 1, 2011. The maximum number of shares assigned (including the amount of co-investment) under the Plan at December 31, 2011 is as follows:

	No. of shares assigned	Unit fair value	End date
1st phase July 1, 2011	5,545,628	8.28	June 30, 2014

In connection with the PIP Plan, Telefónica, S.A. acquired an instrument from a financial institution with the same features of the plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4 million shares). The cost of the financial instrument was 37 million euros, equivalent to 9.22 euros per option (see Note 9.4.1).

“Restricted Share Plan” (RSP)

At Telefónica, S.A.’s General Shareholders’ Meeting held on May 18, 2011, the Company approved the roll-out of the Restricted Share Plan (RSP), a long-term share-based incentive plan with two primary aims: (a) to retain and motivate certain high-potential employees, and (b) to retain key personnel upon new acquisitions, providing them with an ownership interest in the Company through rights convertible to shares.

The RSP is established for a five-year period, with independent deliveries permitted at any time between 2011 and 2015. At each delivery date the Company extends certain Restricted Share Units (RSUs) carrying the right to automatically receive the same number of Telefónica, S.A. shares at the end of the vesting period, subject to compliance with certain length-of-service requirements.

Delivery of shares is conditional on compliance with certain service-related conditions, namely:

1. Final delivery: participants must have been employed by the Company continuously from the grant date to the conversion date
2. Final delivery: participants must have worked for a minimum period of 12 months within the vesting period
3. The specific duration of the vesting period will be set on a case-by-case basis.

At December 31, 2011 Telefónica, S.A. had carried out only one RSU delivery. Consequently, the cost of this plan is not significant in the income statement.

19.4 Average number of employees in 2011 and 2010 and number of employees at year-end:

2011 Professional category	Employees at 12/31/11			Average no. of employees in 2011		
	Females	Males	Total	Females	Males	Total
General managers and chairmen	-	4	4	-	4	4
Directors	41	147	188	40	138	178
Managers	95	131	226	91	112	203
Project Managers	97	153	250	89	125	214
University graduates and experts	93	54	147	89	50	139
Administration, clerks, advisors	158	20	178	160	20	180
Total	484	509	993	469	449	918

2010 Professional category	Employees at 12/31/10			Average no. of employees in 2010		
	Females	Males	Total	Females	Males	Total
General managers and chairmen	-	5	5	-	5	5
Directors	38	127	165	40	134	174
Managers	82	87	169	81	94	175
Project Managers	92	80	172	91	77	168
University graduates and experts	81	38	119	80	37	117
Administration, clerks, advisors	138	21	159	137	20	157
Total	431	358	789	429	367	796

19.5 External services

The items composing “Finance revenue” are as follows:

(Millions of euros)	2011	2010
Rent	11	15
Repairs and maintenance	4	5
Independent professional services	155	140
Bank charges	34	44
Donations (Note 18)	4	333
Marketing and advertising	86	77
Utilities	12	12
Other expenses	84	51
Total	390	677

On December 19, 2007, Telefónica, S.A. signed a rental contract with a view to establishing the headquarters of the “Telefónica Corporate University.” The contract included construction and refurbishment of certain facilities by the lessor. On October 31, 2008, some of the facilities were partially accepted and thus the lease period commenced. The lease period is for 15 years (until 2023), renewable for another five.

Future minimum rentals payable under non-cancellable leases without penalization at December 31, 2011 and 2010 are as follows:

(Millions of euros)	2011		2010	
	Future minimum payments	Present value	Future minimum payments	Present value
Up to one year	5		6	
Between one and five years	19		19	
More than five years	32		37	
Total	56	40	62	46

19.6 Finance revenue

The items composing “Finance revenue” are as follows:

<i>(Millions of euros)</i>	2011	2010
Dividends from other companies	38	37
Other finance revenue	101	187
Total	139	224

“Other finance revenue” includes the 48 million euros in gains accrued from the equity swap contracts on the share price of Portugal Telecom (57 million euros in 2010).

19.7 Finance costs

The breakdown of “Finance costs” is as follows:

<i>(Millions of euros)</i>	2011	2010
Interest on borrowings from Group companies and associates	1,872	1,791
Finance costs payable to third parties and gains (losses) on interest rates of financial hedges	247	21
Total	2,119	1,812

The breakdown by Group company of debt interest expenses is as follows:

<i>(Millions of euros)</i>	2011	2010
Telefónica Europe, B.V,	373	454
Telefónica Emisiones, S,A,U,	1,395	1,286
Other companies	104	51
Total	1,872	1,791

Other companies includes financial costs with Telefónica Finanzas, S.A.U. related to current payables for specific cash needs. In 2011, more withdrawals of funds were made in this way and therefore the attendant financial charge increased.

19.8 Exchange differences:

The breakdown of exchange losses recognized in the income statement is as follows:

<i>(Millions of euros)</i>	2011	2010
On current operations	26	-
On loans and borrowings	982	1,161
On hedging derivatives	927	1,019
On other items	40	24
Total	1,975	2,204

The breakdown of exchange gains recognized in the income statement is as follows:

<i>(Millions of euros)</i>	2011	2010
On current operations	3	20
On loans and borrowings	251	408
On hedging derivatives	1,567	1,834
On other items	16	64
Total	1,837	2,326

The change in exchange gains and losses in 2011 was due mainly to fluctuations in the dollar/euro exchange rate with the dollar losing 3.27% (the dollar rose 7.2% in 2010) and in the pound sterling/euro exchange with the pound sterling falling by 3.05% (the pound gained 3.18% in 2010), which was offset by the effect of hedges arranged for this purpose.

19.9 Impairment and gains (losses) on disposal of financial instruments

At year end, the values of the investments in Group companies and associates were reviewed based on the calculations of their future discounted cash flows. These reviews lead to the recognition of an impairment provision amounting to 1,606 million euros (in 2010, a charge of 1,985 million euros was recognized). The amount of the charge was mainly due to (a) reversal of the impairment provision in respect of Telefónica Europe, plc. For 1,159 million euros, (b) recognition of an impairment of the interest in Telefónica Móviles México, S.A. de C.V., for 2,085 million euros, and (c) recognition of an impairment of the interest in Telco, S.p.A., for 629 million euros (see Note 8.2).

Revenue shown under “Gains (losses) on disposal” reflects the gains on the sale of a 25% stake in Telefónica Móviles Argentina Holding, S.A. for 511 million euros and on the partial cancellation of Portugal Telecom equity swaps, for 13 million euros. Both transactions are described in Note 8.

19.10. Impairment and gains (losses) on disposal of financial instruments with third parties

This caption reflects the 135 million euro valuation adjustment made to Telefónica, S.A.’s stake in Portugal Telecom (both the direct interest and the indirect stake held through the equity swap contracts) in view of the drop in the share price from January to October 2011 (see Note 8).

Revenue recognized under this caption relates to recovery of part of a financial provision made in 2009 upon the collapse of Lehman Brothers. The total amount recovered was 30 million euros.

(20) OTHER INFORMATION

a) Financial guarantees

At December 31, 2011, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 41,513 million euros (39,973 million euros at year-end 2010). These guarantees are measured in the Company’s financial statements as indicated in Note 4.m).

<i>(Millions of euros)</i> <i>Nominal amounts</i>	2011	2010
Debentures and bonds	33,819	31,946
Promissory notes & commercial paper	1,596	1,613
Loans and other payables	4,098	4,414
Other marketable debt securities	2,000	2,000
Total	41,513	39,973

The debentures and bonds in circulation at December 31, 2011 issued by Telefónica Emisiones, S.A.U., Telefónica Europe, B.V. and Telefónica Finanzas México, S.A. de C.V. were guaranteed by Telefónica, S.A. The nominal amount guaranteed was equivalent to 33,819 million euros at December 31, 2011 (31,946 million euros at December 31, 2010). During 2011, Telefónica Emisiones, S.A.U. and Telefonica Europe, B.V. issued debt instruments on capital markets for a nominal amount of 4,495 million euros (5,484 million euros in 2010).

The commercial paper program of Telefónica Europe, B.V. is also guaranteed by Telefónica, S.A. At December 31, 2011 the outstanding balance of commercial paper in circulation issued through this program is 1,596 million euros (1,613 million euros at December 31, 2010).

The main loans and other debts guaranteed by Telefónica, S.A. are: a syndicated loan granted to Telefónica Europe, B.V. by various institutions for the acquisition of shares in O2, Plc. in 2006, the principal of which at December 31, 2011 was equivalent to 2,965 million euros (2,945 million euros at December 31, 2010); and credit facilities obtained by Telefónica Finanzas, S.A.U. from the European Investment Bank, the outstanding principal of which at December 31, 2011 was equivalent to 824 million euros (1,171 million euros at December 31, 2010). The nominal amount of maturities in 2011 was 300 million euros.

“Other marketable debt securities” include the guarantee for preferred shares issued by Telefonica Finance USA, LLC, the redemption value of which amounts to 2,000 million euros guaranteed by Telefónica, S.A.

Telefónica, S.A. provides operating guarantees granted by external counterparties, which are offered during its normal commercial activity. At December 31, 2011, these guarantees amounted to approximately 239 million euros.

b) Litigation

Telefónica is party to several lawsuits or proceedings that are currently in progress in the law courts and administrative and arbitration bodies of the various countries in which the Telefónica Group is present.

Considering the reports of the Company’s legal advisors regarding these proceedings, it is reasonable to assume that this litigation or cases will not materially affect the financial position or solvency of Telefónica Group, regardless of the outcome.

Among unresolved cases or those underway in 2011 (see Note 17.3 for details of tax-related cases), the following are of special note:

1. Contentious proceedings in connection with the merger between Terra Networks, S.A. and Telefónica

On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. This claim was rejected via a ruling issued on September 21, 2009, and the appellants were charged for the court costs. This ruling was appealed on December 4, 2009. On June 16, 2010, Telefónica was notified of the written appeal filed by the appellants. Telefónica opposed this appeal in January 2011.

2. Appeal against the European Commission ruling of July 4, 2007 against Telefónica de España's broadband pricing policy

On July 9, 2007, Telefónica was notified of the decision issued by the European Commission ("EC") imposing a fine of approximately 152 million euros for breach of the former article 82 of EC Treaty rules by charging unfair prices between whole and retail broadband access services. The ruling charged Telefónica with applying a margin squeeze between the prices it charged competitors to provide regional and national wholesale broadband services and its retail broadband prices using ADSL technology between September 2001 and December 2006.

On September 10, 2007, Telefónica and Telefónica de España filed an appeal to overturn the decision before the General Court of the European Union. The Kingdom of Spain, as an interested party, also lodged an appeal to overturn the decision. Meanwhile, France Telecom and the Spanish Association of Bank Users (AUSBANC) filed requests to intervene, which the General Court admitted.

A hearing was held on May 23, 2011, at which Telefónica presented its case. A ruling has yet to be issued as of December 31, 2011.

3. Case before the European Commission, CE COMP 39.839 - Telefónica/Portugal Telecom

On January 5, 2011, the European Commission sent a request to Telefónica, S.A. for information on the agreements entered into with Portugal Telecom SGPS (Portugal Telecom) for the purchase of its ownership interest in Brasilcel, N.V., a joint venture in which both are venturers and which is the owner of Brazilian company Vivo Participações. On January 24, 2011, the European Commission initiated formal proceedings to investigate whether Telefónica and Portugal Telecom had infringed European Union competition law with respect to a clause contained in these agreements. After responding to a number of requests for information from the European Commission, on September 24, 2011, Telefónica received a list of charges from the European Commission. On January 13, 2012, it presented its response to the charges.

c) Commitments

Guarantee provided for Ipse 2000 S.p.A.

The Telefónica Group had provided guarantees for the Italian company Ipse 2000 S.p.A. (holder of a UMTS license in Italy and in which the Company has a stake through

Solivella B.V.) to ensure the amounts payable to the Italian government in connection with the grant of the license.

In November 2010, the last of the 10 annual payments scheduled was paid. Therefore, the guarantee expired on that day, pending the release letter from the Italian government, which was issued in 2011. The guarantee has now been entirely extinguished.

d) Directors' and senior executives' compensation and other benefits

The compensation of Telefónica, S.A.'s 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, which amount shall remain unchanged until and unless the shareholders decide to modify it. 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, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes 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 2011 amounted to 4,549,501 euros in fixed compensation and in fees for attending the Board's advisory or control committees meetings.

The compensation paid to Telefónica 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 plus fees for attending the meetings of the Board's advisory or control Committees. Board members 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.

The following table presents the fixed amounts established for membership to the Telefónica Board of Directors, Executive Commission and the advisory or control Committees:

(Amounts in euro)

Position	Board of Directors	Executive Commission	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 at each of the Advisory or Control Committee's meetings is 1,250 euros.

The following table presents the breakdown by ítem of the compensation and benefits paid by Telefónica to its directors in 2011:

(Euros)

Director	Wage/ Compensation ¹	Fixed Payment Board Committees ²	Attendance fees ³	Short-term Variable Compensation ⁴	Other items ⁵	TOTAL
Executive						
Mr. César Alierta Izuel	2,530,800	100,000	--	4,015,440	265,300	6,911,540
Mr. Julio Linares López	1,973,100	--	--	3,011,580	126,084	5,110,764
Mr. José María Álvarez-Pallete López	316,000	--	--	--	21,570	337,570
Proprietary						
Mr. Isidro Fainé Casas	250,000	100,000	--	--	10,000	360,000
Mr. Vitalino Nafría Aznar	250,000	56,000	26,250	--	--	332,250
Mr. José María Abril Pérez	150,000	122,167	13,750	--	--	285,917
Mr. Antonio Massanell Lavilla	150,000	70,000	32,500	--	10,000	262,500
Mr. Chang Xiaobing	87,500	--	--	--	--	87,500
Independent						
Mr. David Arculus	150,000	28,000	11,250	--	--	189,250
Ms. Eva Castillo Sanz	150,000	42,000	25,000	--	--	217,000
Mr. Carlos Colomer Casellas	150,000	156,000	21,250	--	130,000	457,250
Mr. Alfonso Ferrari Herrero	150,000	212,000	58,750	--	132,500	553,250
Mr. Luiz Fernando Furlán	150,000	14,000	5,000	--	--	169,000
Mr. Gonzalo Hinojosa Fernández de Angulo	150,000	198,000	48,750	--	133,750	530,500
Mr. Pablo Isla Álvarez de Tejera	150,000	75,833	13,750	--	--	239,583
Mr. Javier de Paz Mancho	150,000	156,000	11,250	--	120,000	437,250
Other external						
Mr. Fernando de Almansa Moreno- Barreda	150,000	56,000	25,000	--	10,000	241,000
Mr. Peter Erskine	150,000	156,000	27,500	--	3,750	337,250

1 **Wage/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director's actual attendance at meetings of the Board of Telefónica, S.A. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.

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.

5 **Other items:** Includes, *inter alia*, amounts paid for membership to the various regional advisory committees in Spain, and the Telefónica Corporate University Advisory Council.

It is duly noted that Mr. Vitalino Nafría Aznar tendered his resignation as Director on December 14, 2011. Appointed to replace him by the method of co-optation was Mr. Ignacio Moreno Martínez, which did not receive any compensation in this respect in 2011.

The following table presents the specific compensation paid to Directors of Telefónica for membership of the various advisory or control Committees in 2011:

Telefonica

Board Members	Audit and Control	Nomination, Compensation and Corporate Governance	Human Resources and Corporate Reputation and Responsibility	Regulation	Service Quality and Customer Service	International Affairs	Innovation	Strategy	TOTAL
Mr. César Alierta Izuel	-	-	-	-	-	-	-	-	-
Mr. Isidro Fainé Casas	-	-	-	-	-	-	-	-	-
Mr. Vitalino Manuel Nafría Aznar	26,500	-	16,500	21,500	-	17,750	-	-	82,250
Mr. Julio Linares López	-	-	-	-	-	-	-	-	-
Mr. José María Abril Pérez	-	-	-	-	-	20,250	15,667	-	35,917
Mr. José Fernando de Almansa Moreno-Barreda	-	-	-	21,500	-	34,250	-	25,250	81,000
Mr. José María Álvarez-Pallete López	-	-	-	-	-	-	-	-	-
Mr. David Arculus	-	-	-	20,250	-	19,000	-	-	39,250
Ms. Eva Castillo Sanz	-	-	-	21,500	20,250	-	-	25,250	67,000
Mr. Carlos Colomer Casellas	-	17,750	-	-	17,750	-	41,750	-	77,250
Mr. Peter Erskine	-	20,250	-	-	-	-	24,000	39,250	83,500
Mr. Alfonso Ferrari Herrero	27,750	38,000	17,750	21,500	20,250	20,250	-	25,250	170,750
Mr. Luiz Fernando Furlán	-	-	-	-	-	19,000	-	-	19,000
Mr. Gonzalo Hinojosa Fernández de Angulo	40,500	22,750	19,000	-	20,250	20,250	-	24,000	146,750
Mr. Pablo Isla Álvarez de Tejera	-	20,250	14,000	35,500	14,000	-	5,833	-	89,583
Mr. Antonio Massanell Lavilla	25,250	-	16,500	-	34,250	-	26,500	-	102,500
Mr. Francisco Javier de Paz Mancho	-	-	33,000	16,500	-	17,750	-	-	67,250
Mr. Chang Xiaobing	-	-	-	-	-	-	-	-	-
TOTAL	120,000	119,000	116,750	158,250	126,750	168,500	113,750	139,000	1,062,000

The following presents a breakdown of the amounts received from other Telefónica Group companies by Directors for discharging executive duties or for membership of the companies' governing bodies:

(Amounts in euros)

Director	Wage/ Compensation ¹	Attendance fees ²	Short-term variable compensation ³	Other items ⁴	TOTAL
Executive					
Mr. José María Álvarez-Pallete López	961,709	--	1,140,138	57,553	2,159,400
Proprietary					
Mr. Vitalino Nafría Aznar	16,737	--	--	--	16,737
Independent					
Mr. David Arculus	86,456	--	--	--	86,456
Ms. Eva Castillo Sanz	240,847	--	--	--	240,847
Mr. Alfonso Ferrari Herrero	297,275	--	--	--	297,275
Mr. Luiz Fernando Furlán	299,406	--	--	--	299,406
Mr. Javier de Paz Mancho	840,667	--	--	--	840,667
Other external					
Mr. Fernando de Almansa Moreno-Barreda	436,214	--	--	--	436,214
Mr. Peter Erskine	86,456	--	--	--	86,456

1 **Wage/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director's actual attendance at meetings of the board or analogous organ of the Telefónica Group entity in question. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.

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:** Other amounts related to pension schemes.

