

TELEFONICA S A  
Form 20-F  
March 26, 2010

As filed with the Securities and Exchange Commission on March 26, 2010

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

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FORM 20-F

(Mark  
One)

- REGISTRATION STATEMENT  
PURSUANT TO SECTION 12(b)  
OR (g) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
OR
- ANNUAL REPORT PURSUANT  
TO SECTION 13 OR 15(d)  
OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the fiscal year ended December  
31, 2009  
OR
- TRANSITION REPORT  
PURSUANT TO SECTION 13 OR  
15(d)  
OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_  
to \_\_\_\_\_  
OR
- SHELL COMPANY REPORT  
PURSUANT TO SECTION 13 OR  
15(d)  
OF THE SECURITIES  
EXCHANGE ACT OF 1934

Commission file number: 001-09531

TELEFÓNICA, S.A.  
(Exact name of Registrant as specified in its charter)

KINGDOM OF SPAIN  
(Jurisdiction of incorporation or organization)

Distrito C, Ronda de la Comunicación, s/n

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(Name, Telephone, E-Mail and/or Facsimile number and Address of Company Contact Person)

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Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Ordinary Shares, nominal value €1.00 per share*	New York Stock Exchange
American Depositary Shares, each representing three Ordinary Shares	New York Stock Exchange
Guarantees** by Telefónica, S.A. of the \$1,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2011; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$850,000,000 Floating Rate Guaranteed Senior Notes Due 2013; \$1,250,000,000 Fixed Rate Notes Due 2015; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$1,000,000,000 Fixed Rate Notes Due 2019; \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U.	New York Stock Exchange

\*Not for trading, but only in connection with the listing of American Depositary Shares, pursuant to the requirements of the New York Stock Exchange.

\*\*Not for trading, but only in connection with the listing of the \$1,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2011; \$750,000,000 Fixed Rate Guaranteed Senior Notes Due 2013; \$850,000,000 Floating Rate Guaranteed Senior Notes Due 2013; \$1,250,000,000 Fixed Rate Notes Due 2015; \$1,250,000,000 Fixed Rate Guaranteed Senior Notes Due 2016; \$700,000,000 Fixed Rate Guaranteed Senior Notes Due 2017; \$1,000,000,000 Fixed Rate Notes Due 2019; \$2,000,000,000 Fixed Rate Guaranteed Senior Notes Due 2036; each of Telefónica Emisiones, S.A.U. (a wholly-owned subsidiary of Telefónica, S.A.)

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

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Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

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The number of outstanding shares of each class of capital stock of Telefónica, S.A. at December 31, 2009 was:

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Ordinary Shares, nominal value €1.00 per share: 4,563,996,485

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as Issued by the international Accounting Standards Board  Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17  Item 18

If this is an annual report indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

This Annual Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “will”, “expect”, “aim”, “hope”, “anticipate”, “intend”, “believe” and similar language or the negative thereof or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3. Key Information—Risk Factors”, “Item 4. Information on the Company”, “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures About Market Risk” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of competition in telecommunications markets;
- trends affecting our financial condition or results of operations;
- acquisitions or investments which we may make in the future;
  - our capital expenditures plan;
  - our estimated availability of funds;
- our ability to repay debt with estimated future cash flows;
- our shareholder remuneration policies;
- supervision and regulation of the telecommunications sectors where we have significant operations;
  - our strategic partnerships; and
- the potential for growth and competition in current and anticipated areas of our business.

Such forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties, and actual results may differ materially from those anticipated in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our business that could affect the matters referred to in such forward-looking statements include but are not limited to:

- changes in general economic, business or political conditions in the domestic or international markets (particularly in Latin America) in which we operate or have material investments that may affect demand for our services;
- changes in currency exchange rates, interest rates or in credit risk in our treasury investments or in some of our financial transactions;
  - general economic conditions in the countries in which we operate;
  - existing or worsening conditions in the international financial markets;
- failure to maintain satisfactory working relationships with our joint venture partners;

- the actions of existing and potential competitors in each of our markets;
- the impact of current, pending or future legislation and regulation in countries where we operate;
- failure to renew or obtain the necessary licenses, authorizations and concessions to carry out our operations;



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- the potential effects of technological changes;
- the impact of limitations in spectrum capacity;
- failure of suppliers to provide necessary equipment and services on a timely basis;
- the impact of unanticipated network interruptions;
- the effect of reports suggesting that radio frequency emissions cause health problems;
- the impact of impairment charges on our goodwill and assets as a result of changes in the regulatory, business or political environment; and
  - the outcome of pending litigation.

Readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of the date of this Annual Report. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date of this Annual Report including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

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CERTAIN TERMS AND CONVENTIONS

Our ordinary shares, nominal value €1.00 per share, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges under the symbol “TEF”. They are also listed on various foreign stock exchanges such as the London, Buenos Aires and Tokyo stock exchanges and are quoted through the Automated Quotation System of the Spanish stock exchanges and through the SEAQ International System of the London Stock Exchange. American Depositary Shares (“ADSs”), each representing the right to receive three ordinary shares, are listed on the New York Stock Exchange and on the Lima Stock Exchange. ADSs are evidenced by American Depositary Receipts (“ADRs”) issued under a Deposit Agreement with Citibank, N.A., as Depositary. Brazilian Depositary Receipts (“BDRs”), each representing the right to receive one ordinary share, are listed on the São Paulo Stock Exchange and are issued under a Deposit Agreement with Banco Bradesco, S.A., as Depositary.

As used herein, “Telefónica”, “Telefónica Group”, “Group” and terms such as “we”, “us” and “our” mean Telefónica, S.A. and its consolidated subsidiaries, unless the context requires otherwise.

As used herein, “Atento” means Atento Holding, Inversiones y Teleservicios, S.A. and its consolidated subsidiaries, unless the context requires otherwise.

Below are definitions of certain technical terms used in this Annual Report:

- “Access” refers to a connection to any of the telecommunications services offered by us. We present our customer base using this model because the integration of telecommunications services in bundled service packages has changed the way residential and corporate customers contract for our services. Because a single customer may contract for multiple services, we believe it is more accurate to count the number of accesses, or services a customer has contracted for, as opposed to only counting the number of our customers. For example, a customer that has fixed line telephony service and broadband service represents two accesses rather than a single customer. In addition, we fully count the accesses of all companies over which we exercise control or joint control. The following are the main categories of accesses:
  - Fixed telephony accesses: includes public switched telephone network, or PSTN, lines (including public use telephony), and integrated services digital network, or ISDN, lines and circuits. For purposes of calculating our number of fixed line accesses, we multiply our lines in service as follows: PSTN (x1); basic ISDN (x1); primary ISDN (x30, x20 or x10); 2/6 digital accesses (x30).
    - Internet and data accesses: includes broadband accesses (retail asymmetrical digital subscriber line “ADSL”, satellite, fiber optic and circuits over 2 Mbps), narrowband accesses (Internet service through the PSTN lines) and other accesses, including the remaining non-broadband final client circuits. “Naked ADSL” allows customers to subscribe for a broadband connection without a monthly fixed line fee.
    - Pay TV: includes cable TV, direct to home satellite TV, or DTH, and Internet Protocol TV, or IPTV.
  - Mobile accesses: includes contract and pre-pay mobile telephony. In 2009 in order to align the criteria for the key performance indicators of our mobile operations, the definition of mobile accesses (and, therefore, of total accesses) was revised to include machine-to-machine accesses. In addition, we revised the accounting criteria for pre-pay mobile accesses at Telefónica O2 Czech Republic and Telefónica O2 Slovakia to conform to the accounting criteria for pre-pay mobile accesses throughout the Group. In order to count a pre-pay mobile access, such access must have been active in the most recent three months prior to counting. As a result of both revisions, we restated 2008 mobile accesses. 2007 information is presented based on our prior classifications.