With respect to employee benefits, the following table presents a breakdown of internal or external contributions made in 2011 to both long-term savings schemes (including retirement and any other survival benefit) financed fully or partially by the Company for Directors, along with any other compensation in kind received by the Director during the year:

Board Members (Executive)	Contributions to pension plans	Contribution to the Pension Plan for Senior Executives ¹	Compensation in kind ²
Mr. César Alierta Izuel	8,402	1,014,791	57,955
Mr. Julio Linares López	9,468	555,033	83,923
Mr. José María Álvarez-Pallete López	7,574	355,563	17,346

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

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

Share-based payment plans information is as follows (see Note 19.3):

- (i) The "Performance Share Plan" ("PSP") approved at the General Shareholders' Meeting of June 21, 2006, whose fifth and final phase began in 2010. Under this plan, shares corresponding to the third phase were delivered in July 2011. In accordance with the general terms and conditions, a rate of 97.8% was applied to the notional number of shares assigned to each participant to determine the number of shares to deliver.

Accordingly, the shares delivered in the third phase of the PSP to the three Executive Directors were as follows: 145,544 shares to Mr. César Alierta Izuel, 99,233 shares to Mr. Julio Linares López, and 66,155 shares to Mr. José María Álvarez-Pallete López.

Meanwhile, it is laid down that the maximum number of shares for the fourth and the fifth phase of this Plan to be delivered (from July 1, 2012 and July 1, 2013), to each Executive Director of the Company, in case the covenants are met, are as follows: Mr. César Alierta Izuel (173,716 shares for the fourth phase, and 170,897 shares for the fifth phase), Mr. Julio Linares López (130,287 shares for the fourth phase, y 128,173 shares for the fifth phase), Mr. José María Álvarez-Pallete López (78,962 shares for the fourth phase, y 77,680 shares for the fifth phase); and

- (ii) The “Performance & Investment Plan” (“PIP”) approved at the General Shareholders’ Meeting of May 18, 2011. Under this plan, participants who meet qualifying requirements receive a number of Telefónica shares as variable remuneration. The first phase of this plan began in 2011, once the PSP had finished. The theoretical number of shares assigned and the maximum possible number of shares to be received by the Executive Directors in the first phase of the PIP if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met are as follows: (i) to Mr. César Alierta Izuel: 249,917 theoretical shares and a maximum of 390,496 shares; to Mr. Julio Linares López: 149,950 theoretical shares and a maximum of 234,298; and Mr. José María Álvarez-Pallete López: 79,519 theoretical shares and a maximum of 124,249 shares.

Furthermore, at the General Shareholders’ Meeting of Telefónica, S.A. on June 23, 2009, its shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees, including executives and board members, of the Telefónica Group worldwide. Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, 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.

The three board members decided to participate in this plan, contributing the maximum, i.e. 100 euros a month, over 12 months. Therefore, at the date of preparing these financial statements, the three executive Directors had acquired a total of 212 shares through this plan, whereby they are entitled to receive, free of charge, an equivalent number of shares providing that, among other conditions, they retain the acquired shares during the consolidation period (12 months from the end of the acquisition period).

It should be noted that the external Directors do not receive and did not receive in 2011 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 2011 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, S.A. as a listed company in that market.

(iii) Senior executives' compensation

Meanwhile, the seven senior executives¹ of the Company (considering the period since they are senior executives), excluding those that are also members of the Board of Directors, received a total for all items in 2011 of 12,122,954 euros. In addition, the contributions by the Telefónica Group in 2011 with respect to the Pension Plan described in Note 20 for these Directors amounted to 2,709,866 euros. Contribution to the pension plan amounted to 50,208 euros and compensation in kind including life and other insurance premiums (e.g. general medical and dental insurance) to 154,955 euros.

Meanwhile, a total of 299,377 shares corresponding to the third phase of the PSP were delivered to senior executives of the Company. In relation to the fourth and the fifth phase of the forementioned Plan, assigned to senior executives of the Company amounts to 394,779, shares for the fourth phase and 350,485 for the fifth one.

Regarding the PIP approved at the General Shareholders' Meeting of May 18, 2011, a total of 457,949 shares were assigned to all executive directors of the Company.

¹ In this context, senior executive are taken as being those individuals who, in fact or in law, perform senior management duties, reporting directly to their board of directors or executive committees or the CEOs thereof, including in all cases the Director of Internal Audit.

e) Detail of equity investments, positions held and duties performed in companies engaging in an activity that is identical, similar or complementary to that of the Company.

Pursuant to article 229 of the revised text of the Spanish Enterprise Law, introduced by Royal Legislative Decree 1/2010 of July 2, details are given below of (i) the direct and indirect interests held by members of the Board of Directors of Telefónica, S.A., and by persons related thereto as set out in article 231 of the Spanish Enterprise Law and (ii) the positions or duties carried out by those individuals, both of the foregoing in respect to companies with the same, analogous, or similar corporate purpose as that of Telefónica, S.A.

Name	Activity performed	Company	Position or functions	Stake %(*)
Mr. Isidro Fainé	Telecommunications	Abertis Infraestructuras, S.A.	Vice Chairman	< 0.01%
Mr. David Arculus	Telecommunications	British Sky Broadcasting Group, Plc.	--	< 0.01%
	Telecommunications	BT Group, Plc.	--	< 0.01%
Mr. Ignacio Moreno Martínez	Telecommunications	Conitas Comunicaciones, S.A.	Director	4.89%

(*) Shareholding of less than 0.01% of share capital indicated by "<0.01%".

Information on Board member Chang Xiaobing, Executive Chairman of China Unicom (Hong Kong) Limited, is not included in this section given that:

- in accordance with Article 26 bis of the Company's Bylaws, whereby "(...) the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (...) companies with which Telefónica, S.A. maintains a strategic alliance", Mr. Xiaobing's interests are not in conflict with those of Telefónica, S.A.
- Mr. Xiaobing holds no stakes in the capital of the companies in which he is a Board member (Article 229 of the Spanish Enterprise Law).

In addition, for information purposes, details are provided below on the positions or duties performed by members of the Board of Directors of Telefónica, S.A. in those companies whose activity is identical, similar or complementary to the corporate purpose of the Company, of any Telefónica Group company, or of any company in which Telefónica, S.A. or any of its Group companies holds a significant interest whereby it is entitled to board representation in those companies or in Telefónica, S.A.

Name	Company	Position or functions
Mr. César Alierta Izuel	Telecom Italia, S.p.A.	Director
	China Unicom (Hong Kong) Limited	Director
Mr. Julio Linares López	Telecom Italia, S.p.A.	Director
Mr. Alfonso Ferrari Herrero	Telefónica Chile, S.A.	Acting Director
	Telefónica del Perú, S.A.A.	Director

Mr. Francisco Javier de Paz Mancho	Atento Inversiones y Teleservicios, S.A.U.	Non-executive Chairman
	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
Mr. José Fernando de Almansa Moreno-Barreda	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
	Telefónica del Perú, S.A.A.	Director
	Telefónica Móviles México, S.A. de C.V.	Director
Mr. José María Álvarez-Pallete López	Telefónica Europe, Plc.	Chairman of the Board of Directors
	Telefónica Czech Republic, a.s.	Chairman of Supervisory Board
	Telefónica de Argentina, S.A.	Acting Director
	Telefónica del Perú, S.A.A.	Director
	Telefónica Datacorp, S.A.U. (*)	Director
	Telefónica Móviles Colombia, S.A.	Acting Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. María Eva Castillo Sanz	Telefónica Czech Republic, a.s.	First Vice Chairman of Supervisory Board
Mr. Chang Xiaobing	China United Network Communications Group Company Limited	Chairman
	China United Network Communications Corporation Limited	Chairman
	China Unicom (Hong Kong) Limited	Executive Chairman
	China United Network Communication Limited	Chairman

(*) On February 3, 2012, Mr. José María Álvarez-Pallete López tendered his resignation as Director of Telefónica DataCorp, S.A.U.

f) Related-party transactions

Significant shareholders

The main transactions between Telefónica, S.A. and its significant shareholders – always concluded at arm's length – are as follows:

Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries comprising the consolidated group:

- Financing transactions, with approximately 232 million euros drawn down at December 31, 2011 (323 million euros in 2010).
- Derivative transactions, for a total nominal amount of approximately 23,275 million euros at December 31, 2011 (11,062 million euros in 2010).
- Time deposits for a total nominal amount of approximately 277 million euros at December 31, 2011 (227 million euros in 2010).
- Guarantees granted by BBVA for approximately 0.6 million euros at December 31, 2011 (420 million euros in 2010).
- Dividends and other earnings distributed to BBVA in 2011 for 514 million euros (439 million euros in 2010) as a result of the 0.9% shareholding disclosed in Note 9.

Caja de Ahorros y Pensiones de Barcelona (“la Caixa”), and subsidiaries comprising the consolidated group:

- Financing transactions, with approximately 355 million euros drawn down at December 31, 2011 (291 million euros in 2010).
- Derivative transactions, for a total nominal amount of approximately 800 million euros at December 31, 2011 (800 million euros in 2010).
- Time deposits for a total nominal amount of approximately 298 million euros at December 31, 2011 (118 million euros in 2010).
- Dividends and other benefits paid to La Caixa in 2011 for 366 million euros (298 million euros in 2010).

Group companies

Telefónica, S.A. is a holding company for various investments in companies in Latin, Spain and the rest of Europe which do business in the telecommunications, media and entertainment sectors.

The balances and transactions between the Company and these subsidiaries at December 31, 2011 and 2010 are detailed in the notes to these individual financial statements.

Directors and senior executives

During the financial year to which these accompanying annual financial statements refer, the Directors and senior executives did not perform any transactions with Telefónica or any Telefónica Group company other than those in the Group’s normal trading activity and business.

Compensation and other benefits paid to members of the Board of Directors and senior executives, as well as the detail of the equity interests and positions held and duties performed in companies engaging in an activity that is identical, similar or

complementary to that of the Company are detailed in Note 20.d and e) to these financial statements.

g) Auditors' fees

The fees paid in 2011 and 2010 to the various member firms of the Ernst & Young international organization, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A. in 2011 and 2010) belongs, amounted to 4.34 million and 3.71 million euros, respectively, broken down as follows.

<i>(Millions of euros)</i>	2011	2010
Audit services	4.03	3.29
Audit-related services	0.31	0.42
TOTAL	4.34	3.71

Ernst & Young, S.L. has not provided the Company with tax advice or other services except as disclosed above.

h) Environmental matters

As head of the Telefónica Group, Telefónica, S.A. engages in environmental management activities and projects in line with its environmental strategy. In 2011 and 2010, expenditure and investment for non-material amounts were recognized in the income statement and balance sheet, respectively.

The Group has launched various projects aimed at improving current systems to reduce the environmental impact of its existing installations, with project costs being added to the cost of the installation to which the project relates.

In addition, in line with its commitment to the environment, the Group announced the creation of a Climate Change Office to provide a framework for strategic and RD&I projects in the quest for energy efficient solutions. This initiative entails the launch and implementation of solutions in each area that contribute to optimizing the Company's processes (operations, suppliers, employees, customers and society).

- In the area of operations, the main objective is to develop and implement projects that will allow for more efficient networks and systems by reducing and optimizing energy consumption.
- In the area of suppliers, active efforts are underway to include energy efficiency criteria in the purchasing process for all product lines in the Telefónica value chain.
- In the area of employees, the aim is to foster among the Company's employees a culture of respect and awareness regarding the environment and energy saving.
- In the area of customers, work is being carried out to better leverage ICTs (information and communication technologies) and increase energy efficiency with the objective of reducing carbon emissions.
- And finally, in the area of society, the objective is to promote change in citizens' behavior through Telefónica's actions.

The Group has also rolled out internal control mechanisms sufficient to pre-empt any environmental liabilities that may arise in future, which are assessed at regular intervals either by Telefónica staff or renowned third-party institutions. No significant risks have been identified in these assessments.

i) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued (see Note 16.b).

j) Contribution of business unit to Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.)

On December 14, 2011, the Board of Directors of Telefónica, S.A. authorized the contribution of the digital business unit to Telefónica Digital España, S.L., including assets, accounts receivable and accounts payable, and staff dedicated to that business. The contribution will be finally completed on April 1, 2012.

(21) CASH FLOW ANALYSIS

Profit before tax in 2011 amounted to 3,999 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in the year.

These adjustments mainly relate to:

- Impairments to investments in Group companies, associates and other investments of 1,606 million euros (impairment in 2010 of 1,985 million euros),
- Declared dividends as income in 2011 for 6,967 million euros (6,474 million euros in 2010), interest accrued on loans granted to subsidiaries of 275 million euros (378 million euros in 2010) and a net financial loss of 2,314 million euros (1,711 million euros in 2010), adjusted initially to include only movements related to cash inflows or outlooks during the year under “Other cash flows from operating activities.”

“Other cash flows from operating activities” amounted to 6,305 million euros (6,753 million euros in 2010). The main items included are:

- a) Net interest paid: Payments of net interest and other financial expenses amounted to 1,405 million euros (1,061 million euros in 2010), including:
 - net interest received from external credit entities of 130 million euros (net payments of 609 million euros in 2010), and
 - interest and hedges paid to Group companies of 1,535 million euros (452 million euros in 2010). The main interest payments in 2011 were to Telefónica Emisiones, S.A.U., for 1,365 million euros, and to Telefónica Europe, B.V., for 352 million euros, although these amounts are reduced by hedges contracted.

- b) Dividends received:

The main receipts relate to:

<i>(Millions of euros)</i>	2011	2010
Telefónica de España, S.A.U.	2,430	2,827
Telefónica Móviles España, S.A.U.	1,980	2,190
Telefónica Europe, plc.	715	708
Telefónica Czech Republic, a.s.	360	365
Vivo Participações	517	-
Telefónica Brasil, S.A. (Telesp)	151	-
Telefónica Móviles Argentina Group	179	42
Sao Paulo Telecomunicações	170	-
Other dividends received	571	489
Total	7,073	6,621

The figures disclosed are dividends recognized as revenue in 2011 (see Note 19.1) and collected in the same year.

c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them. As indicated in Note 17, no payments were made on account of income tax in 2011. In any event, taxes passed on to companies within the tax group are as follows:

- Telefónica Móviles España, S.A.U.: 235 million euros, comprising income tax for 2010. In 2010, a payment of 625 million euros was recognized, 309 million euros for 2009 corporate income tax and 316 million euros for payments on account of corporate income tax in 2010.
- Telefónica de España, S.A.U.: 369 million euros, comprising income tax for 2010. In 2010, a payment of 874 million euros was recognized, 314 million euros for 2009 corporate income tax and 560 million euros for corporate income tax in 2010.

“Payments on investments” under “Cash flows used in investing activities” included a total payment of 3,554 million euros (10,521 million euros in 2010). The main transactions to which these payments refer are as follows:

- Acquisition of 50% of Brasilcel, N.V. In October 2011 the last deferred payment for this transaction was made (see Note 18.b).
- Several capital increases for a total amount of 458 million euros, primarily in Telefónica Móviles Costa Rica for 127 million euros and in Telefónica Móviles México for 176 million euros, among others. These cash flows are disclosed fully in Note 8.1.a.
- Acquisition of bonds issued by Telefónica Emisiones, S.A.U. for 103 million euros (see Note 8.5).

This caption also includes payments in respect of share options.

In addition, “Proceeds from disposals” includes the repayment of loans granted by Telefónica, S.A. to subsidiaries, the most significant amounts of which, in 2011, were received from Telefónica de España, S.A.U. (681 million euros), Telefónica Internacional, S.A.U. (700 million euros), and Inversiones Telefónica Móviles Holding, Ltd (50 million euros). In addition, 786 million euros was received from Telefónica Internacional, S.A.U. for the sale of 25% of Telefónica Móviles Argentina Holding, S.A. (see Note 8.1.b).

In 2010 the main proceeds recognized under this heading came from Telefónica de España, S.A.U. (698 million euros), Telefónica Internacional, S.A.U. (795 million euros), Telefónica Móviles Argentina, S.A. (118 million euros), and Telefónica Móviles España, S.A.U. (352 million euros).

“Cash flows from financing activities” includes the following:

- i. Payments for equity instruments of 377 million euros (883 million in 2010), relating to the net amount of treasury shares acquired in 2011 (Note 11).

ii. Payments of financial liabilities

a) Debt issues: The main collections comprising this heading are as follows:

<i>(Millions of euros)</i>	2011	2010
€8bn syndicated loan (Note 14.2)	2,000	6,000
EKN credit facility (Note 14.2)	267	-
Telefónica Emisiones, S.A.U. (Note 15)	4,387	5,484
Telefónica Europe, B.V. commercial paper (Note 20.a)	-	1,062
Telfisa Global, B.V. financing (Note 15)	742	1,630
Equity swaps by Portugal Telecom (Note 14.4)	-	541
Other collections	137	131
Total	7,533	14,848

b) **Amortización y cancelación de deuda:** The main payments comprising this heading are as follows:

<i>(Millions of euros)</i>	2011	2010
Cesky syndicate loan (Note 14.2)	300	5,700
Telefónica Europe, B.V.	15	2,779
Telefónica Finanzas, S.A.U.	1,262	-
Telefónica Emisiones, S.A.U. (Note 15)	2,954	1,348
Cancellation of debentures and bonds (Note 13)	-	19
Promissory note program (Note 13)	255	217
Telefónica Móviles España, S.A.U. (Note 15)	-	300
Other payments	335	722
Total	5,121	11,085

The 8 billion euro increase in the amount of the syndicated loan reflects a drawdown of 2,000 million in 2011, for the purpose of honoring the final payment obligation in respect of the acquisition of Brasilcel, N.V. (see Note 18.b).

The commercial paper transactions with Telefónica Europe, B.V. are stated at their net balance as recognized for the purposes of the cash flow statement, being high-turnover transactions where the interval between purchase and maturity never exceeds six months.

The financing obtained by the Company from Telefónica Finanzas, S.A.U. and Telfisa Global, B.V. relates to the Group's integrated cash management (see Note 15). These amounts are stated net in the cash flow statement as new issues or redemptions on the basis of whether or not at year-end they represent short-term investment of surplus cash or financed balances payable.

In 2010, the cancellation of Telefónica Europe, B.V. debt mainly comprises the repayment of a loan and hedges contracted to cover this debt.

iii. Payments of dividends for 6,852 million euros (5,872 million euros in 2010) (see movements in Note 11.1.d)

(22) EVENTS AFTER THE REPORTING PERIOD

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

- On January 5, 2012, Telefónica Europe, B.V. arranged financing guaranteed by Telefónica, S.A. with China Development Bank (CDB) for an aggregate amount of 375 million US dollars (equivalent to approximately 290 million euros) at a floating rate and maturing in 2022. This financing was paid on February 15, 2012.
- On February 7, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (“EMTN”) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, extended the issue of bonds made on February 7, 2011 for an initial aggregate amount of 1,200 million euros maturing on February 7, 2017, by 120 million euros. These bonds are guaranteed by Telefónica, S.A.
- On February 21, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (“EMTN”) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, issue bonds for an aggregate amount of 1,500 million euros maturing on February 21, 2018. These bonds are guaranteed by Telefónica, S.A.