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- Unbundled local loop, or ULL: includes accesses to both ends of the copper local loop leased to other operators to provide voice and DSL services (fully unbundled loop, fully UL) or only DSL service (shared unbundled loop, “shared UL”).
  - Wholesale ADSL: means wholesale asymmetrical digital subscriber line.
    - Other: includes other circuits for other operators.

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Certain technical terms used with respect to our business are as follows:

- “ARPU” is the average revenue per user per month. ARPU is calculated by dividing total service revenue (excluding inbound roaming revenue) from sales to customers for the preceding 12 months by the weighted average number of customers for the same period, and then divided by 12 months. ARPU is calculated using gross service revenue before deduction of wholesale discounts.
- “CDMA” means Code Division Multiple Access, which is a type of radio communication technology.
- “Commercial activity” includes the addition of new lines, replacement of handsets and changes in types of contracts.
- “Customer revenue” means service revenue less interconnection revenue.
- “Duo bundle” means broadband plus voice service. We measure “duo bundles” in terms of units, where each bundle of broadband and voice service counts as one unit.
- “Final clients accesses” means accesses provided to residential and corporate clients.
- “Gross adds” means the gross increase in the customer base measured in terms of accesses in a period.
- “HSDPA” means High Speed Downlink Packet Accesses, which is a 3G mobile telephony communications protocol in the High-Speed Packet Access (HSPA) family, which allows networks based on UMTS to have higher data transfers speeds and capacity.
- “Interconnection revenue” means revenues received from other operators which use our networks to connect to our customers.
- “ISP” means Internet service provider.
- “LMDS” means local multipoint distribution service.
- “Local loop” means the physical circuit connecting the network termination point at the subscriber’s premises to the main distribution frame or equivalent facility in the fixed public telephone network.
- “MOU”, or minutes of use, is calculated by dividing the total number of voice minutes for the preceding 12 months by the weighted average number of mobile accesses for the same period, and then divided by 12 months. Over the past several years, we have experienced strong growth in mobile accesses related primarily to data services (such as accesses related to machine-to-machine and mobile broadband devices). Such growth in mobile accesses related to data services limits the use of MOU as an indicator of usage as it increases the total number of mobile accesses in the relevant period without any corresponding increase in the number of voice minutes related to such accesses for the relevant period. As a result, for 2009 and 2008 we have decided to publish traffic evolution in absolute minutes of use terms rather than MOU.
- “MVNO” means mobile virtual network operator, which is a mobile operator that is not entitled to use spectrum for the provision of mobile services. Consequently, an MVNO must subscribe to an access agreement with a mobile network operator in order to provide mobile access to their customers. An MVNO pays such mobile network operator for using the infrastructure to facilitate coverage to their customers. There are two types of MVNOs: (i) pure MVNOs, which are typically telecommunications companies without licensed frequency allocation and want to complete their telecommunications service portfolio (for example, ONO in Spain); and (ii) reseller MVNOs which

are companies that purchase wholesale mobile minutes and resell to end-users, and use their brand and distribution channel (for example, Carrefour in Spain).

- “Net adds” means the difference between the customer base measured in terms of accesses at the end of the period and the beginning of a period.
- “Revenues” means net sales and rendering of services.

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- “Service revenues” means revenues less revenues from handset sales.
- “Traffic” means voice minutes used by our customers over a given period, both outbound and inbound. On-net traffic is only included once (outbound), and promotional traffic (free minutes included in commercial promotions) is included. Traffic not associated with our mobile customers (roaming-in; MVNOs; interconnection of third parties and other business lines) is excluded. To arrive at the aggregate traffic for a given period, the individual components of traffic are not rounded.
- “Trio bundle” means broadband plus voice service plus IPTV. We measure “trio bundles” in terms of units, where each bundle of broadband, voice service and IPTV counts as one unit.
- “UMTS” means Universal Mobile Telecommunications System.
- “VoIP” means voice over Internet protocol.
- “Wholesale accesses” means accesses we provide to our competitors, who then sell such accesses to their residential and corporate clients.