(23) ADDITIONAL NOTE FOR ENGLISH TRANSLATION

These annual financial statements were originally prepared in Spanish and were authorized for issue by the Company’s Directors in the meeting held on February 22, 2012. In the event of a discrepancy, the Spanish-language version prevails.

APPENDIX I

**Details of subsidiaries and
associates at December 31, 2011**

DETAILS OF SUBSIDIARIES AND ASSOCIATES AT DECEMBER 31, 2011 (millions of euros)

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telefónica Europe plc (UNITED KINGDOM) <i>Wireless communications services operator</i> <i>Wellington Street, Slough, SL1 1YP</i>	100.00%	-	13	7,656	715	(33)	8,215	25,300
Telefónica Internacional, S.A. (SPAIN) <i>Investment in the telecommunications industry abroad</i> <i>Gran Vía, 28 - 28013 Madrid</i>	100.00%	-	2,839	7,925	-	(299)	937	8,132
Telefónica Móviles España, S.A.U. (SPAIN) <i>Wireless communications services provider</i> <i>Plaza de la Independencia, 6 - Pta. 5 - 28001 Madrid</i>	100.00%	-	423	498	1,980	1,996	1,435	5,775
Telfin Ireland Limited (IRELAND) <i>Intragroup financing</i> <i>28/29 Sir John Rogerson's Quay, Dublin 2</i>	100.00%	-	-	3,410	58	(1)	105	3,410
Telefónica de España, S.A.U. (SPAIN) <i>Telecommunications service provider in Spain</i> <i>Gran Vía, 28 - 28013 Madrid</i>	100.00%	-	1,024	1,923	2,430	597	298	3,034
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) <i>Holding company</i> <i>Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, Mexico D.F. CP.05349</i>	100.00%	-	3,047	(2,436)	-	210	(66)	2,795
Telefónica de Contenidos, S.A.U. (SPAIN) <i>Organization and operation of multimedia service-related activities and businesses</i> <i>Don Ramón de la Cruz, 84 4ª Pta.- 28006 – Madrid</i>	100.00%	-	1,865	(1,675)	-	(7)	22	2,242
Latin American Cellular Holdings, B.V. (NETHERLANDS) <i>Holding company</i> <i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>	100.00%	-	281	2,708	218	-	586	1,747

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telefónica Datacorp, S.A.U. (SPAIN) <i>Telecommunications service provider and operator</i> <i>Gran Via, 28 - 28013 Madrid</i>	100.00%	-	700	70	-	55	44	1,343
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA) <i>Holding company</i> <i>Ing Enrique Butty 240, piso 20-Capital Federal-Argentina</i>	75%	25%	306	674	143	536	318	856
Inversiones Telefónica Móviles Holding, Ltd. (CHILE) <i>Holding company</i> <i>Miraflores, 130 - 12° - Santiago de Chile</i>	100.00%	-	752	(152)	-	-	249	741
Ecuador Cellular Holdings, B.V. (NETHERLANDS) <i>Holding company</i> <i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>	100.00%	-	46	(59)	58	-	31	581
Atento Inversiones y Teleservicios, S.A. (SPAIN) <i>Telecommunications service provider</i> <i>C/ Santiago de Compostela, 94 - 28035 Madrid</i>	100.00%	-	24	20	34	(30)	24	256
O2 (Europe) Ltd. (UK) <i>Wireless communications services operator</i> <i>Wellington Street, Slough, SL1 1YP</i>	100.00%	-	1,239	6,453	-	-	(97)	8,779
Telefónica Centroamérica de Guatemala Holdings, S.A. (GUATEMALA) (1) <i>Holding company</i> <i>Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 – Guatemala City</i>	100.00%	-	280	(109)	24	36	26	238
Panamá Cellular Holdings, B.V. (NETHERLANDS) <i>Holding company</i> <i>Strawinskylaan 3105, Atium 7th, Amsterdam</i>	100%		40	44	2	-	21	238

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telefónica El Salvador Holding, S.A. de C.V. (EL SALVADOR) (1) <i> Holding company Alameda Roosevelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador</i>	100.00%	-	149	(66)	-	-	(1)	161
Telefónica Móviles Puerto Rico, Inc. (PUERTO RICO) <i> Ownership of shareholdings in cellular operators in Puerto Rico Metro Office Park Calle Edificio #17, Suite 600 - 00968 Guaynabo</i>	100.00%	-	107	(107)	-	-	-	110
Telefónica Global Technology, S.A. (formerly Ateseco Comunicación, S.A.) (SPAIN) <i> Gloabl management and operation of IT systems Gran Vía, 28 - 28013 Madrid</i>	100.00%	-	10	53	-	(4)	(5)	121
Telefónica Digital España, S.L. (formerly Terra Networks Asociadas, S.L.) (SPAIN) <i> Holding company Gran Via, 28 - 28013 Madrid</i>	100.00%	-	7	(20)	-	(2)	2	65
Guatemala Cellular Holdings, B.V. (NETHERLANDS) <i> Holding company Strawinskylaan 3105, Atium 7th, Amsterdam</i>	100.00%	-	17	4	3	-	5	30
Taetel, S.L. (SPAIN) <i> Acquisition, ownership and disposal of shares and stakes in other companies Gran Via, 28 - 28013 Madrid</i>	100.00%	-	28	6	1	-	1	28
Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN) <i> Management and administrative services rendered Gran Via, 28 - 28013 Madrid</i>	100.00%	-	8	39	-	8	6	24
Telefónica Capital, S.A. (SPAIN) <i> Finance company Gran Via, 28 - 28013 Madrid</i>	100%	-	7	94	-	(1)	-	34

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Lotca Servicios Integrales, S.L. (SPAIN) <i>Holding and operation of aircraft and aircraft leases.</i> <i>Gran Vía, 28 - 28013 Madrid</i>	100.00%	-	17	(5)	-	2	-	17
Comet, Compañía Española de Tecnología, S.A. (SPAIN) <i>Promotion of business initiatives and holding of real estate assets</i> <i>Villanueva, 2 duplicado planta 1ª Oficina 23 - 28001 Madrid</i>	100.00%	-	5	4	-	-	-	14
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) <i>Integrated cash management, consulting and financial support for Group companies</i> <i>Gran Vía, 30 - 4ª Plta. - 28013 Madrid</i>	100.00%	-	3	47	-	(1)	3	13
Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE) <i>IT and communications services provider</i> <i>Avenida del Cóndor N° 720, piso 4, comuna de Huechuraba, Santiago de Chile</i>	100.00%	-	10	(3)	-	-	1	11
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) <i>Design of communications products</i> <i>Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid</i>	100.00%	-	-	N/A	-	N/A	N/A	10
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) <i>Security services and systems</i> <i>Condesa de Venadito, 1 - 28027 Madrid</i>	100.00%	-	7	1	-	-	-	15
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) <i>Telecommunications research activities and projects</i> <i>Ronda de la Comunicación, s/n - 28050 Madrid</i>	100.00%	-	6	54	-	(7)	(5)	6
Venturini España, S.A. (SPAIN) <i>Property leasing</i> <i>Avda. de la Industria, 17 Tres Cantos - 28760 Madrid</i>	100.00%	-	3	1	-	-	-	4

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telfisa Global, B.V. (NETHERLANDS) <i>Integrated cash management, consulting and financial support for Group companies</i> <i>Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX - Amsterdam</i>	100.00%	-	-	2	2	(1)	3	2
Telefónica de Centroamérica, S.L. (SPAIN) <i>Dormant company</i> <i>Gran Via, nº 28, 28013 Madrid</i>	100.00%	-	-	-	-	-	-	1
Fisatel Mexico, S.A. de C.V. (MEXICO) <i>Integrated cash management, consulting and financial support for Group companies</i> <i>Boulevard Manuel Avila Camacho, 24 - 16ª Plta. - Lomas de Chapultepec - 11000 Mexico D.F.</i>	100.00%	-	-	2	-	-	-	-
Telefónica Emisiones, S.A.U. (SPAIN) <i>Issuance of preferred securities and/or other financial debt instruments</i> <i>Gran Via, 28 - 28013 Madrid</i>	100.00%	-	-	2	-	(2)	1	-
Telefónica Europe, B.V. (NETHERLANDS) <i>Fund raising in capital markets</i> <i>Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX – Amsterdam</i>	100.00%	-	-	4	2	(1)	2	-
Telefónica Internacional USA Inc. (US) <i>Financial advisory services</i> <i>1221 Brickell Avenue suite 600 - 33131 Miami - Florida</i>	100.00%	-	-	1	-	-	-	-
Telefónica International Wholesale Services II, S.L. (SPAIN) <i>Telecommunications service provider and operator</i> <i>Ronda de la Comunicación, s/n – 28050 Madrid</i>	100.00%	-	-	(11)	-	(17)	(15)	12
Telefonica Luxemburgo Holding S.à.r.L. (LUXEMBOURG) <i>Holding company</i> <i>26, rue Louwingny, L-1946- Luxembourg</i>	100.00%	-	8	323	-	7	6	84

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telefónica International Wholesale Services, S.L. (SPAIN) <i>International services provider</i> <i>Gran Via, 28 - 28013 Madrid</i>	92.51%	7.49%	230	23	-	17	9	213
Telefónica de Costa Rica TC, S.A. <i>Wireless telephony operator</i> <i>Plaza Roble, Edificio Los Balcones 4to. Piso, San José, Costa</i>	100.00%	-	127	7	-	(24)	(24)	127
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) <i>Life insurance, pensions and health insurance</i> <i>Ronda de la Comunicación, s/n Distrito C Edificio Oeste 1, planta 9- 28050 Madrid</i>	89.99%	10.01%	51	60	-	2	2	59
Corporation Real Time Team, S.L. (SPAIN) <i>Internet design, advertising and consulting</i> <i>Claudio Coello, 32, 1º ext. – Madrid</i>	87.96%	12.04%	-	N/A	-	N/A	N/A	12
Telefónica International Wholesale Services America, S.A. (URUGUAY) (1) <i>Provision of high bandwidth communications services</i> <i>Luis A. de Herrera, 1248 Piso 4 - Montevideo</i>	74.36%	25.64%	562	(181)	-	(42)	(43)	325
Telefónica Czech Republic, a.s. (CZECH REPUBLIC) (*) <i>Telecommunications service provider</i> <i>Za Brumlovkou 266/2,140 22 Praga 4-Michle Czech Republic</i>	69.41%	-	833	1,285	365	424	332	3,468
Telefónica Móviles Panamá, S.A. (PANAMA) <i>Wireless telephony services</i> <i>Edificio Magna Corp. Calle 51 Este y Avda Manuel María Icaza, Ciudad de Panamá</i>	56.31%	43.69%	20	121	-	22	15	301
Aliança Atlântica Holding B.V. (NETHERLANDS) <i> Holding company</i> <i>Strawinskylaan 1725 – 1077 XX - Amsterdam</i>	50.00%	43.99%	40	11	6	-	3	22
Telefónica Móviles Colombia, S.A. (COLOMBIA) (1) <i>Wireless operator</i> <i>Calle 100, N° 7-33, Piso 15, Bogotá, Colombia</i>	49.4%	50.6%	-	538	-	97	5	271

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Sao Paulo Telecomunicacoes Participacoes, Ltda <i>Holding company</i> <i>Rua Martiniano de Carvalho, 851 20° andar, parte, Sao Paolo</i>	44.72%	55.27%	3,813	411	91	(1)	190	3,092
Telefónica Brasil, S.A. (formerly Telecomunicacoes de Sao Paulo, S.A.) (1)(*) <i>Wireline telephony operator in Sao Paulo</i> <i>Sao Paulo</i>	24.68%	49.21%	15,124	873	235	818	784	9,820
Telefónica Móviles del Uruguay, S.A. (URUGUAY) <i>Wireless communications and services operator</i> <i>Constituyente 1467 Piso 23, Montevideo 11200</i>	32.00%	68.00%	7	182	-	80	83	13
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) <i>Distribution, promotion or preparation of insurance contracts, operating as a broker</i> <i>Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid</i>	16.67%	83.33%	-	-	1	3	4	-
Telefónica Móviles Argentina, S.A. (ARGENTINA) <i>Wireless communications and services operator</i> <i>Ing Enrique Butty 240, piso 20-Capital Federal-Argentina</i>	15.40%	84.60%	N/A	N/A	35	N/A	N/A	139
Telefónica Móviles Guatemala, S.A. (GUATEMALA) <i>Provision of wireless, wireline and radio paging communications services</i> <i>Bulevar Los Próceres 20-09 Zona 10. Edificio Iberoplaza. Guatemala City</i>	13.60%	86.38%	-	-	3	-	-	38
Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA) <i>Management and administrative services rendered</i> <i>Av. Ing. Huergo 723 PB - Buenos Aires</i>	4.99%	95.00%	-	1	-	1	-	-
Telefónica de Argentina, S.A. (1) (ARGENTINA) (*) <i>Telecommunications service provider</i> <i>Av. Ingeniero Huergo, 723, PB - Buenos Aires</i>	1.80%	98.20%	185	232	-	232	140	23
Telefónica del Perú, S.A.A. (PERU) (1) (*) <i>Operator of local, domestic and international long distance telephony services in Peru</i> <i>Avda. Arequipa, 1155 Santa Beatriz - Lima</i>	0.15%	98.18%	691	262	-	121	120	2

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Telcel, C.A. (VENEZUELA) (1) <i>Wireless operator</i> <i>Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060</i>	0.09%	99.91%	414	722	-	870	738	123
Telefónica Factoring España, S.A. (SPAIN) <i>Factoring</i> <i>Pedro Teixeira, 8 - 28020 Madrid</i>	50.00%	-	5	2	3	8	6	3
Telco, S.p.A. (ITALY) <i> Holding company of a stake in Telecom Italia</i> <i>Galleria del Corso, 2 - Milan</i>	46.18%	-	2,186	1,051	-	(1)	(1,127)	2,315
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) <i>Factoring</i> <i>Mexico City</i>	40.50%	9.50%	2	-	-	-	1	1
Telefónica Factoring Perú, S.A.C. (PERU) <i>Factoring - Lima</i>	40.50%	9.50%	1	1	-	-	1	1
Telefónica Factoring Colombia, S.A. (COLOMBIA) <i>Factoring - Bogota</i>	40.50%	9.50%	1	1	-	1	-	1
Telefónica Factoring Chile, S.A. <i>Factoring</i> <i>Santiago City</i>	40.50%	9.50%	-	1	-	1	-	-
Telefónica Factoring Do Brasil, Ltd. (BRAZIL) <i>Factoring</i> <i>Avda. Paulista, 1106 – Sao Paulo</i>	40.00%	10.00%	1	(1)	3	(2)	9	1
Jubii Europe N.V. (*) (formerly Lycos Europe, N.V.) <i>Internet portal - In liquidation</i> <i>Richard Holkade 36, 2033 PZ Haarlem – Netherlands</i>	32.10%	-	N/A	N/A	-	N/A	N/A	15
Torre de Collçerola, S.A. (SPAIN) <i>Operation of a telecommunications mast and technical assistance and consulting services</i> <i>Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona</i>	30.40%	-	6	-	-	-	-	2

Telefonica

Name and corporate purpose	% Ownership		Share capital	Reserves	Dividends received	Income (loss)		Gross carrying amount
	Direct	Indirect				From operations	For the year	
Other investments	-	-	-	341	518	-	18	340

Total Group companies and associates

86,956

(1) Consolidated data

() Companies listed on international stock exchanges at December 31, 2011*

N/A No data available

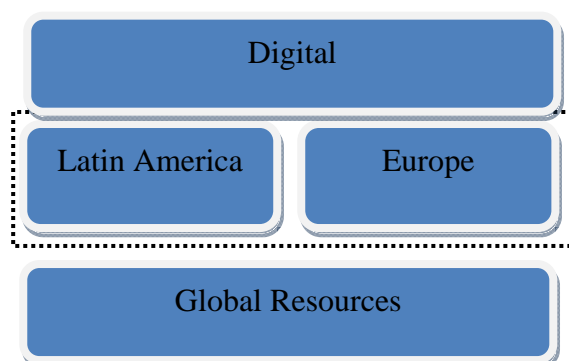
MANAGEMENT REPORT

TELEFÓNICA, S.A.
2011

ECONOMIC RESULTS

Telefónica is one of the world's leading mobile and fixed communications services providers. Its strategy is to become the leader in the new digital world and transform the possibilities it brings into reality.

Against this backdrop and with the aim of reinforcing its growth story, actively participating in the digital world and capturing all the opportunities afforded by its scale and industrial and strategic alliances, a new organizational structure was approved in September. This new structure, which will become fully operational in 2012, will be as follows:



This new organization should bolster Telefónica's place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its large customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica's transformation into a fully global company.

Telefónica Europe's and Telefónica Latin America's objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation. The three differentiated segments –Telefónica Spain, Telefónica Europe and Telefónica Latin America– have been maintained for the presentation of this report as the organizational change took place virtually at the end 2011.

The growth strategy for the next few years is geared towards:

- Improving the customer experience to continue increasing the number of accesses.
- Leading growth:
 - Boosting the penetration of smart phones in all markets to accelerate the growth of mobile data, unlocking the value of increased data usage.
 - Defending the competitive position with a focus on fixed broadband, offering faster speeds, bundled offers and full IP voice and video services.
 - Leveraging growth opportunities arising in an increasingly digital environment, e.g. video, OTT, financial services, cloud computing.
- Continuing efforts to transform the operating model:
 - Increasing network capacity in key markets through technological advances or acquisitions of spectrum.
 - Accelerating the transformation primarily through the systems area.

- Progressing towards becoming a more on-line company.
- Maximizing economies of scale to boost efficiency.

The Telefónica Group has operations in Spain, the United Kingdom, Germany, the Czech Republic, Ireland and Slovakia in Europe, as well as in Brazil, Mexico and several countries in Central America, Venezuela, Colombia, Peru, Argentina, Chile, Uruguay and Ecuador in Latin America.

Telefónica also has an industrial alliance with Telecom Italia and a strategic alliance with China Unicom, having increased its stake in China Unicom to 9.6% in 2011. In addition, the “Partners Program” was created in 2011 in line with the objective of unlocking the value of Telefónica’s scale. Three operators have already signed up for this program (Bouygues, Etisalat and Sunrise). This initiative makes a host of services available to selected operators under commercial terms that allow the partners to leverage Telefónica’s scale and to cooperate in key business areas (e.g. roaming, services to multinationals, procurement, handsets).

In addition to the explanation of 2011 results, the Telefónica Group holds significant direct and indirect stakes (of over 5% in all cases) in listed telecommunications companies other than in those in which it has control. These are: China Unicom, Telecom Italia, S.A., Zon Multimedia, S.p.A. and Hispasat, S.A.

Results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 4,910 million euros in 2011. Highlights of the 2011 income statement include:

- Growth in revenue from operations year on year, primarily due to the following:
 - Most of the contracts signed in 2008 for use of the Telefónica brand entailing royalties stipulated an increasing percentage for the years 2008 to 2011. The 2011 income statement included 618 million euros of revenue from royalties for use of the brand (518 million in 2010).
 - Dividends received from Group companies and associates: the main amounts of which relate to Telefónica Europe, plc. (715 million euros), Telefónica de España, S.A.U. (2,430 million euros) and Telefónica Móviles España, S.A.U. (1,980 million euros).
 - Interest income on loans to Group companies and associates, the main amounts of which relate to interest from Telefónica Móviles México, S.A. de C.V. of 145 million euros (188 million euros in 2010) and Telefónica de España, S.A.U. of 83 million euros (130 million euros in 2010).
- Net financial expense totaled 2,314 million euros in 2011, compared to 1,711 million euros in 2010. This was mainly due to finance costs with Group companies and associates, of which the largest came from Telefónica Europe, B.V. amounting to 373 million euros (454 million euros in 2010) and Telefónica Emisiones, S.A.U. totaling 1,395 million euros (1,286 million euros in 2010).

Investment activity

2011

On March 25, 2011 the Boards of Directors of each of the subsidiaries controlled by Telefónica, Vivo Participações and Telesp, approved the terms and conditions of a restructuring process whereby all shares of Vivo Participações that were not owned by Telesp were exchanged for Telesp shares, at a rate of 1.55 new Telesp shares for each Vivo Participações share. These shares then became the property of Telesp, whereby Vivo Participações then became a wholly owned subsidiary of Telesp. The restructuring process was approved by the shareholders of Vivo Participações at the Extraordinary General Shareholders' Meeting held on April 27, 2011 and by the shareholders of Telesp at the Extraordinary General Shareholders' Meeting held on the same date following authorization by the Brazilian telecommunications regulator, Anatel.

At that date, Telefónica, S.A. held a direct stake of approximately 60% in Vivo Participações, Ltda., valued at 13,021 million euros, subsequent to the liquidation by absorption of Portelcom Participações, S.A., PTelecom Brasil, S.A. and Telefónica Brasil Sul Celular Participações, Ltda.

On June 14, 2011, the Boards of Directors of Vivo Participações and Telesp approved a restructuring plan whose objective was to simplify the corporate structure of both companies and foster their integration, eliminating Vivo Participações from the corporate chain through the incorporation of its total equity into Telesp, and concentrating all mobile telephony activities in Vivo, S.A. (now a direct subsidiary of Telesp).

This deal was submitted for consideration by the Brazilian telecommunications regulator and finally approved at the General Shareholders' Meetings of both companies on October 3, 2011. The company arising from the merger changed its name to Telefónica Brasil, S.A.

Following the share exchange, a partial contribution was made to Sao Paulo Telecomunicações (SPT), leaving the direct stake in Telesp at 24.68%. All the aforementioned transactions were performed at the carrying amounts.

On June 27, 2011, Telefónica, S.A. performed a capital increase of 1,285 million Mexican pesos (76 million euros). In October 2011, several more capital increases were carried out, totaling 1,832 million Mexican pesos (100 million euros).

In late 2010, the Telefónica Group was awarded a mobile telephone license in Costa Rica. Until that date, the Group had no operations in that country. To operate under this license, on February 14, 2011 Telefónica, S.A. incorporated the company Azules y Platas, S.A., with 2 million US dollars. The Company made an additional contribution to equity of 6 million euros on February 15, 2011, as well as a capital increase of 170 million US dollars on June 26, 2011. The euros value of the three aforementioned capital increases is 127 million euros. On September 22, 2011 the change of name of this company, to Telefónica de Costa Rica, S.A., was formally entered in the pertinent mercantile registry.

On September 26, 2011, Telefónica, S.A. injected a further 80 million euros of equity into Casiopea Re, S.A.

In 2011, equity swap contracts were partially cancelled through the sale of 33 million shares in Portugal Telecom, generating gains of 13 million euros. These gains were recognized under the income statement caption "Gains (losses) on disposal and other gains and losses". Given that the listed price of these shares dropped considerably in the second half of the year, the Company

made a financial provision amounting to 135 million euros, recognized under the income statement caption “Impairment and gains (losses) on disposal of financial instruments”. In October 2011, in view of the adverse outlook published for this stock by financial analysts, the Company decided to extend the equity swap contracts and reclassified the net carrying amount of the direct stake in Portugal Telecom (which continued to be 2.02%) and the remaining portion of the equity swap contracts, totaling both stakes, direct and indirect an amount of 235 million euros, to “Available-for-sale assets”.

At each year end, the Company reviews its subsidiaries’ business plans and cash flows derived there from and, based on the value of each company, estimates whether to recognize an impairment of these investments. In 2011, a write-down of 1,606 million euros was recognized as a result of this review. This amount reflects the net effect of the following: (a) the reversal of the impairment loss recorded for Telefónica Europe, plc. (1,279 million euros), less 120 million euros for the effect of the net investment hedge; (b) the write-down of 2,085 million euros in Telefónica Móviles México, S.A. de C.V.; (c) the write-down of 629 million euros made in Telco, S.p.A. to reflect the decrease in value of the stake in Telecom Italia, along with the effect of recovering part of the operational synergies during the year.

In 2011, Telefónica, S.A. adjusted the cost of its investment in Banco Bilbao Vizcaya Argentaria, S.A. by 80 million euros, in order to bring the cost per share in line with the fair value. This adjustment was taken directly to the income statement, under “Gain (loss) on available-for-sale financial assets recognized in the period”, with no impact on the statement of recognized income and expenses.

2010

On February 10, 2010 Irish company Telfin Ireland Ltd. was incorporated by means of a 919 million euro contribution by Telefónica, S.A. (its sole shareholder). On April 28, 2010, Telefónica, S.A. injected a further 243 million euros of equity into this company. Then on May 21, 2010, Telefónica, S.A. injected a further 1,379 million euros and on June 24, 2010 another 869 million euros. These funds were used by Telfin Ireland, Ltd. to finance other Group companies in transactions performed during 2010.

On July 28, 2010 Telefónica, S.A. and Portugal Telecom, SGPS, S.A. reached an agreement for the acquisition by Telefónica, S.A. of 50% of the share capital of Brasilcel, N.V. (a company in which Portugal Telecom and Telefónica had equal joint interests until that date, and which held approximately 60% of the share capital of the Brazilian company Vivo Participações, S.A.). The agreed acquisition price was 7,500 million euros, of which the last 2,000 million euros were paid on October 31, 2011. On the purchase date, the company declared its intention to absorb in a single act Brasilcel, N.V. This agreement also established inter alia that Portugal Telecom waived the declared dividend payable by Brasilcel, N.V. amounting to 49 million euros, which was recognized as a reduction in the cost of this acquisition. Taking into account the conditions established, the discounted price at which this acquisition was recognized was 7,419 million euros.

Subsequently, on September 28, 2010 the two boards of directors approved the merger of Telefónica and Brasilcel, N.V., which was recognized on that date. This merger was entered in the Mercantile Registry on December 21, 2010 and gave rise to a reserve of 3,602 million euros, reduced by 49 million euros corresponding to the aforementioned dividends. The net amount by which Telefónica, S.A.’s equity was affected by this transaction was therefore 3,553 million euros.

Telefonica

In 2010, Telefónica, S.A. took the stake in Banco Bilbao Vizcaya Argentaria, S.A. of 191 million euros and in Zon Multimedia Serviços de Telecomunicações e Multimedia, S.G.P.S., S.A. of 52 million euros to profit and loss. These transfers were recognized in “Gain (loss) on available-for-sale financial assets recognized in the period”.

SHARE PRICE PERFORMANCE

The sovereign debt crisis across Europe, which led to Portugal's bailout and Greece's application for a second rescue package, lingering doubts regarding financial stability in the rest of the European peripherals and pressure from rating agencies caused Europe's main stock indices to retreat in 2011 (AthexComposite: -51.9%; PSI-20: -27.6%; FTSEMIB: -25.2%; EStoxx-50 -17.1%; CAC-40 -17.0%; DAX -14.7%; Ibex-35 -13.1% and FTSE-100 -5.6%).

Shaping market performance in 2011 was the sovereign debt crisis, especially in southern Europe. For instance, Spain's benchmark 10-year bond ended 2011 yielding 5.1% (5.5% at the end of 2010), leaving the spread with the German bund at 325.9 basis points (248.9bp at the end of 2010). Portugal's bond spread at year end stood at 1,153.3bp (compared to 363bp at the end of 2010), Italy's at 528bp (compared to 185.1bp) and Greece's at 3,313.5bp (compared to 950.9bp).

Telefónica's share price closed 2011 down 21.1% at 13.39 euros per share. It underperformed its European sector benchmark index by 6.2%, mostly due to macroeconomic risk in Spain given the country's high exposure to southern Europe, and to Vodafone's 7.9% gain given its large index weight. Europe's other main operators also ended the year poorly, with France Telecom down by 22.2%, KPN by 15.3%, Telecom Italia by 14.6% and Deutsche Telekom by 8.2%. Telefónica's total return, however, was only 12.1% lower including the dividends paid in 2011 (0.75 euros per share on May 6, 2011 and 0.77 euros per share on November 7, 2011).

At the end of 2011, Telefónica was the world's seventh largest telecommunications company by market cap (61,089 million euros) and 65th among the 100 largest companies in the world of any kind.

Daily trading volume in Telefónica shares on Spain's continuous market was 56.4 million shares in 2011 (59.8 million shares in 2010).

RESEARCH, DEVELOPMENT AND INNOVATION

Telefónica remains firmly committed to technological innovation as a core means to generating competitive advantages, anticipating market trends and the differentiation of its products. By introducing new technologies and developing new products and business processes, the Group seeks to become more effective, efficient and customer-oriented.

Telefónica has developed an open innovation model for the management of technological innovation to boost the application of technical research in the development of new commercial products and services. The Group focuses on certain applied research and development (R&D) priorities that are aligned with its strategy. Open innovation initiatives driving this model include the creation of a venture capital fund and involvement in business collaboration forums, among others. The model also promotes the use of knowledge developed at technology centers, universities and start-ups, among other sources, and encourages innovation in conjunction with other agents (e.g. customers, universities, public administrations, suppliers, content providers and other companies), making them “technological partners.” The Company believes it cannot rely solely on acquired technology to differentiate its products from those of its competitors and to improve its market positioning. Telefónica also considers it is important to encourage R&D initiatives in an effort to achieve this differentiation and make inroads in other innovation activities. The Telefónica Group’s R&D policy is geared towards:

- developing new products and services in order to win market share;
- boosting its customers’ loyalty;
- driving revenue growth;
- enhancing innovation management;
- improving business practices;
- increasing the quality of its infrastructure services to improve customer service and reduce costs;
- promoting global products;
- supporting open innovation; and
- creating value from the technology generated.

In 2011, the technological innovation projects being undertaken focused on sustainable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of the Group’s operations in new markets, and technological leadership.

Technical innovation activities are a key part of Telefónica’s strategy of creating value through broadband communications and services, the IP network, wireless networks and new generation networks (fiber optic).

In 2011, projects were being undertaken to promote greater access to information technology, new services focused on new internet business models, advanced user interfaces, mobile television and other broadband services. These initiatives, among others, were built on the basis

of rapid identification of emerging technologies that could have a relevant impact on the Group's businesses and the testing of these technologies in new services, applications and platform prototypes.

Most of the R&D activities are carried out by Telefónica Investigación y Desarrollo, S.A.U., (Telefónica I+D), a wholly-owned subsidiary, which works mainly for the Group's lines of business. In its operations, Telefónica I+D receives the assistance of other companies and universities. Telefónica I+D's mission is centered on enhancing competitiveness by leveraging technological innovation and product development. Telefónica I+D undertakes experimental and applied research and new product development with the overriding goal of broadening the Group's range of services offered and reducing its operating costs. It also provides technical assistance to operations in Latin America and Europe.

Telefónica I+D's technological innovation activities focus on certain areas:

- Natural P2P communication of the future, using the Internet, Web 2.0 and smart phones.
- Video and multimedia services (combining text, audio, images and video) offering a user experience in all connected devices.
- Advanced solutions in emerging ITC businesses such as e-health, and remote patient support or monitoring.
- M2M (machine-to-machine) service management associated with energy efficiency and mobility.
- Cloud computing, which makes intensive use of resources available on the Web to develop, publish, commercialize and distribute applications.
- Making use of user communication profiles to exploit opportunities to operate different products and business models (marketing campaigns, target marketing, contextual services, churn reduction, cross-selling, etc.)
- Network and architecture services as a new global infrastructure shared by all business lines to cut operating and maintenance costs, on which the Group can roll out new services and provide greater capacity amid increasing demand for mobile data, video content and the shift from people-based Internet to an object-based Internet.

At December 31, 2011, Telefónica I+D had 653 employees and collaborated with skilled professionals from over 80 companies and more than 50 universities.

Research and development costs at Telefónica amounted to 983 million euros and 797 million euros in 2011 and 2010, respectively, representing 1.6% and 1.3% of the Group's consolidated revenue, respectively. These figures were calculated using guidelines of the Organization for Economic Co-operation and Development (OECD).

Telefónica registered 95 patents in 2011, of which 57 were registered with the Spanish Patent Office and 38 with patent offices in the European Union, the US and with other international patent offices.

FINANCING

The main financing transactions undertaken in the bonds market in 2011 are as follows:

- Under Telefónica Emisiones, S.A.U.'s European Medium Term Note ("EMTN"), Telefónica, S.A. guaranteed the issue of debt instruments for a global amount of 2,370 million euros, with the following features:

Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
02/07/2011	02/07/2017	1,200,000,000	EUR	4.750%
03/21/2011	02/07/2017	100,000,000	EUR	4.750%
11/03/2011	02/03/2016	1,000,000,000	EUR	4.967%
11/04/2011	11/04/2016	7,000,000,000	JPY	2.8247%

- Under Telefónica Emisiones, S.A.U.'s debt issue program registered with the United States Securities Exchange Commission (SEC), Telefónica, S.A. guaranteed the issues of debt instruments for a global amount equivalent to 2,750 million US dollars (equivalent to approximately 2,125 million euros), with the following features:

Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
02/16/2011	02/16/2016	1,250,000,000	USD	3.992%
02/16/2011	02/16/2021	1,500,000,000	USD	5.462%

The main financing transactions carried out in the banking market in 2011 are the following:

- On May 3, 2011, Telefónica, S.A. signed a long-term line of credit for an aggregate amount of 376 million US dollars at a fixed rate and guaranteed by the Finnish Export Credits Guarantee Board (Finnvera). This line of credit is structured into four tranches: a tranche of 94 million US dollars maturing on January 30, 2020, another of 90 million US dollars maturing on July 30, 2020, a third of 94 million US dollars maturing on January 30, 2021, and a fourth of 98 million US dollars maturing on July 30, 2021. At December 31, 2011, none of this credit had been drawn down; and
- On May 12, 2011 Telefónica, S.A. signed an amendment to the syndicated loan agreement entered into on July 28, 2010 whereby it was agreed that, in exchange for the additional payment of certain fees and an upward adjustment to applicable interest rates, of the 5,000 million euros that would initially mature in July 2013, 2,000 million euros would be extended for another year, i.e. until July 2014, and another 2,000 million for a further three years, i.e. until July 2016. At December 31, 2011, this line of credit had been drawn down by 8,000 million euros (6,000 million euros at December 31, 2010).

TRANSACTIONS WITH TREASURY SHARES

At December 31, 2011 and 2010, Telefónica, S.A. held the following treasury shares:

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/11	84,209,363	15.68	13.39	1,127	1.84508%

(1) Millions of euros

	Number of shares	Euros per share		Market value (1)	%
		Acquisition price	Trading price		
Treasury shares at 12/31/10	55,188,046	17.01	16.97	937	1.20920%

(1) Millions of euros

The movement in treasury shares of Telefónica, S.A. in 2010 and 2011 is as follows:

	Number of shares
Treasury shares at 12/31/09	6,329,530
Acquisitions	52,650,000
Disposals	(827,047)
Delivery PSP Phase II (Note 19.3)	(2,964,437)
Treasury shares at 12/31/10	55,188,046
Acquisitions	55,979,952
Disposals	(24,058,446)
Delivery PSP Phase III (Note 19.3)	(2,900,189)
Treasury shares at 12/31/11	84,209,363

Furthermore, at December 31, 2011, one Telefónica, S.A. share is held by Telefónica Móviles Argentina, S.A. (16,896 treasury shares held by Telefónica Móviles Argentina, S.A. at December 31, 2010).

The amount paid to acquire treasury shares in 2011 and 2010 was 822 million euros and 897 million euros, respectively.

On June 30, 2011 and July 4, 2011, following the end of the third phase of the Performance Share Plan (PSP), a total of 2,446,104 treasury shares were added, corresponding to two financial instruments arranged by the Company to meet its obligations to deliver treasury shares to managers and executives. The gross number of shares linked to the Plan amounted to 4,166,304 shares, with a net 2,900,189 shares finally delivered (32.6 million euros).

On June 30, 2010, subsequent to the maturing of the second phase of the Performance Share Plan (PSP) a total of 2,964,437 treasury shares were delivered at a price of 16.93 euros per share (50.1 million euros).

Expanding on the existing strategic alliance, 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. In 2011, Telefónica acquired through its subsidiary Telefónica Internacional, S.A.U. 2011 282,063,000 shares of China Unicom amounting to 358 million euros. 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.

Treasury shares sold in 2011 and 2010 amounted to 445 million euros and 14 million euros, respectively. The sales for 2011 included 371 million euros in respect of the Strategic Partnership Agreement with China Unicom, referred to above.

At the date of authorization for issue of these financial statements, Telefónica held 234 million call options on treasury shares subject to physical settlement (190 million and 160 million options on treasury shares at December 31, 2011 and 2010, respectively).

The Company also holds a derivative on approximately 26 million Telefónica shares, subject to net settlement, recognized under "Derivative financial liabilities" (current) on the balance sheet.

RISKS AND UNCERTAINTIES FACING THE COMPANY

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 risks described below are the most significant:

Group-related risks

▪ *Country risk (investments in Latin America).* At December 31, 2011, approximately 48.5% of the Telefónica Group's assets were located in Latin America. In addition, approximately 46.5% of its revenues from operations for 2011 were derived from its Latin American operations. At December 31, 2011 approximately 54.5% of its assets and 49.0% of the income from the Latin American segment were derived from its Brazil transactions. 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.