In this Annual Report we make certain comparisons in local currency or on a “constant euro basis” or “excluding foreign exchange rate effects” in order to present an analysis of the development of our results of operations from year-to-year without the effects of currency fluctuations. To make comparisons on a local currency basis, we compare financial items in the relevant local currency for the periods indicated as recorded in the relevant local currency for such periods. To make comparisons on a “constant euro basis” or “excluding foreign exchange rate effects”, we convert the relevant financial item into euros using the prior year’s average euro to relevant local currency exchange rate. In addition, we present certain financial information excluding the effects of Venezuela being considered a hyperinflationary economy in 2009 by eliminating all of the adjustments made as a result of such consideration.

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PRESENTATION OF CERTAIN FINANCIAL INFORMATION

In this Annual Report, references to “U.S. dollars”, “dollars” or “\$”, are to United States dollars, references to “pounds sterling”, “sterling” or “£” are to British pounds sterling, references to “reais” refer to Brazilian reais and references to “euro” or “€” are to the single currency of the participating member states in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time.

Our consolidated financial statements as of December 31, 2008 and 2009, and for the years ended December 31, 2007, 2008 and 2009 included elsewhere in this Annual Report including the notes thereto (the “Consolidated Financial Statements”), are prepared in conformity with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”), which do not differ for the purposes of the Telefónica Group from IFRS as adopted by the European Union.

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PART I

Item 1. Identity of Directors, Senior Management and Advisors

A. Directors and Senior Management

Not applicable.

B. Advisers

Not applicable.

C. Auditors

Not applicable.

Item 2. Offer Statistics and Expected Timetable

Not applicable.

Item 3. Key Information

A. Selected Financial Data

The following table presents our selected consolidated financial data. It is to be read in conjunction with “Item 5. Operating and Financial Review and Prospects” and the Consolidated Financial Statements. The consolidated income statement and cash flow data for the years ended December 31, 2007, 2008 and 2009 and the consolidated statement of financial position data as of December 31, 2008 and 2009 set forth below are derived from, and are qualified in their entirety by reference to, the Consolidated Financial Statements. The consolidated income statement and cash flow data for the years ended December 31, 2005 and 2006 and the consolidated statement of financial position data as of December 31, 2005, 2006 and 2007 set forth below are derived from Telefónica, S.A.’s consolidated financial statements for such years, which are not included herein.

Our Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the IASB.



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The basis of presentation and principles of consolidation are described in detail in Notes 2 and 3.q., respectively, to our Consolidated Financial Statements.

	2005(1)	As of or for the year ended December 31,			2009
		2006(1)	2007	2008	
		(in millions of euros, except share data)			
Revenues	37,383	52,901	56,441	57,946	56,731
Other income	1,416	1,571	4,264	1,865	1,645
Supplies	(9,999)	(16,629)	(17,907)	(17,818)	(16,717)
Personnel expenses	(5,532)	(7,622)	(7,893)	(6,762)	(6,775)
Other expenses	(8,212)	(11,095)	(12,081)	(12,312)	(12,281)
Depreciation and amortization	(6,693)	(9,704)	(9,436)	(9,046)	(8,956)
Operating income	8,363	9,422	13,388	13,873	13,647
Share of profit (loss) of associates	(128)	76	140	(161)	47
Net financial expenses	(1,790)	(2,795)	(2,851)	(2,821)	(2,767)
Net exchange differences	162	61	7	24	(540)
Net financial income (expense)	(1,628)	(2,734)	(2,844)	(2,797)	(3,307)
Profit before taxes from continuing operations	6,607	6,764	10,684	10,915	10,387
Corporate income tax	(1,904)	(1,781)	(1,565)	(3,089)	(2,450)
Profit for the year from continuing operations	4,703	4,983	9,119	7,826	7,937
Profit from discontinued operations after taxes	124	1,596	—	—	—
Profit for the year	4,827	6,579	9,119	7,826	7,937
Non-controlling interests	(381)	(346)	(213)	(234)	(161)
Profit for the year attributable to equity holders of the parent	4,446	6,233	8,906	7,592	7,776
Weighted average number of shares (thousands)	4,870,852	4,778,999	4,758,707	4,645,852	4,552,656
Basic and diluted earnings per share from continuing operations attributable to equity holders (euros)(2)	0.90	0.97	1.87	1.63	1.71
Basic and diluted earnings per share attributable to equity holders of the parent (euros)(2)	0.91	1.30	1.87	1.63	1.71
Earnings per ADS (euros)(2)(3)	2.74	3.91	5.62	4.90	5.12
Weighted average number of ADS (thousands)	1,623,617	1,592,999	1,586,236	1,548,617	1,517,552
Cash dividends per ordinary share (euros)	0.50	0.55	0.65	0.90	1.00
<b>Consolidated Statement of Financial Position Data</b>					
Cash and cash equivalents	2,213	3,792	5,065	4,277	9,113
Property, plant and equipment	27,993	33,887	32,460	30,545	31,999
Total assets	73,174	108,982	105,873	99,896	108,141
Non-current liabilities	35,126	62,645	58,044	55,202	56,931