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, as well as the terms of licenses and concessions under which the Telefónica Group operates, may change unexpectedly and negatively affect the economic conditions or business environment in which it operates, and, therefore, the Group's interests in such countries;
- inflation may rise, currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies;
- 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.

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. These risk management strategies may not achieve the desired effect, while these hedges are exposed to counterparty risk.

▪ *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 evolution 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 the economic recovery, the health of the international banking system or the increasing

concerns regarding the burgeoning deficits of some European countries. Worsening conditions in international financial markets due to any of these factors may make it more difficult and more expensive for the Telefónica Group to refinance its debt –at December 31, 2011, average net debt maturing in the next six years is approximately 6,850 million euros per year– or take on additional debt if necessary.

In addition, the capacity to raise capital in the international capital markets would be impaired in terms of access and cost if Telefónica's credit ratings were downgraded. Nonetheless, after the downgrade to the long-term credit rating, funds were raised in the capital markets through Telefónica Emisiones, S.A.U. in 2011 for an aggregate amount of 4,495 million euros. In February 2012, it tapped the European market with a 1,500 million euro issue of bonds maturing February 21, 2018 with an annual coupon of 4.797%.

Moreover, the current market conditions could make it harder to renew existing undrawn bilateral credit lines, 24% of which, at December 31, 2011 initially mature prior to December 31, 2012. Finally, the current financial situation could make it more difficult and costly to raise additional equity capital from shareholders.

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 the economic recovery will continue may negatively affect the level of demand of 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 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 high in Europe, but basically negligible in the rest of the countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain Euro Area countries and rating downgrades in some of these 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 financial and/or obtain liquidity. This could have an adverse impact on the Group's businesses, financial position, results or cash flow.

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.

- *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 dominant 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 compared to the end of 2010 of over 83%) and Germany (cuts of over 50% since December 2010). In Spain, in December

2011, the regulator (CMT) launched a public consultation on mobile network call termination rates, proposing a reduction of between 75% and 80%.

Other services with regulated prices include SMS and call roaming. In this case, a declining scale for maximum wholesale and retail prices is in place, with Telefónica already having been forced to cut the maximum prices of voice calls, text messages and wholesale roaming prices by 2012 by 11.43%, 36.36% and 60%, respectively, from those in force in mid 2011. In July, the European Commission released a proposal for a review of the Roaming Regulation aimed at achieving a long-term solution. According to this proposal, 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. The proposal includes a transitional period during which the current maximum prices would be applied until the structural measure is implemented. Retail data roaming prices would also include new caps.

Finally, regarding net neutrality, the Commission released a report on net neutrality in which it maintains the non-regulatory alternative. It did, however, pose the need to know and supervise operators' traffic management practices. Moreover, the Commission turned to BEREC to draft a set of guidelines for transparency and minimum quality of service standards.

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 a move to review –and reduce– mobile network termination prices. For instance, reductions have been approved in Mexico and Chile of 61% and 60%, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates by applying a CPI- factor. This reduction factor is 18% in 2012, 12% in 2013 and 10% in 2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend toward reductions in termination rates in Peru, Venezuela and Colombia.

Meanwhile, the regulatory landscape in Europe has changed as a consequence of the approval in 2009 of the European Union's common regulatory framework, which had to be transposed into national law by Member States by May 2011. At the date of preparation of this document, of the countries in which the Telefónica Group operates, Spain and Germany had yet to transpose this community law. The regulatory principles established suggest that the new frameworks in each Member State could result in increased regulatory pressure on the local competitive environment. 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 could play a key role in the incentives for operators to invest in net fixed broadband networks in the short and medium term, thus affecting the outlook for the business and competition in this market segment. The European Commission is currently recording the respective recommendations on cost accounting and non-discrimination which could apply more regulatory pressure to fixed operators.

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 the imposition of fines or even revocation or forfeiture of the license, authorization or concession.

In addition, since the Telefónica Group holds a leading market share in many of the countries where it operates, the Group could be affected by regulatory actions of antitrust or competition authorities. These authorities could prohibit certain actions, such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on the Company, which, if significant, could result in loss of market share and/or in harm to 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 with these competitors, 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 Telefónica Group's financial position, operating results and cash flow.

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 can force Telefónica to investment in the development of new products, technology and services so it can continue to compete effectively with current or future competitors. This can reduce the revenue margins it obtains. In this respect, margins from traditional voice and data business are shrinking, while new sources of revenues are arising from mobile internet.

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, hefty investment is required to deploy these networks, which entails fully or partially substituting the copper of the access loop with fiber optics. As things stand now, 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 these network upgrade tasks and the ability 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 capacity and spectrum coverage, and assume the related costs of obtaining this capacity, could have an adverse impact on the quality of services and on the Company's ability to provide new services, potentially adversely affecting the Group's financial position and results of operations.

Specifically, in Germany, the regulator launched a public consultation to identify demand for spectrum in the 900 MHz and 1800 MHz frequencies from 2017. A decision in this respect is expected for 2013. Regarding the allocation of new spectrum and the related costs, in 2011, additional spectrum was awarded in Spain covering all bands attributed to mobile services for a total costs for all blocks of approximately 842 million euros.

- *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. 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 Telefónica Group's businesses and the results of its operations.

- *Risks associated with unforeseen network interruptions.* Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including due to network, hardware or software failures, 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 building security. However, these measures are not always effective. Although the Telefónica Group carries business interruption insurance, its insurance policy may not provide coverage in amounts sufficient to compensate for potential losses.

- *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 body of the World Health Organization in research on cancer (IARC) recently classified electromagnetic fields of 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, although it was announced that in 2012 a formal assessment of this risk will be conducted, taking into account all scientific evidence available.

Regardless of the scientific evidence that may be obtained and even though the Telefónica Group has considered these risks and has a action plan of the various countries in which it provides services to assure compliance of codes of good practices and relevant regulations, this concern, which may affect the capacity to capture or retain customers or may discourage the use of the mobile telephone, should not be ruled out.

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 position, results and cash flow.

- *Risk of asset impairment.* 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 the future cash flows expected, 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 result in a non-cash charge on the income statement, it could adversely affect the Telefónica Group's results of operations. In this respect, the Telefónica Group has taken impairment losses on certain of its investments, affecting the results of the year when they were made. In 2011, 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 629 million euros.

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 in, or any settlement of, these or other proceedings could result in significant costs and may have a material adverse effect on the Telefónica Group's business, financial condition, results of operations and cash flow.

TREND EVOLUTION

Telefónica is an integrated diversified telecommunications group that offers a wide range of services, mainly in Spain, Europe, and Latin America. Its activity is based upon providing fixed and mobile services, Internet and data, pay TV and value added services, among others. The Group's operations in 25 countries, managed through a regional organization geared towards certain businesses in global units, enable it to leverage its strong local positioning, as well as the advantages afforded by its scale, two features that have been reinforced by the opportunities arising from its holdings in and strategic alliances with China Unicom and Telecom Italia.

As a multinational telecommunications company that operates in regulated markets, Telefónica is subject to different laws and regulations in each of the jurisdictions in which it provides services. It can expect the regulatory landscape to continue to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, it may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

Telefónica faces intense competition in most of its markets, and is therefore subject to the effects of actions taken by its competitors. The intensity of the competition may deepen, which could have an impact on tariff structures, consumption, market share and commercial activity and negatively affect the number of customers, revenues and profitability.

However, Telefónica is in a strong competitive position in most of the markets where it operates, enabling it to continue taking advantage of the growth opportunities that arise in these markets, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. In this respect, Telefónica seeks to lead the industry by anticipating trends in the new digital environment.

As a result, Telefónica embarked on a restructuring in September 2011 with the aim of reinforcing its growth story, actively participating in the digital world and capturing the most of the opportunities afforded by its scale and industrial alliances. This new organization gave rise to two cross-cutting areas, Telefónica Digital and Telefónica Global Resources, in addition to the Telefónica Europe and Telefónica Latin America segments. This structure should bolster Telefónica's place in the digital world, enabling it to tap any growth opportunities arising in this environment, drive innovation, strengthen the product and services portfolio and maximize the advantages afforded by its global customer bases in an increasingly connected world. In addition, the creation of a Global Resources operating unit ensures the profitability and sustainability of the business by leveraging economies of scale and driving Telefónica's transformation into a fully global company. Telefónica Europe's and Telefónica Latin America's objective is to shore up the results of the business and generate sustainable growth through available capacity, backed by the Global Corporation.

In Spain, following the commercial positioning carried out at the end of 2011, Telefónica will continue to intensify its commercial commitment to offering quality services, increasing the effectiveness of its sales channels and further improving the quality and features of its networks to increase customer satisfaction through targeted commercial offerings that ensure the best response to their communications' needs. In this respect, the Group will continue to boost innovation to offer the best products and services, drive the mobile and fixed broadband growth and bundling services to provide the best integrated communications solution in the market.

Efficiency will continue to play a very important role in all areas of management, both in commercial and operational areas, including systems, networks and processes. Telefónica will focus on its customers and their satisfaction, while continuing to remain committed to ensuring Telefónica Spain remains the best place to work.

In Latin America, Telefónica's strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. The mobile business will continue to play a fundamental role as an engine of regional growth. That is why Telefónica will continue to improve the capacity and coverage of its networks, adapting its distribution channel to enhance the quality of its offerings both in voice and data in order to keep and attract high-value customers. Regarding the fixed telephony business, Telefónica will encourage the increase of broadband speed and expand the supply of bundled services. Meanwhile, Telefónica will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In Europe, customers will remain at the center of the Group's strategy and management priorities in the region in order to guarantee a high level of customer satisfaction with its services. With the objective of offering customers the best value, Telefónica will boost the mobile and fixed broadband services, adding new products and services to its current services. In such a competitive market such as presently prevails, efforts will focus on reinforcing the Group's market positioning. Another objective in coming years is to improve operating efficiency, for which Telefónica will roll out several local and regional initiatives, with the support of Telefónica Global Resources.

In summary, in the context of intense competition and regulatory pressure on pricing, Telefónica will continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while the Group will focus even more on the customer.

EVENTS AFTER THE REPORTING PERIOD

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

- On January 5, 2012, Telefónica Europe, B.V. arranged financing guaranteed by Telefónica, S.A. with China Development Bank (CDB) for an aggregate amount of 375 million US dollars (equivalent to approximately 290 million euros) at a floating rate and maturing in 2022. This financing was paid on February 15, 2012.
- On February 7, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (“EMTN”) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, extended the issue of bonds made on February 7, 2011 for an initial aggregate amount of 1,200 million euros maturing on February 7, 2017, by 120 million euros. These bonds are guaranteed by Telefónica, S.A.
- On February 21, 2012, Telefónica Emisiones, S.A.U., as part of the European Medium Term Note (“EMTN”) registered with the Financial Services Authority (FSA) in London and updated on June 20, 2011, issue bonds for an aggregate amount of 1,500 million euros maturing on February 21, 2018. These bonds are guaranteed by Telefónica, S.A.

ANNUAL CORPORATE GOVERNANCE REPORT

LISTED LIMITED COMPANIES

ISSUER'S PARTICULARS

YEAR ENDED: 31-12-2011

COMPANY TAX ID NO. (CIF): A-28015865

Corporate name: TELEFÓNICA, S.A.

ANNUAL CORPORATE GOVERNANCE REPORT FOR LISTED LIMITED COMPANIES

For a better understanding of this model report and how to fill it out, and its subsequent preparation, please read the instructions provided at the end.

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
28-12-2009	4,563,996,485.00	4,563,996,485	4,563,996,485

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.	257,947,943	269,194	5.658
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	0	246,898,917	5.410
Blackrock, Inc.	0	177,257,649	3.884

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 Correduria de Seguros y Reaseguros, S.A.	12,000	0.000
Banco Bilbao Vizcaya Argentaria, S.A.	BBVA Seguros, S.A. de Seguros y Reaseguros	257,194	0.006
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Caixabank, S.A.	246,855,309	5.409
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	VidaCaixa, S.A. de Seguros y Reaseguros	43,608	0.001
Blackrock, Inc.	Blackrock Investment Management (UK)	177,257,649	3.884

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	4,228,033	78,000	0.094
Mr. Isidro Fainé Casas	495,827	0	0.011
Mr. José María Abril Pérez	92,160	98,609	0.004
Mr. Julio Linares López	408,128	1,840	0.009
Mr. Alfonso Ferrari Herrero	571,364	18,999	0.013
Mr. Antonio Massanell Lavilla	2,286	0	0.000
Mr. Carlos Colomer Casellas	16,664	63,190	0.002
Mr. David Arculus	10,500	0	0.000

Mr. Francisco Javier de Paz Mancho	53,852	0	0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	85,476	436,000	0.011
Mr. Ignacio Moreno Martínez	12,387	0	0.000
Mr. José Fernando de Almansa Moreno-Barreda	19,349	0	0.000
Mr. José María Álvarez-Pallete López	317,297	0	0.007
Mr. Luiz Fernando Furlán	10,100	0	0.000
Ms. María Eva Castillo Sanz	94,600	0	0.002
Mr. Pablo Isla Álvarez de Tejera	8,601	0	0.000
Mr. Peter Erskine	69,259	0	0.002

% of total voting rights held by the Board of Directors	0.158
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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	344,613	0	344,613	0.008
Mr. César Alierta Izuel 2	100,000	0	10,000,000	0.002
Mr. César Alierta Izuel 3	249,917	0	390,496	0.005
Mr. Julio Linares López	258,460	0	258,460	0.006

Mr. Julio Linares López 2	149,950	0	234,298	0.003
Mr. Carlos Colomer Casellas	63,508	0	0	0.001
Mr. José María Álvarez-Pallete López	156,642	0	156,642	0.003
Mr. José María Álvarez-Pallete López 2	79,519	0	124,249	0.002

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.

Type of relationship:

Corporate

Brief description:

Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A.

Name or company name of related party
Banco Bilbao Vizcaya Argentaria, 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

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 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 530 of the Corporate Enterprises Act. By virtue of these clauses, Telefónica may not, while the strategic alliance agreement is in force, 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. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica's voting share capital (excluding intragroup transfers). This undertaking is without effect, the aforementioned period of one year having expired.

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

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

Members of the shareholders' agreement:

China Unicom (Hong Kong) Limited

Telefónica, S.A.

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 during the year.

Expanding on the existing strategic partnership, 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. 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. The General Shareholders' Meeting held on 18 May 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.

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

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 year-end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
84,209,363	1	1.845

(*) Through:

Name or corporate name of direct shareholder	Number of shares held directly
Telefónica Móviles Argentina, S.A.	1

Total:	1
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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
06/07/2011	46,623,681	164,444	1.016

Gain/(loss) on treasury shares sold during the year (thousands of euros)	3,473
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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 the General Shareholders' Meeting of Telefónica of June 2, 2010, shareholders renewed the authorization granted by the General Shareholders' Meeting of June 23, 2009, for the derivative acquisition of treasury shares, 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 legal restrictions on voting rights a shareholder can exercise	0
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Indicate whether there are any restrictions included in the bylaws on exercising voting rights.

No

Maximum percentage of restrictions under the company's bylaws on voting rights a shareholder can exercise	0
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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 included 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	29-01-1997	10-05-2007	Vote at General Shareholders' Meeting

Mr. Isidro Fainé Casas	-	Vice Chairman	26-01-1994	18-05-2011	Vote at General Shareholders' Meeting
Mr. José María Abril Pérez	-	Vice Chairman	25-07-2007	22-04-2008	Vote at General Shareholders' Meeting
Mr. Julio Linares López	-	Chief Operating Officer	21-12-2005	18-05-2011	Vote at General Shareholders' Meeting
Mr. Alfonso Ferrari Herrero	-	Director	28-03-2001	18-05-2011	Vote at General Shareholders' Meeting
Mr. Antonio Massanell Lavilla	-	Director	21-04-1995	18-05-2011	Vote at General Shareholders' Meeting
Mr. Carlos Colomer Casellas	-	Director	28-03-2001	18-05-2011	Vote at General Shareholders' Meeting
Mr. Chang Xiaobing	-	Director	18-05-2011	18-05-2011	Vote at General Shareholders' Meeting
Mr. David Arculus	-	Director	25-01-2006	18-05-2011	Vote at General Shareholders' Meeting
Mr. Francisco Javier de Paz Mancho	-	Director	19-12-2007	22-04-2008	Vote at General Shareholders' Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo	-	Director	12-04-2002	10-05-2007	Vote at General Shareholders' Meeting
Mr. Ignacio Moreno Martínez	-	Director	14-12-2011	14-12-2011	Cooptation
Mr. José Fernando de Almansa Moreno-Barreda	-	Director	26-02-2003	22-04-2008	Vote at General Shareholders' Meeting
Mr. José María Álvarez-Pallete	-	Director	26-07-2006	10-05-2007	Vote at General Shareholders' Meeting

López					Meeting
Mr. Luiz Fernando Furlán	-	Director	23-01-2008	22-04-2008	Vote at General Shareholders' Meeting
Ms. María Eva Castillo Sanz		Director	23-01-2008	22-04-2008	Vote at General Shareholders' Meeting
Mr. Pablo Isla Álvarez de Tejera	-	Director	12-04-2002	10-05-2007	Vote at General Shareholders' Meeting
Mr. Peter Erskine	-	Director	25-01-2006	18-05-2011	Vote at General Shareholders' Meeting

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

Name or corporate name of director	Status of the director at the time	Leaving date
Mr. Vitalino Manuel Nafría Aznar	Proprietary	14-12-2011

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. Julio Linares López	Nominating, Compensation and Corporate Governance Committee	Chief Operating Officer (C.O.O.)
Mr. José María Álvarez-Pallete López	Nominating, Compensation and Corporate Governance Committee	Chairman Telefónica Europe

Total number of executive directors	3
% of the board	16.667

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. David Arculus	Graduate in Engineering and Economics. Director of Pearson, Plc., Chairman of Numis, Plc., and Aldemore Bank, Plc.

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.
Ms. María Eva Castillo Sanz	Degrees in Business, Economics and Law. Previously Head of Merrill Lynch's Private Banking operations in Europe, the Middle East, & Africa (EMEA).
Mr. Pablo Isla Álvarez de Tejera	Law Graduate. Member of the Body of State Lawyers (on sabbatical). Chairman and CEO of Inditex, S.A.

Total number of independent directors	8
% of the board	44.444

OTHER EXTERNAL DIRECTORS

Name or corporate name of director	Committee proposing appointment
Mr. José Fernando de Almansa Moreno-Barreda	Nominating, Compensation and Corporate Governance Committee
Mr. Peter Erskine	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. Peter Erskine	On December 31, 2007, Mr. Peter Erskine resigned from 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"> - He is an Acting 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. - 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. 	BBVA Bancomer

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

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	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")

	<p>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 18 May 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>
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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. Vitalino Manuel Nafria Aznar	Mr. Vitalino Manuel Nafri Aznar tendered his voluntary resignation verbally to the Chairman of the Board of Directors, citing personal reasons. The rest of the Board was duly notified at the meeting held on 14 December, 2011.