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Equity (net)	16,158	20,001	22,855	19,562	24,274
Capital stock	4,921	4,921	4,773	4,705	4,564
Consolidated Cash Flow Data					
Net cash from operating activities	11,139	15,414	15,551	16,366	16,148
Net cash used in investing activities	(9,592)	(28,052)	(4,592)	(9,101)	(9,300)
Net cash (used in) from financing activities	(435)	14,572	(9,425)	(7,765)	(2,281)

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(1) Telefónica Publicidad e Información, S.A. (TPI) was sold in 2006 and its results of operations for 2006 and the gain we recorded on its sale are included under “Profit from discontinued operations after taxes” for 2006. Figures for 2005 have been restated to present TPI’s results under the same caption.

(2) The per share and per ADS computations for all periods presented have been presented using the weighted average number of shares and ADSs, respectively, outstanding for each period, and have been adjusted to reflect the stock dividends which occurred during the periods presented, as if these had occurred at the beginning of the earliest period presented.

(3) Each ADS represents the right to receive three ordinary shares. Figures do not include any charges of the Depositary.

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## Exchange Rate Information

As used in this Annual Report, the term “Noon Buying Rate” refers to the rate of exchange for euros, expressed in U.S. dollars per euro, in the City of New York for cable transfers payable in foreign currencies as certified by the Federal Reserve Bank of New York for customs purposes. The Noon Buying Rate certified by the New York Federal Reserve Bank for the euro on March 19, 2010 was \$1.3530 = €1.00. The following tables describe, for the periods and dates indicated, information concerning the Noon Buying Rate for the euro. Amounts are expressed in U.S. dollars per €1.00.

Year ended December 31,	Period end	Noon Buying Rate		
		Average(1)	High	Low
2005	1.1842	1.2400	1.3476	1.1667
2006	1.3197	1.2661	1.3327	1.1860
2007	1.4603	1.3797	1.4862	1.2904
2008	1.3919	1.4698	1.6010	1.2446
2009	1.4332	1.3955	1.5100	1.2547
2010 (through March 19, 2010)	1.3530	1.3687	1.4536	1.3476

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Source: Federal Reserve Bank of New York.

(1) The average of the Noon Buying Rates for the euro on the last day reported of each month during the relevant period.

Month ended	Noon Buying Rate	
	High	Low
October 31, 2009	1.5029	1.4532
November 30, 2009	1.5085	1.4658
December 31, 2009	1.5100	1.4243
January 31, 2010	1.4536	1.3870
February 28, 2010	1.3955	1.3476
March 31, 2010 (through March 19, 2010)	1.3758	1.3516

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Source: Federal Reserve Bank of New York.

Monetary policy within the member states of the euro zone is set by the European Central Bank. The European Central Bank has set the objective of containing inflation and will adjust interest rates in line with this policy without taking account of other economic variables such as the rate of unemployment. It has further declared that it will not set an exchange rate target for the euro.