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 establish, 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. Julio Linares López – 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.	Acting Director
	Telefónica del Perú, S.A.A.	Director
Mr. Francisco Javier de Paz Mancho	Atento Inversiones y Teleservicios, S.A.U.	Chairman
	Telefónica Brasil, S.A.	Director
	Telefónica de Argentina, S.A.	Director
Mr. José Fernando de	Telefónica Brasil, S.A.	Director

Almansa Moreno-Barreda	Telefónica de Argentina, S.A.	Director
	Telefónica del Perú, S.A.A.	Director
	Telefónica Móviles México, S.A. de C.V.	Director
Mr. José María Álvarez-Pallete López	Telefónica Czech Republic, a.s.	Chairman of Supervisory Board
	Telefónica DataCorp, S.A.U.	Director
	Telefónica de Argentina, S.A.	Acting Director
	Telefónica del Perú, S.A.A.	Director
	Telefónica Europe, Plc.	Chairman of the Board of Directors
	Telefónica Móviles Colombia, S.A.	Acting Director
Mr. Luiz Fernando Furlán	Telefónica Brasil, S.A.	Director
Ms. María Eva Castillo Sanz	Telefónica Czech Republic, a.s.	First Vice Chairman of Supervisory Board

B.1.8 List any company board members who likewise 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	Name of listed company	Post
Mr. César Alierta Izuel	International Consolidated Airlines Group, S.A. ("IAG")	Director
Mr. Isidro Fainé Casas	Caixabank, S.A.	Chairman
	Abertis Infraestructuras, S.A.	Vice Chairman
	Repsol YPF, S.A.	2nd vice chairman

Mr. Carlos Colomer Casellas	Ahorro Bursátil, S.A. SICAV	Chairman
	Inversiones Mobiliarias Urquiola S.A. SICAV	Chairman
Mr. Pablo Isla Alvarez 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 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
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B.1.11 Complete the following tables on the aggregate remuneration paid to directors during the year.

a) In the reporting company:

Concept	In thousands €
Fixed remuneration	9,162
Variable remuneration	7,027
Per diems	320
Statutory compensation	0
Share options and/or other financial instruments	3,698
Other	2,213
TOTAL:	22,420

Other benefits	In thousands €
Advances	0
Loans	0
Pension funds and plans: Contributions	18
Pension funds and plans: Obligations	0
Life insurance premiums	142
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	In thousands €
Fixed remuneration	3,324
Variable remuneration	1,140
Per diems	0
Statutory compensation	0
Share options and/or other financial instruments	1,000
Other	268
TOTAL:	5,732

Other benefits	In thousands €
Advances	0
Loans	0
Pension funds and plans: Contributions	8
Pension funds and plans: Obligations	0
Life insurance premiums	11
Guarantees issued by the company in favor of directors	0

c) Total remuneration by type of director:

Type of director	By company	By group
Executive	17,721	3,427
External proprietary	1,328	17
External independent	2,789	1,765
Other external	582	523
Total	22,420	5,732

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

Total remuneration received by directors (in thousand €)	28,152
Total remuneration received by directors/profit attributable to parent company (%)	0.5

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. Matthew Key	Chairman Telefónica Digital
Mr. Santiago Fernández Valbuena	Chairman Telefónica Latin America
Mr. Luis Abril Pérez	Technical General Secretary to the Chairman
Mr. Ramiro Sánchez de Lerín García-Ovies	General Legal Secretary and of the Board of Directors
Mr. Calixto Ríos Pérez	Internal Auditing Manager
Mr. Guillermo Ansaldo Lutz	General Manager of Global Resources
Mr. Ángel Vilá Boix	General Manager of Finance and Corporate Development

Total remuneration received by senior management (in thousand €)	19,786
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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.

<p>Process for establishing board members' remuneration and relevant provisions in the bylaws</p>
<p>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.</p> <p>The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors.</p> <p>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.</p> <p>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.</p> <p>The Nominating, Compensation and Corporate Governance Committee has the following powers and duties (article 22 of the Regulations of the Board of</p>

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.

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

On the proposal of the company's chief executive, the appointment and removal of senior officers, and their compensation clauses.	Yes
Directors' remuneration, and, in the case of executive directors, the additional remuneration for their executive functions and other contract conditions.	Yes

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.

No

Role of the Remunerations Committee
<ul style="list-style-type: none"> - To propose to the Board of Directors, within the framework established in the Bylaws, the compensation for the Directors. - To prepare and propose to the Board of Directors an annual report regarding the policy for Directors' compensation. <p>The annual report drawn up by Telefónica, S.A. regarding the policy for Directors' compensation deals with the following:</p> <ul style="list-style-type: none"> - Objectives of the compensation policy - Detailed structure of compensation. - Scope of application and reference parameters for variable remuneration. - Relative importance of variable remuneration with regard to fixed remuneration. - Basic terms of the contracts of Executive Directors. - Changes in remuneration over time. - Process for the preparation of the compensation policy.

Have external consultancy firms been used?	Yes
Identity of external consultants	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
Mr. Isidro Fainé Casas	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Chairman of Criteria Caixaholding, S.A.
		Chairman of Caja de Ahorros y Pensiones de Barcelona, "la Caixa"
		Chairman of Caixabank, S.A.
Mr. Antonio Massanell Lavilla	Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	General Manager of Caixabank, S.A.
		Director of Bousorama, S.A.

		Chairman of Barcelona Digital Technological Centre
		Director of Caixa Capital Risc, S.G.E.C.R., S.A.
		Chairman of Port Aventura Entertainment, S.A.
		Director of e-la Caixa, S.A.
		Director of Mediterranea Beach & Golf Community, S.A.
		Director of Serveis Informàtics de la Caixa, S.A.
Mr. José Fernando de Almansa Moreno-Barreda	Banco Bilbao Vizcaya Argentaria, S.A.	Acting Director of Grupo Financiero BBVA Bancomer, S.A. de C.V.
		Acting 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.

Yes

During the meeting held on 12 April 2011 the Board of Directors of Telefónica, S.A. approved the partial modification of the Regulations of the Board of Directors, the main purpose being to adapt them to the new legislation published up to that time regarding listed public companies and corporations and to bring them into line with the changes to the bylaws which would be approved by the 2011 General Shareholders' Meeting. Consequently, with a view to coordinating the regulatory texts dealing with the corporate governance of the Company, the implementation of the partial amendments to the Regulations was postponed until the corresponding changes to the bylaws were approved, which took place on 18 May 2011.

The amendments to the Regulations of the Board proposed in April 2011 were particularly concerned with the following changes in legislation: (i) Law 12/2010, of 30 June, modifying Law 19/1988, of 12 July, concerning auditing, Law 24/1988, of 28 July, concerning the securities market, and the revised text of the Spanish Companies Act approved by Royal Legislative Decree 1564/1989, of 22 December, to bring it into line with EU regulations; (ii) Royal Legislative decree 1/2010, of 2 July, approving the revised text of the Corporate Enterprises Act; and (iii) Law 2/2011, of 4 March, on sustainable economy.

The following articles of the Regulations of the Board of Directors were amended:

- Article 10.- Appointment, re-election and ratification of Directors.
- Article 21.- The Audit and Control Committee.
- Article 30.- Duty of loyalty.
- Article 32.- Specific applications of the duty of loyalty.
- Article 36.- Report on compensation policy.

These modifications were notified to the CNMV and inscribed in the Mercantile Register of Madrid on June 24, 2011.

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.

The Board of Directors shall have the power to fill, on an interim basis, any vacancies that may arise after the General Shareholders Meeting, by coopting 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 the 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 Appointments, Compensation and Good 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.

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 Appointments, Compensation and Good Governance Committee, and in the case of independent Directors by the corresponding proposal by the committee.

Appraisal

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 and 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 termination of the appointment of any independent Director before the expirations of their statutory term, except in the event of just cause, recognized by the Board on the basis of a prior report submitted by 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 Board may also propose the termination of the appointment of independent Directors in the case 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 "Removal" (B.1.19) 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

Measures for limiting risk
<ul style="list-style-type: none">- Pursuant to the provisions of the Regulations of the Board of Directors, the actions of the Chairman must always be in accordance with the guidelines and criteria established by the shareholders at the General Shareholders' Meeting and by the Board of Directors and its Committees.- 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 note 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.

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.

Description of resolution:

All resolutions

Quorum	%
Personal or proxy attendance of one half plus one of all Directors.	50.01

Type of majority	%
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 Committee, 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

Description of requirements
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

Age limit for Chairman	Age limit for CEO	Age limit for directors
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

Maximum number of years in office	0
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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
<p>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.</p> <p>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.</p> <p>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.</p> <p>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 their work as members of the board. There is thus no implicit bias against the selection of women directors, if, among the potential candidates, there are women who meet the professional profile sought in each case.</p>

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.1.28 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.

Number of board meetings	12
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	17
Number of meetings of the Audit and Compliance Committee	11
Number of meetings of the Appointments and Remunerations Committee	8

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	1
% of non-attendances of the total votes cast during the year	0.476

B.1.31 Indicate whether the individual and consolidated financial statements submitted for authorization for issue by the board 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 laid before 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.

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 eleven (11) meetings in the course of 2011.

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.

Appointment and removal procedure
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.

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

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

Yes

Remarks
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).

B.1.35 Indicate and explain, where applicable, the mechanisms implemented by the company to preserve the independence of the auditor, financial analysts, investment banks and 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.

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.

Likewise, 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 non-audit work for the company and/or its group. If so, state the amount of fees paid for such work and the percentage they represent of all fees invoiced to the company and/or its group.

Yes

	Company	Group	Total
Amount of non-audit work (in thousands €)	0	2	2
Amount of non-audit work as a % of the total amount billed by the audit firm	0.000	0.008	0.007

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 for how many years the current firm has been auditing the financial statements as a percentage of the total number of years over which the financial statements have been audited.

	Company	Group
Number of consecutive years	7	7

	Company	Group
Number of years audited by current audit firm/Number of years the company's financial statements have been audited (%)	24.1	33.3

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	Abertis Infraestructuras, S.A.	0.008	Vice Chairman
Mr. David Arculus	BT Group Plc.	0.000	---
	British Sky Broadcasting Group Plc.	0.000	---

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

Yes

Details of procedure
<p>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.</p> <p>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.</p>

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

Details of procedure
<p>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.</p> <p>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.</p> <p>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.</p> <p>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</p>

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.

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
<p>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.</p> <p>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.</p>

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	Other external

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, AND CORPORATE REPUTATION AND 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. David Arculus	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	Independent

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	Independent
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. David Arculus	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
Mr. Isidro Fainé Casas	Vice Chairman	Proprietary
Mr. José María Abril Pérez	Vice 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. Julio Linares López	Member	Executive
Mr. Peter Erskine	Member	Other external

STRATEGY COMMITTEE

Name	Post	Type
Mr. Peter Erskine	Chairman	Other external
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	Independent

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. Julio Linares López	Member	Executive
Mr. Peter Erskine	Member	Other external

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
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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:

- (i) To pay special attention to institutional relations in the countries in which the companies of the Telefónica Group operate.
- (ii) To review those matters of importance that affect it in international bodies and forums, or those of economic integration.
- (iii) To review regulatory and competition issues and alliances.
- (iv) 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 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 consist of not less than three nor more than 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 Spanish 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, should 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 mechanism to allow 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:

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

c) 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 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 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 their implementation and development across the Group.

c) 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 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 nor 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 Bylaws, 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 Bylaws, 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 the 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 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 and Corporate Reputation and 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:

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

- (i) 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.

(ii) 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 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 execution 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.

c) 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 and Corporate Reputation and 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 their 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.

At its meeting held on 12 April 2011 the Company's Board of Directors approved the partial modification of the Regulations of the Board of Directors, with a view to adapting them to new legislation published to that date concerning corporate enterprises and listed limited companies. The Committee's composition and duties were also modified in the bylaws by a resolution passed at the General Shareholders' Meeting last year. Consequently, with a view to coordinating the regulatory texts dealing with the corporate governance of the Company, the implementation of the partial amendments to the Regulations was postponed until the corresponding changes to the bylaws were approved, which took place on 18 May 2011.

The amendments to the Regulations of the Board proposed in April 2011 were particularly concerned with the following changes in legislation: (i) Law 12/2010, of 30 June, modifying Law 19/1988, of 12 July, concerning auditing, Law 24/1988, of 28 July, concerning the securities market, and the revised text of the Spanish Companies Act approved by Royal Legislative Decree 1564/1989, of 22 December, to bring it into line with EU regulations; (ii) Royal Legislative decree 1/2010, of 2 July, approving the revised text of the Corporate Enterprises Act; and (iii) Law 2/2011, of 4 March, on sustainable economy.

The articles in the Regulations of the Board of Directors which were modified include Article 21, concerning the Audit and Control Committee, which was amended to bring the duties of the Committee into line with the text of the eighteenth additional provision of the Spanish Securities Market Law, modified by Law 12/2010.

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 their 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 their 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 their 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 their powers and duties, composition and operation.

Human Resources and Corporate Reputation and 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 their 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 their 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 (in thousands €)
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance agreements, loans and capital contributions (borrower)	305,900
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance costs	27,365
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Commitments acquired	16,165
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance leases (lessor)	8,606
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Financing agreements: capital contributions and loans (lender)	71,760
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Repayment or cancellation of loans and finance leases (lessor)	2,708
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	6,741
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other income	2,760
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Finance income	14,274
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Receipt of services	16,134
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Leases	716
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees and deposits given	583,789
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Other expenses	3,434
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Guarantees and deposits received	46
Banco Bilbao Vizcaya Argentaria, S.A.	Rest of Telefónica Group	Contractual	Commitments acquired	16,516
Banco Bilbao Vizcaya	Rest of Telefónica	Contractual	Services rendered	217,702

Argentaria, S.A.	Group			
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance income	2,892
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Financing agreements: capital contributions and loans (lender)	277,274
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance costs	6,166
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Commitments acquired	23,274,960
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Receipt of services	2,201
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Finance agreements, loans and capital contributions (borrower)	232,282
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees and deposits received	0
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Guarantees and deposits given	569
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends received	8,832
Banco Bilbao Vizcaya Argentaria, S.A.	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	514,390
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Receipt of services	19,858
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance agreements, loans and capital contributions (borrower)	14,826
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance costs	995
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Commitments acquired	259
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Services rendered	36,555

Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance leases (lessor)	2,408
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Guarantees and deposits received	1
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Guarantees and deposits given	56,307
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Finance income	11
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Commitments acquired	44,354
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Repayment or cancellation of loans and finance leases (lessor)	0
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Other income	0
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Leases	2,199
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Sale of goods (finished or in progress)	27,629
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Rest of Telefónica Group	Contractual	Other expenses	30
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance agreements, loans and capital contributions (borrower)	355,369
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Financing agreements: capital contributions and loans (lender)	298,472
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Guarantees and deposits given	10
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance costs	7,764

Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Finance income	3,040
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Dividends and other distributed earnings	366,347
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Commitments acquired	800,000
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Receipt of services	1,670
Caja de Ahorros y Pensiones de Barcelona, "la Caixa"	Telefónica, S.A.	Contractual	Guarantees and deposits received	0

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.ter of the LSA.

No

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.

The Company policy has established 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 be aware of the transactions that the Company enters 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 risks described below are the most significant:

Group-related risks

- *Country risk (investments in Latin America).* At December 31, 2011, approximately 48.5% of the Telefónica Group's assets were located in Latin America. In addition, approximately 46.5% of its revenues from operations for 2011 were derived from its Latin American operations. At December 31, 2011 approximately 58.5% of its assets and 49.0% of the income from the Latin American segment were derived from its Brazil transactions. 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.

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, as well as the terms of licenses and concessions under which the Telefónica Group operates, may change unexpectedly and negatively affect the economic conditions or business environment in which it operates, and, therefore, the Group's interests in such countries;
- inflation may rise, currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies;
- 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.

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. These risk management strategies may not achieve the desired effect, while these hedges are exposed to counterparty risk.

See Note 16 of the consolidated financial statement for a more detailed description of the use of financial instruments to manage risk.

- *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 evolution 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 the economic recovery, the health of the international banking system or the increasing concerns regarding the burgeoning deficits of some European countries. Worsening conditions in international financial markets due to any of these factors may make it more difficult and expensive for the Telefónica Group to refinance its debt (at December 31, 2011, average net debt maturing in the next six years is approximately 6,850 million euros per year) or take on additional debt if necessary.

In addition, the capacity to raise capital in the international capital markets would be impaired in terms of access and cost if Telefónica's credit ratings were downgraded. On September 28, 2011, Fitch Ratings announced that it was downgrading Telefónica's long-term rating from A-, negative outlook, to BBB+, stable outlook, and on December 21, 2011, Standard and Poor's rating Services (S&P) confirmed our BBB+ rating but changed the outlook from stable to negative and on February 2, 2012, Moody's confirmed our BBB+ credit rating, also changing the outlook from stable to negative. Despite this uncertainty, Telefónica, through its subsidiary Telefónica Emisiones, S.A.U., raised funds in the capital markets in 2011 for an aggregate amount of 4,495 million euros. In February 2012, it tapped the European market with a 1,500 million euro issue of bonds maturing February 21, 2018 with an annual coupon of 4.797%.

Moreover, the current market conditions could make it harder to renew existing undrawn bilateral credit lines, 24% of which, at December 31, 2011 initially mature prior to December 31, 2012. Finally, the current financial situation could make it more difficult and costly to raise additional equity capital from shareholders.

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 the economic recovery will continue may negatively affect the level of demand of 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 high in Europe, but basically negligible in the rest of the countries where the Telefónica Group operates.

Similarly, the sovereign debt crisis in certain euro-area countries and rating downgrades in some of these 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 financial and/or obtain liquidity. This could have a negative effect on the Group's businesses, financial position, results or cash flow.

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.

- *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 dominant 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 compared to the end of 2010 of over 83%) and Germany (cuts of over 50% since December 2010). In Spain, in December 2011, the regulator (CMT) launched a public consultation on mobile network call termination rates, proposing a reduction of between 75% and 80%.

Other services with regulated prices include SMS and call roaming. In this case, a declining scale for maximum wholesale and retail prices is in place, with Telefónica already having been forced to cut the maximum prices of voice calls, text messages and wholesale roaming prices from those in force in mid 2011 by 11.43%, 36.36% and 60%, respectively, by mid 2012. In July, the European Commission released a proposal for a review of the Roaming Regulation aimed at achieving a long-term solution. According to this proposal, 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. The proposal includes a transitional period during which the current maximum prices would be applied until the structural measure is implemented. Retail data roaming prices would also include new caps.