Our ordinary shares are quoted on the Spanish stock exchanges in euro. Currency fluctuations may affect the dollar equivalent of the euro price of our shares listed on the Spanish stock exchanges and, as a result, the market price of our ADSs, which are listed on the New York Stock Exchange. Currency fluctuations may also affect the dollar amounts received by holders of ADSs on conversion by the depositary of any cash dividends paid in euro on the underlying shares.

Our consolidated results are affected by fluctuations between the euro and the currencies in which the revenues and expenses of some of our consolidated subsidiaries are denominated (principally the Brazilian real, the Venezuelan

Bolivar fuerte (see “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Classification of Venezuela as a hyperinflationary economy”), pounds sterling, the Czech koruna (crown), the Argentine peso, the Chilean peso, the Peruvian nuevo sol, the Mexican peso and the Colombian peso).

B. Capitalization and Indebtedness

Not applicable.

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C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

In addition to the other information contained in this Annual Report, prospective investors should carefully consider the risks described below before making any investment decision. The risks described below are not the only ones that we face. Additional risks not currently known to us or that we currently deem immaterial may also impair our business and results of operations. Our business, financial condition, results of operations and cash flow could be materially adversely affected by any of these risks, and investors could lose all or part of their investment.

Risks Relating to Our Business

A material portion of our operations and investments are located in Latin America, and we are therefore exposed to risks inherent in operating and investing in Latin America.

At December 31, 2009, approximately 35.7% of our assets were located in Latin America. In addition, approximately 40.6% of our revenues for 2009 were derived from our Latin American operations. Our operations and investments in Latin America (including the revenues generated by these operations, their market value and the dividends and management fees expected to be received therefrom) are subject to various risks linked to the economic, political and social conditions of these countries, including risks related to the following:

- government regulation or administrative policies may change unexpectedly and negatively affect our interests in such countries;
- currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- the effects of inflation or currency depreciation may result in certain of our subsidiaries having negative equity, which would require them to undertake a mandatory recapitalization or commence dissolution proceedings;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies;
  - governments may impose burdensome taxes or tariffs;
- political changes may lead to changes in the economic conditions and business environment in which we operate; and
  - economic downturns, political instability and civil disturbances may negatively affect our operations.

For instance, throughout 2009 and in the early part of 2010, certain factors affecting the Venezuelan economy have had an impact on the accounting treatment applied with respect to our subsidiaries in that country, notably the level of inflation reached in 2009, the cumulative inflation rate over the last three years, restrictions placed on the official foreign exchange market and the devaluation of the Venezuelan Bolivar fuerte on January 8, 2010. As a result, in accordance with IFRS, Venezuela was considered a hyperinflationary economy in 2009, which has had a series of effects on our consolidated financial statements as of and for the year ended December 31, 2009 and will have additional effects on our consolidated financial statements as of and for the year ended December 31, 2010. A more detailed description of these effects is included in “Item 5. Operating and Financial Review and Prospects—A. Operating

Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Classification of Venezuela as a hyperinflationary economy” and Note 2 to our Consolidated Financial Statements.

In addition, our operations are dependent, in many cases, on concessions and other agreements with existing governments in the countries in which we operate. These concessions and agreements, including their renewal,

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could be directly affected by economic and political instability, altering the terms and conditions under which we operate.

Our financial condition and results of operations may be adversely affected if we do not effectively manage our exposure to foreign currency exchange rate, interest rate or financial investment risks.

We are exposed to various types of market risk in the normal course of our business, including the impact of changes in foreign currency exchange rates and the impact of changes in interest rates, as well as the impact of changes of credit risk in our treasury investments (in cash and cash equivalents) or in some of our financial transactions. We employ risk management strategies to manage this exposure, in part through the use of financial derivatives such as foreign currency forwards, currency swap agreements and interest rate swap agreements. If the financial derivatives market is not sufficiently liquid for our risk management purposes, or if we cannot enter into arrangements of the type and for the amounts necessary to limit our exposure to currency exchange rate fluctuations and interest rate fluctuations or if our counterparties fail to deliver on their commitments due to lack of solvency or otherwise, such failure could adversely affect our financial condition, results of operations and cash flow. Also, our other risk management strategies may not be successful, which could adversely affect our financial condition, results of operations and cash flow. Finally, if the rating of our counterparties in treasury investments or in our structured financial transactions deteriorates significantly or if any of such counterparties were to fail in its obligations to us, we may suffer a loss of value in our investments, incur unexpected losses and assume additional financial obligations under these transactions, and such failure could adversely affect our business, financial condition, results of operations and cash flow.