Finally, regarding net neutrality, the Commission released a report on net neutrality in which it maintains the non-regulatory alternative. It did, however, pose the need to know and supervise operators' traffic management practices. Moreover, the Commission turned to BEREC to draft a set of guidelines for transparency and minimum quality of service standards.

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 a move to review –and reduce– mobile network termination prices. For instance, reductions have been approved in Mexico and Chile of 61% and 60%, respectively. In Brazil, in October 2011, the regulator (Anatel) approved the fixed-mobile rate adjustment regulation, which entails a gradual reduction of these rates by applying a CPI- factor. This reduction factor is 18% in 2012, 12% in 2013 and 10% in 2014. The absolute decrease in public rates must be passed on to mobile interconnection rates (VU-M). In addition, there is a trend toward reductions in termination rates in Peru, Venezuela and Colombia.

Meanwhile, the regulatory landscape in Europe has changed as a consequence of the approval in 2009 of the European Union's common regulatory framework, which had to be transposed into national law by Member States by May 2011. At the date of preparation of this document, of the countries in which the Telefónica Group operates, Spain and Germany had yet to transpose this community law. The regulatory principles established suggest that the new frameworks in each Member State could result in increased regulatory pressure on the local competitive environment. 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 could play a key role in the incentives for operators to invest in net fixed broadband networks in the short and medium term, thus affecting the outlook for the business and competition in this market segment. The European Commission is currently recording the respective recommendations on cost accounting and non-discrimination which could apply more regulatory pressure to fixed operators.

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 the imposition of fines or even revocation or forfeiture of the license, authorization or concession.

In addition, since the Telefónica Group holds a leading market share in many of the countries where it operates, the Group could be affected by regulatory actions of antitrust or competition authorities. These authorities could prohibit certain actions, such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on the Company, which, if significant, could result in loss of market share and/or in harm to 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 Telefónica Group's financial position, operating results and cash flow.

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 can force Telefónica to invest in the development of new products, technology and services so it can continue to compete effectively with current or future competitors, which may reduce the revenue margins it obtains. In this respect, margins from the traditional voice and data businesses are shrinking, while new sources of revenues are arising from mobile internet.

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, hefty investment is required to deploy these networks, which entails fully or partially substituting the copper of the access loop with fiber optics. As things stand now, 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 these network upgrade tasks and the ability 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 capacity and spectrum coverage, and assume the related costs of obtaining this capacity, could have an adverse impact on the quality of services and on the Company's ability to provide new services, potentially adversely affecting the Group's financial position and results of operations.

Specifically, in Germany, the regulator launched a public consultation to identify demand for spectrum in the 900 MHz and 1800 MHz frequencies from 2017. A decision in this respect is expected for 2013. Regarding the allocation of new spectrum and the related costs, in 2011, additional spectrum was awarded in Spain covering all bands attributed to mobile services for a total costs for all blocks of approximately 842 million euros.

- *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. 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 Telefónica Group's businesses and the results of its operations.

- *Risks associated with unforeseen network interruptions.* Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including those due to network, hardware or software failures, 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 security measures on its premises. However, these measures are not always effective. Although the Telefónica Group carries business interruption insurance, its insurance policy may not provide coverage in amounts sufficient to compensate for potential losses.

- *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 body of the World Health Organization in research on cancer (IARC) classified electromagnetic fields of 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, although it was announced that in 2012 a formal assessment of this risk will be conducted, taking into account all scientific evidence available.

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, which may affect the capacity to capture or retain customers or may discourage the use of the mobile telephone, should not be disregarded.

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 position, results and cash flow.

- *Risk of asset impairment.* 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 the future cash flows expected, 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 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 taken impairment losses on certain of its investments, affecting the results of the year when they were made. In 2011, 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 and the contribution to profit for the year, resulted in a negative impact of 620 million euros.

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 in, or any out of court settlement of, these or other proceedings could result in significant costs and may have a material adverse effect on the Telefónica Group's business, financial condition, results of operations and cash flow.

D.2 Indicate whether the company or group has been exposed to different types of risk (operational, technological, financial, legal, reputational, fiscal...) 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 the future cash flows expected, 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 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 taken impairment losses on certain of its investments, affecting the results of the year when they were made. In 2011, 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 and the contribution to profit for the year, resulted in a negative impact of 620 million euros. The Company also transferred 80 million euros of the value of its holding in BBVA, up to its fair value.

D.3 Indicate whether there is a committee or other governing body in charge of responsible for 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</p>

	<p>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 Regulations of the General Shareholders' Meeting with a view to facilitating shareholders' attendance and participation therein:

* 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:

a) The text of all the proposed resolutions that are to be submitted to the shareholders at the General Shareholders' Meeting and that have by then been approved by the Board of Directors, provided, however, that the Board of Directors may amend such proposals up to the date of the Meeting when so permitted by the Law.

b) Information regarding the place where the General Shareholders' Meeting is to be held, describing, when appropriate, the means of access to the meeting room.

- c) The procedure to obtain attendance cards or certificates issued by the entities legally authorized to do so.
- d) The means and procedures to grant a proxy for the General Shareholders' Meeting.
- e) If established, the means and procedures to cast votes from a distance.
- f) 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) 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.

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

Details of measures
<p>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.</p> <p>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:</p> <ul style="list-style-type: none"> - 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. <p>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).</p>

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 18, 2011, shareholders approved a partial amendment of the Regulations of the General Shareholders' Meeting to adjust them to legislative changes concerning corporate enterprises and listed limited companies to that date, in particular (i) Royal Legislative decree 1/2010, of 2 July, approving the revised text of the Corporate Enterprises Act; and (ii) Royal Legislative decree 13/2010, of 3 December, on fiscal, labor and liberalization measures designed to encourage investment and to create jobs.

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 May 18, 2011, 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 5.- Amended to ensure the enumerated powers of the General Shareholders' Meeting reflect those set out in article 160 of the Corporate Enterprises Act, in line with the amendments to article 14 of the Company Bylaws.
- Article 8.1.- Amended to adapt the text taken from article 173 of the Corporate Enterprises Act to article 6, section 2 of Royal Legislative decree 13/2010, in line with the amendment to article 16.1 of the Company Bylaws.
- Article 11.- Amended to incorporate the provision concerning the Electronic Shareholders' Forum included in article 539 of the Corporate Enterprises Act.
- Article 13.1.- Amended to replace a reference to the Spanish Companies Act with one to the Corporate Enterprises Act and a reference to article 114 of the Securities Market Act with one to article 514 (currently article 526) of the Corporate Enterprises Act.
- Article 14.1.- Amended to agree with modified article 16 of the Company's Bylaws allowing for the possibility of holding the General Shareholders' Meeting on premises other than those of the registered offices (any location in Spain) if so agreed by the Board of Directors and in accordance with the provisions of article 175 of the Corporate Enterprises Act.

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

Date of general meeting	Attendance data				Total
	% attending in person	% by proxy	% remote voting		
			Electronic means	Other	
18-05-2011	13.562	38.295	0.000	0.000	51.857

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 18, 2011

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 2010.	2,207,810,618 (93.284%)	5,956,363 (0.252%)	152,982,880 (6.464%)	Approved
II	Distribution of a dividend to be charged to unrestricted reserves.	2,219,645,239 (93.785%)	4,149,697 (0.175%)	142,954,925 (6.040%)	Approved

III.1	Amendment of articles 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 bis and 36 of the Company's Bylaws.	2,223,675,521 (93.955%)	433,129 (0.018%)	142,641,211 (6.027%)	Approved
III.2	Addition of a new section 5 to article 16 of the Company's Bylaws.	2,208,538,171 (93.314%)	15,555,091 (0.657%)	142,656,599 (6.028%)	Approved
III.3	Addition of a new article 26 bis to the Company's Bylaws.	2,223,321,465 (93.940%)	771,470 (0.033%)	142,656,926 (6.028%)	Approved
IV.1	Amendment of Articles 5, 8.1, 11 and 13.1 of the Regulations for the General Shareholders' Meeting.	2,221,601,233 (93.867%)	2,549,750 (0.108%)	142,598,878 (6.025%)	Approved
IV.2	Amendment to article 14.1 of the Regulations of the General Shareholders' Meeting.	2,221,561,630 (93.866%)	2,567,030 (0.108%)	142,621,201 (6.026%)	Approved
V.1	Re-election of Mr. Isidro Fainé Casas as Director.	1,814,864,916 (76.682%)	401,429,841 (16.961%)	150,455,104 (6.357%)	Approved
V.2	Re-election of Mr. Vitalino Manuel Nafría Aznar as Director.	1,855,363,380 (78.393%)	363,702,533 (15.367%)	147,683,948 (6.240%)	Approved
V.3	Re-election of Mr. Julio Linares López as Director.	1,944,245,758 (82.148%)	277,433,490 (11.722%)	145,070,613 (6.130%)	Approved
V.4	Re-election of Mr. David Arculus as Director.	2,192,558,357 (92.640%)	30,152,806 (1.274%)	144,038,698 (6.086%)	Approved
V.5	Re-election of Mr. Carlos Colomer Casellas as Director.	2,159,448,026 (91.241%)	63,286,058 (2.674%)	144,015,777 (6.085%)	Approved
V.6	Re-election of Mr. Peter Erskine as Director.	1,860,884,336 (78.626%)	352,593,877 (14.898%)	153,271,648 (6.476%)	Approved
V.7	Re-election of Mr. Alfonso Ferrari Herrero as Director.	2,137,217,589 (90.302%)	85,512,315 (3.613%)	144,019,957 (6.085%)	Approved
V.8	Re-election of Mr. Antonio Massanell Lavilla as Director.	1,866,463,963 (78.862%)	349,569,679 (14.770%)	150,716,219 (6.368%)	Approved
V.9	Appointment of Mr. Chang Xiaobing as Director.	1,925,895,607 (81.373%)	292,272,374 (12.349%)	148,581,880 (6.278%)	Approved
VI	To authorize the Board of Directors in order that, under Section 297.1.b) of the Corporate Enterprises Act, it may increase the share capital of the company.	2,033,763,073 (85.931%)	182,876,859 (7.727%)	150,109,929 (6.342%)	Approved
VII	Re-election of the Auditor for Fiscal Year 2011.	2,222,589,711 (93.909%)	1,788,628 (0.076%)	142,371,522 (6.015%)	Approved

VIII	Approval of a long-term incentive Plan based on shares of Telefonía, S.A. aimed at members of the Executive Team of the Telefonía Group.	2,186,188,141 (92.371%)	29,190,388 (1.233%)	151,371,332 (6.396%)	Approved
IX	Approval of a long-term incentive restricted Plan based on shares of Telefonía, S.A. aimed at Employees and Executive Personnel of the Telefonía Group.	2,159,764,629 (91.254%)	62,981,871 (2.661%)	144,003,361 (6.084%)	Approved
X	Approval of global purchase plan of Telefonía, S.A. shares for employees of the Telefonía Group	2,185,541,679 (92.344%)	38,741,588 (1.637%)	142,466,594 (6.020%)	Approved
XI	Delegation of powers to formalize, interpret, correct and implement the resolutions adopted by the General Shareholders' Meeting.	2,223,620,267 (93.952%)	682,863 (0.029%)	142,446,731 (6.019%)	Approved

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

Yes

Number of shares required to attend the General Shareholders' Meetings	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. If no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda and against those proposals which, albeit not included in the Agenda, may be submitted to a vote in said Meeting

* 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.

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 fulfils 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.es) in the section "Shareholders and Investors" (<http://www.telefonica.es/investors/>), 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.

- 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.**

See sections: A.9, B.1.22, B.1.23 and E.1, E.2.

Explain

According to Article 21 of the Company's Bylaws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed, and those held by other shareholders that have granted their proxy to the first-mentioned shareholder shall not be computed, without prejudice to the application of the aforementioned limit of 10 percent to each of the shareholders that have granted a proxy.

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 that this measure does not entail a device designed to block public tender offers, but rather 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.

Notwithstanding the above, in accordance with the provisions of article 527 of the Corporate Enterprises Act, from July 1 2011 any clauses in the bylaws of listed corporations that restrict the number of shares that may be cast by a single shareholder or by shareholders belonging to the same group were null and void.

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.

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.**

See sections: C.4 and C.7

Not applicable

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

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

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.

See section: E.8

Complies

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

See section: E.4

Complies

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; fulfills 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

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 plans, 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.**

See sections: B.1.10, B.1.13, B.1.14 and D.3

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

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.

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.

See sections: A.2 , A.3, B.1.3 and B.1.14.

Complies

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.

See section: B.1.3

Complies

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, despite the considerable sums actually invested.**
- 2. In companies with a plurality of shareholders represented on the board but not otherwise related.**

See sections: B.1.3, A.2 and A.3

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 December 31, 2011, the group of external Directors of Telefónica, S.A. was composed of 15 members (of a total of 18 Members), of whom five are proprietary Directors, eight 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 5.410% of the capital stock of Telefónica, S.A., and two act in representation of Banco Bilbao Vizcaya Argentaria, S.A. (BBVA), which holds 5.658% 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 highest stock market capitalization, reaching the figure of 61,089 million euros at December 31, 2011, which means a very high absolute value of the stakes of "la Caixa" and BBVA in Telefónica (that of "la Caixa" is 3,305 million euros, and that of BBVA is 3,456 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, at the General Shareholders' Meeting held on May 18, 2011 the Company approved the appointment of the Board member named by China Unicom.

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

See section: B.1.3

Complies

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.

See sections: B.1.3 and B.1.4

Complies

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.**

See sections: B.1.2, B.1.27 and B.2.3.

Explain

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.

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 their work as members of the board. There is thus no implicit bias against the selection of women directors, if, among the potential candidates, there are women who meet the professional profile sought in each case.

- 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.**

See section: B.1 42

Complies

- 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.**

See section: B.1.21

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 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.

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.

See section: B.1.34

Complies

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.

See section: B.1.29

Complies

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.

See sections: B.1.28 and B.1.30

Complies

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

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.**

See section: B.1.19

Complies

- 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.**

See section: B.1.42

Complies

- 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.**

See section: B.1.41

Complies

- 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

- 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.**

See sections: B.1.8, B.1.9 and B.1.17

Complies

- 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.

See section: B.1.2

Complies

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

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

See section: B.1.2

Complies

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.

See sections: A.2, A.3 and B.1.2

Complies

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.

See sections: B.1.2, B.1.5 and B.1.26

Complies

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.

See sections: B.1.43, B.1.44

Complies

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

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.

See section: B.1.5

Complies

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, itemized 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:**
 - i) **The types of directors they apply to, with an explanation of the relative weight of variable to fixed remuneration items;**
 - ii) **Performance evaluation criteria used to calculate entitlement to the award of shares or share options or any performance-related remuneration;**
 - iii) **The main parameters and grounds for any system of annual bonuses or other non cash benefits; and**
 - iv) **An estimate of the sum total of variable payments arising 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:**
 - i) **Duration;**
 - ii) **Notice periods; and**
 - iii) **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.**

See section: B.1.15

Complies

- 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.

See sections: A.3, B.1.3

Complies

- 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

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

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

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.

See sections: B.1.16

Partially complies

At the Company's Ordinary General Shareholders' Meeting, the annual report regarding the Board of Directors compensation policy is given to shareholders for information purposes, containing the information stipulated in recommendation 40 of the Unified Good Governance Code and made available to shareholders from the date of publication of the call for the General Shareholders' Meeting.

Telefónica provides extensive information at its Annual General Shareholders' Meetings, through the presentations made thereat by the General Secretary and Secretary of the Board of Directors of the Company, regarding the contents and highlights of such Report on the Compensation Policy for the Board of Directors.

As regards submitting such report to a consultative vote at the General Shareholders' Meeting, as a separate item on the agenda, Telefónica did not deem it advisable for the General Shareholders' Meeting held on May 18, 2011 because it believes that this matter falls outside the purview of the shareholders at a General Meeting and, in addition, because it is a highly strategic issue and a vote thereon might therefore lead to open debate at each Meeting, thus generating instability and uncertainty.

The Annual Report on Directors' Compensation referred to in article 61 ter of the Securities Market Act will be submitted to a consultative vote at the General Shareholders' Meeting to be held in the first half of 2012, as a separate item on the agenda.

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:**
 - i) **Participation and attendance fees and other fixed directors payments;**
 - ii) **Additional compensation for acting as chairman or member of a board committee;**
 - iii) **Any payments made under profit-sharing or bonus schemes, and the reason for their accrual;**
 - iv) **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;**
 - v) **Any severance packages agreed or paid;**
 - vi) **Any compensation they receive as directors of other companies in the group;**
 - vii) **The remuneration executive directors receive in respect of their senior management posts;**
 - viii) **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, itemized by:**
 - i) **Number of shares or options awarded in the year, and the terms set for their execution;**
 - ii) **Number of options exercised in the year, specifying the number of shares involved and the exercise price;**
 - iii) **Number of options outstanding at the annual close, specifying their price, date and other exercise conditions;**
 - iv) **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

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.

See sections: B.2.1 and B.2.6

Complies

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

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.

See sections: B.2.1 and B.2.3

Complies

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

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

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

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

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.

See sections: D

Complies

50. The Audit Committee's role should be:

1. 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. 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 program, 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 Committee should 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.

See sections: B.1.35, B.2.2, B.2.3 and D.3

Complies

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

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.**

See sections: B.2.2 and B.2.3

Complies

- 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.**

See section: B.1.38

Complies

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

See section: B.2.1

Complies

- 55. The Nomination 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.**

See section: B.2.3

Complies

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

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.

See sections: B.1.14, B.2.3

Complies

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 RELATED TO SECTION G ARE INCLUDED IN THE APPENDIX TO THIS ANNUAL REPORT ON CORPORATE GOVERNANCE.

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.

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

This annual corporate governance report was adopted by the company's Board of Directors at its meeting held on: 22-2-2012

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

No

This Annual Corporate Governance Report was originally prepared in Spanish. In the event of a discrepancy, the Spanish-language version prevails.

APPENDIX TO THE TELEFÓNICA, S.A. 2011 ANNUAL REPORT ON CORPORATE GOVERNANCE

I.- SECTION G OF THE ANNUAL REPORT ON CORPORATE GOVERNANCE: 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.

GENERAL CLARIFICATION: It is hereby stated that the details contained in this report refer to the Financial Year ended on December 31, 2011, 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 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 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.

On December 28, 2011, Mr. Carlos Colomer Casellas notified the CNMV of his ownership of various put options on shares of Telefónica, S.A., to be settled by offset. Mr. Colomer thus holds 63,508 put options on Telefónica shares, with an exercise price of 16 euros on 31,250, maturing on June 30, 2012 and of 15.5 euros on the remaining 32,258 which mature on the same date.

The amounts appearing in Section A.3. of this report under “Number of direct options” (i.e. Mr. César Alierta Izuel, 344,613; Mr. Julio Linares López, 258,460; and Mr. José María Álvarez-Pallete López, 156,642) related to the maximum number of shares corresponding to the fourth and fifth phases of the “Performance Share Plan” to be delivered (from July 1, 2012 and 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. 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, 249,917--390,496; Mr. Julio Linares López, 149,950--234,298; and Mr. José María Álvarez-Pallete López, 79,519--124,249) relate to the theoretical number of shares assigned and the maximum possible number of shares to be received if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met.

- Note 3 to Sections A.10 and E.2]

Article 21 of the Company Bylaws establishes that the General Shareholders' Meeting shall adopt its resolutions with the majority of votes established by law, cast by the shareholders present in person or by proxy.

Each share whose holder is present at the General Shareholders' Meeting in person or by proxy shall give the right to one vote, except in the case of non-voting shares, subject to the provisions of Law.

Notwithstanding the provisions of the preceding paragraph, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder.

In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed, and those held by other shareholders that have granted their proxy to the first-mentioned shareholder shall not be computed, without prejudice to the application of the aforementioned limit of 10 percent to each of the shareholders that have granted a proxy.

The 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.

For purposes of the provisions contained in the preceding paragraph, the provisions of article 4 of the current Securities Market Act of July 28, 1998 (in the reference to article 42 of the Commercial Code) shall apply in order to decide whether or not a group of entities exists and to examine the situations of control indicated above.

Without prejudice to the limitations upon the right to vote described above, all shares present at the Meeting shall be computed for purposes of determining the existence of a quorum in constituting the Meeting, provided, however, that the 10 percent limit on the number of votes

established in article 21 of the Company's Bylaws shall apply to such shares at the time of voting.

Notwithstanding the above, in accordance with the provisions of article 527 of the Corporate Enterprises Act, from July 1 2011 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 or by shareholders belonging to the same group will be null and void.

- Note 4 to Section B.1.7.]

On February 3, 2012, Mr. José María Álvarez-Pallete López tendered his resignation as Director of Telefónica DataCorp, S.A.U.

- 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 2011, below we provide the remuneration and benefits received by the Directors of Telefónica, S.A. in the year 2011.

i) Directors' compensation

The compensation of Telefónica, S.A.'s 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, which amount shall remain unchanged until and unless the shareholders decide to modify it. 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, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes a fixed payment and fees for attending meetings of the Board of Director's advisory or control Committees. Total compensation paid to Telefónica, S.A.'s Directors for discharging their duties in 2011 amounted to 4,549,501 euros in fixed compensation and fees for attending the Board's advisory or control committee meetings.

Therefore, the compensation paid to 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 plus fees for attending the meetings of the Board's advisory or control committees. Executive Board members 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.

The following table presents the fixed amounts established for membership of the Telefónica, S.A. Board of Directors, Executive Commission and the advisory or control Committees:

Position	Board of Directors	Executive Commission	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

(Euros)

In addition, the amount paid for attendance at each of the Advisory or Control Committee meetings is 1,250 euros.

ii) Individual breakdown

The following table presents the breakdown by item of the compensation and benefits paid to Telefónica, S.A. directors in 2011:

(euros)

Director	Salary/ Compensation ¹	Fixed Payment Board Committees ²	Attendan ce fees ³	Variable short-term remuneratio n ⁴	Other items ⁵	TOTAL
Executive						
Mr. César Alierta Izuel	2,530,800	100,000	--	4,015,440	265,300	6,911,540
Mr. Julio Linares López	1,973,100	--	--	3,011,580	126,084	5,110,764
Mr. José María Álvarez-Pallete López	316,000	--	--	--	21,570	337,570
Proprietary						
Mr. Isidro Fainé Casas	250,000	100,000	--	--	10,000	360,000
Mr. Vitalino Nafría Aznar	250,000	56,000	26,250	--	--	332,250
Mr. José María Abril Pérez	150,000	122,167	13,750	--	--	285,917
Mr. Antonio Massanell Lavilla	150,000	70,000	32,500	--	10,000	262,500
Mr. Chang Xiaobing	87,500	--	--	--	--	87,500
Independent						
Mr. David Arculus	150,000	28,000	11,250	--	--	189,250
Ms. Eva Castillo Sanz	150,000	42,000	25,000	--	--	217,000

Mr. Carlos Colomer Casellas	150,000	156,000	21,250	--	130,000	457,250
Mr. Alfonso Ferrari Herrero	150,000	212,000	58,750	--	132,500	553,250
Mr. Luiz Fernando Furlán	150,000	14,000	5,000	--	--	169,000
Mr. Gonzalo Hinojosa Fernández de Angulo	150,000	198,000	48,750	--	133,750	530,500
Mr. Pablo Isla Álvarez de Tejera	150,000	75,833	13,750	--	--	239,583
Mr. Javier de Paz Mancho	150,000	156,000	11,250	--	120,000	437,250
Other external						
Mr. Fernando de Almansa Moreno-Barreda	150,000	56,000	25,000	--	10,000	241,000
Mr. Peter Erskine	150,000	156,000	27,500	--	3,750	337,250

- 1 **Salary/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director's actual attendance at meetings of the Board of Telefónica, S.A. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.
- 2 **Fixed Payment Board Committees:** Amount of items other than attendance at meetings payable to Directors for membership of the Executive Committee or advisory or control Committees of Telefónica, S.A., irrespective of effective attendance at meetings of said Committees.
- 3 **Attendance fees:** Amounts payable for attendance at 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.
- 5 **Other items:** Includes, inter alia, amounts paid for membership of the various regional advisory committees in Spain, and the Telefónica Corporate University Advisory Council.

It is duly noted that Mr. Vitalino Nafría Aznar tendered his resignation as Director on December 14, 2011. Appointed to replace him by the method of co-option was Mr. Ignacio Moreno Martínez, who did not receive any compensation in this respect in 2011.

The following table presents the specific compensation paid to Directors of Telefónica, S.A. for membership of the various advisory or control Committees in 2011:

Board Members	Audit and Control	Nominating, Compensation and Corporate Governance	Human Resources, Corporate Reputation and Responsibility	Regulation	Service Quality and Customer Service	International Affairs	Innovation	Strategy	TOTAL
Mr. César Alierta Izuel	-	-	-	-	-	-	-	-	-
Mr. Isidro Fainé Casas	-	-	-	-	-	-	-	-	-
Mr. Vitalino Manuel Nafría Aznar	26,500	-	16,500	21,500	-	17,750	-	-	82,250
Mr. Julio Linares López	-	-	-	-	-	-	-	-	-
Mr. José María Abril Pérez	-	-	-	-	-	20,250	15,667	-	35,917
Mr. José Fernando de Almansa Moreno-Barreda	-	-	-	21,500	-	34,250	-	25,250	81,000
Mr. José María Álvarez-Pallete López	-	-	-	-	-	-	-	-	-
Mr. David Arculus	-	-	-	20,250	-	19,000	-	-	39,250
Ms. Eva Castillo Sanz	-	-	-	21,500	20,250	-	-	25,250	67,000
Mr. Carlos Colomer Casellas	-	17,750	-	-	17,750	-	41,750	-	77,250
Mr. Peter Erskine	-	20,250	-	-	-	-	24,000	39,250	83,500
Mr. Alfonso Ferrari Herrero	27,750	38,000	17,750	21,500	20,250	20,250	-	25,250	170,750
Mr. Luiz Fernando Furlán	-	-	-	-	-	19,000	-	-	19,000
Mr. Gonzalo Hinojosa Fernández de Angulo	40,500	22,750	19,000	-	20,250	20,250	-	24,000	146,750
Mr. Pablo Isla Álvarez de Tejera	-	20,250	14,000	35,500	14,000	-	5,833	-	89,583
Mr. Antonio Massanell Lavilla	25,250	-	16,500	-	34,250	-	26,500	-	102,500
Mr. Francisco Javier de Paz Mancho	-	-	33,000	16,500	-	17,750	-	-	67,250
Mr. Chang Xiaobing	-	-	-	-	-	-	-	-	-
TOTAL	120,000	119,000	116,750	158,250	126,750	168,500	113,750	139,000	1,062,000

Figures in euros

The following presents a breakdown of the amounts received from other Telefónica Group companies by Directors for discharging executive duties or for membership of the companies' governing bodies:

(euros)

Director	Salary/ Compensation ¹	Attendance fees ²	Variable short-term remuneration ³	Other items ⁴	TOTAL
Executive					
Mr. José María Álvarez-Pallete López	961,709	--	1,140,138	57,553	2,159,400
Proprietary					
Mr. Vitalino Nafría Aznar	16,737	--	--	--	16,737
Independent					
Mr. David Arculus	86,456	--	--	--	86,456
Ms. Eva Castillo Sanz	240,847	--	--	--	240,847
Mr. Alfonso Ferrari Herrero	297,275	--	--	--	297,275
Mr. Luiz Fernando Furlán	299,406	--	--	--	299,406
Mr. Javier de Paz Mancho	840,667	--	--	--	840,667
Other external					
Mr. Fernando de Almansa Moreno-Barreda	436,214	--	--	--	436,214
Mr. Peter Erskine	86,456	--	--	--	86,456

1 **Salary/Compensation:** Cash compensation on an established schedule, whether or not consolidable over time, and payable in consideration of the mere fact of employment, regardless of the director's actual attendance at meetings of the board or analogous organ of the Telefónica Group entity in question. Also includes fixed components of pay earned by the director for performing executive duties, as the case may be.

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:** Other amounts related to pension schemes.

With respect to employee benefits, the following table presents a breakdown of internal or external contributions made in 2011 to both long-term savings schemes (including retirement and any other survival benefit) financed fully or partially by the Company for Directors, along with any other compensation in kind received by the Director during the year:

Board Members (Executive)	Contributions to pension plans	Contributions to the Plan de Previsión Social ¹	Compensation in kind ²
Mr. César Alierta Izuel	8,402	1,014,791	57,955
Mr. Julio Linares López	9,468	555,033	83,923
Mr. José María Álvarez-Pallete López	7,574	355,563	17,346

¹ **Contributions to the Plan de Previsión Social** for Executives, set up in 2006, funded exclusively by the Company to complement the existing Pension Plan. It entails defined contributions equivalent to a certain percentage of the Director's fixed remuneration in accordance with their professional category within the Telefónica Group's organization.

² **"Compensation in kind"** includes life and other insurance premiums (e.g. general medical and dental insurance).

Share-based payment plans information is as follows:

- (i) The "Performance Share Plan" (PSP), which was approved at the General Shareholders' Meeting of June 21, 2006, began its fifth and final phase in 2010. In accordance with the terms of the Plan, the shares corresponding to the third phase of the Plan were delivered in July 2011. As established in the general conditions for this phase, a coefficient of 97.8% was applied to the theoretical number of shares assigned to each participant to determine the number of shares to be delivered.

Accordingly, the shares delivered in the third phase of the PSP to the three Executive Directors were as follows: 145,544 shares to Mr. César Alierta Izuel, 99,233 shares to Mr. Julio Linares López, and 66,155 shares to Mr. José María Álvarez-Pallete López. Meanwhile, it is laid down that the maximum number of shares for the fourth and the fifth phase of this Plan to be delivered (from July 1, 2012 and July 1, 2013), to each Executive Director of the Company, in case the covenants are met, are as follows: Mr César Alierta Izuel (173,716 shares for the fourth phase, and 170,897 shares for the fifth phase), Mr Julio Linares López (130,287 shares for the fourth phase, y 128,173 shares for the fifth phase), Mr José María Álvarez-Pallete López (78,962 shares for the fourth phase, y 77,680 shares for the fifth phase); and

- (ii) The "Performance & Investment Plan" ("PIP") approved at the General Shareholders' Meeting of May 18, 2011. Under this plan, participants who meet qualifying requirements receive a number of Telefónica shares as variable remuneration. The first phase of this plan began in 2011, once the PSP had finished. The theoretical number of shares assigned and the maximum possible number of shares to be received by the Executive Directors in the first phase of the PIP, if the co-investment requirement established in the Plan and the maximum target TSR established for each phase are met, are as follows (i) to Mr. César Alierta Izuel: 249,917 theoretical shares and a maximum of 390,496 shares; to Mr. Julio Linares

López: 149,950 theoretical shares and a maximum of 234,298; and Mr. José María Álvarez-Pallete López: 79,519 theoretical shares and a maximum of 124,249 shares.

Furthermore, at the General Shareholders' Meeting of Telefónica, S.A. on June 23, 2009, the Company's shareholders approved the introduction of a Telefónica, S.A. share incentive plan for all employees, including executives and board members, of the Telefónica Group worldwide. Under this plan, employees that meet the qualifying requirements are offered the possibility of acquiring Telefónica, S.A. shares, 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.

The three board members decided to participate in this plan, contributing the maximum, i.e. 100 euros a month, over 12 months. Therefore, at the date of preparing these financial statements, the three executive Directors had acquired a total of 212 shares through this plan, whereby they are entitled to receive, free of charge, an equivalent number of shares providing that, among other conditions, they retain the acquired shares during the consolidation period (12 months from the end of the acquisition period).

It should be noted that the external Directors do not receive and did not receive in 2011 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 2011 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, S.A. as a listed company in that market.

- Note 7 to Section B.1.11.]

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 2011 to the Pension Plan for Senior Executives was 1,658,714.82 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 2011 Annual Corporate Governance Report, as it was done in the Annual Corporate Governance Reports for 2008, 2009 and 2010.

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 2011 to the Pension Plan.

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 2011, below we provide the remuneration and benefits received by the Directors of Telefónica, S.A. in the year.

The seven senior executives of the Company in 2011, excluding those that are also members of the Board of Directors, received since their appointment a total for all items in 2011 of 12,122,954 euros. In addition, the contributions made by the Telefónica Group in 2011 with respect to the Pension Plan for these senior executive officers amounted to 2,709,866 euros. Contribution to the pension plan amounted to 50,208 euros and compensation in kind including life and other insurance premiums (e.g. general medical and dental insurance) to 154,955 euros.

Meanwhile, a total of 299,377 shares corresponding to the third phase of the PSP were delivered to senior executives of the Company. In relation to the fourth and the fifth phase of the forementioned Plan, assigned to senior executives of the Company amounts to 394,779, shares for the fourth phase and 350,485 for the fifth one.

Regarding the PIP approved at the General Shareholders' Meeting of May 18, 2011, a total of 457,949 shares were assigned to all executive directors of the Company.

- Note 10 to Section B.1.16.]

The Board plans to submit a report on the directors' remuneration policy to the advisory vote of the General Shareholders' Meeting, as a separate point on the agenda, during 2011.

- Note 11 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 12 to Section B.1.29.]

In 2011, the other Board Committees held the following meetings:

- Human Resources and Corporate Reputation and Responsibility Committee: 4
- Regulation Committee: 6
- Service Quality and Customer Service Committee: 4
- International Affairs Committee: 4
- Innovation Committee: 11
- Strategy Committee: 10

- Note 13 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 CFO and Director of Corporate Development. However, this certification is made after the Financial Statements have been prepared by the Board of Directors of the Company.

- Note 14 to Section B.1.39.]

Financial year 1983 was the first audited by an external auditor. Prior to that, the financial statement 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 15 to Section C.2.]

The transactions included under "Commitments Undertaken" in amounts of 23,274,960 and 800,000 euros, the first with Banco Bilbao Vizcaya Argentaria, S.A. and the second 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 DISCLOSURE REQUIREMENTS UNDER ARTICLE 61 BIS OF THE SPANISH SECURITIES MARKET ACT

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

Securities that are not 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.

Pursuant to Article 21 of the Company's By-Laws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed, and those held by other shareholders that have granted their proxy to the first-mentioned shareholder shall not be computed, without prejudice to the application of the aforementioned limit of 10 percent to each of the shareholders that have granted a proxy.

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.

However, this restriction on voting rights ceased to be legally binding (section 527 of the Corporate Enterprises Act) on July 1, 2011.

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 the wording of the proposed amendment in full and they shall also draft a written report 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 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 and when they signed their contracts, establish by contract, in some cases, their right to receive compensation in the same circumstances 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

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 (SCIIF in Spanish) exists and is updated.

Likewise, 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 regulated financial information and the effectiveness of the Company's internal control system and risk management systems. 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.
- To ensure the independence of the External Auditor, supervising their work and acting as a channel of communication between the Board of Directors and the External Auditor, as well as between the External Auditor and the Company management team.
- 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.

In order to carry out this function, the Audit and Control Committee is assisted by the Internal Audit department which periodically submits its activities report to the Committee. The Audit and Control Committee shall meet monthly and as often as appropriate.

The different areas and functional units of the Telefónica Group play a key role in Internal Control over Financial Reporting System 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 Corporate Finance Department regularly issues the corresponding instructions to the teams involved in the different Group companies in charge of preparing financial information. These instructions outline the processes, procedures, accounting and other regulations to be followed to guarantee that the consolidated financial information is gathered in accordance with the current legal framework.

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.

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.

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 to all personnel working in the Group's financial areas, with the aim of informing them of any accounting or financial changes which are applicable to their job of preparing consolidated financial information.

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.

In addition to the previously mentioned Model, financial risks maps are used to detect other processes which, even though they have not been identified as critical processes by the Scope Definition Model, pose significant risks to financial 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" (NCIM in Spanish). 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 which will be presented to the Company's decision-making 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 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 Internal Control over Financial Reporting System.

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 centre 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, 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, incident management).

When a process or part of a process concerning financial information is outsourced, suppliers are requested to present the ISAE 3402 certificate.

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 Legal 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 April 2011 the Audit and Control Committee was informed of the findings of the Internal Control over Financial Reporting System review which directly affected **20 companies, 267 material accounting items, 587 critical processes and 184 IT systems**, with a total of 5,110 control activities reviewed covering approximately 80% on the main accounting headings.

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 **282 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 Internal Control over Financial Reporting System (SCIIF in Spanish) 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. 2011 Annual Report on Corporate Governance was originally prepared in Spanish. In the event of a discrepancy, the Spanish-language version prevails.

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, 2011, 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, 2011, 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.

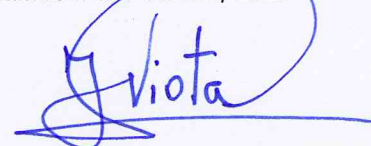
Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements, fraud or illegal acts. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, 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, 2011, 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, 2011 comply, in all material respects, with the requirements of Securities Market Law 24/1988 of 28 July, 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, 2011, 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 28, 2012 expressed an unqualified opinion on the aforementioned consolidated financial statements.

ERNST & YOUNG, S.L.



Ignacio Viota del Corte

March 28, 2012