For a more detailed description of our financial derivatives transactions, see “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and Note 16 to our Consolidated Financial Statements.

Adverse economic conditions could reduce purchases of our products and services.

Our business is impacted by general economic conditions and other similar factors in each of the countries in which we operate. The current adverse global economic environment and uncertainty about an economic recovery may negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers. Other factors that could influence customer demand include access to credit, unemployment rates, consumer confidence and other general macroeconomic factors. Spanish gross domestic product, or GDP, contracted by 3.6% in 2009 and, according to the Stability Program 2009-2013 forecasts from the Spanish Ministry of Economy, the Spanish economy is expected to remain in recession in 2010, which could have a material adverse effect on our business, financial condition, results of operations and cash flow.

In addition, there could be other possible follow-on effects from the financial crisis on our business, including insolvency of key suppliers or customers. A loss of customers or a reduction in purchases by our current customers could have a material adverse effect on our business, financial condition, results of operations and cash flow and may therefore negatively affect our ability to meet our growth targets.

Existing or worsening conditions in the international financial markets may limit our ability to carry out our business plan.

The development and distribution of our services as well as the operation, expansion and upgrading of our networks, require substantial financing. Moreover, our liquidity and capital resource requirements may increase if we participate in other fixed line or mobile license award processes or make acquisitions. We also have major capital resource requirements relating to, among other things, the development of distribution channels in new countries of operations and the development and implementation of new technologies.

If our ability to generate cash flow were to decrease, whether due to the current worldwide financial and economic crisis or otherwise, we may need to incur additional debt or raise other forms of capital to support our liquidity and capital resource requirements for the ongoing development and expansion of our business.



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The current state of the financial markets in terms of liquidity, cost of credit and volatility has improved compared to the situation in the second half of 2008 and during most of 2009. Nevertheless, there remain several factors that could affect the ordinary performance of financial markets, such as uncertainty about an economic recovery, reorganization of the international banking system, and growing concern over increases in government deficits, among other factors. Worsening conditions in the international credit markets due to any of these factors may make it more difficult and more expensive to refinance our financial debt (of which €8,647 million matures in 2010) or to incur additional debt.

In addition, our capacity to raise capital in the international capital markets would be impaired if our credit ratings were downgraded, whether due to decreases in our cash flow or otherwise. Further, current market conditions may make it more difficult to renew our unused bilateral credit facilities scheduled to expire prior to December 31, 2010 (for an aggregate amount of €2,779 million). The current financial situation may also make it more difficult and costly for us to launch a rights issue to our current shareholders or to raise additional equity capital if further funds were needed for pursuing our business plans.

The successful implementation of our strategy for our mobile operations in Brazil depends on the development of our joint venture company with Portugal Telecom, SGPS, S.A.

Our mobile business in Brazil is conducted through a 50/50 joint venture company, Brasilcel, N.V., or Brasilcel, which is jointly controlled by us and Portugal Telecom SGPS, S.A., or Portugal Telecom. As a result of our less than controlling interest in this joint venture, we do not have absolute control over the operations of the venture. As a result, there is an inherent risk for management or operational disruptions whenever a disagreement between us and our partner arises. Therefore, we must cooperate with Portugal Telecom in order to implement and expand upon our business strategies and to finance and manage the operations of the joint venture. If we do not manage to obtain the cooperation of Portugal Telecom or if a disagreement or deadlock arises we may not achieve the expected benefits from this joint venture, including economies of scale and opportunities to achieve potential synergies and cost savings.

### Risks Relating to Our Industry

We face intense competition in most of our markets, which could result in decreases in current and potential customers, revenues and profitability.

We face significant competition in all of the markets in which we operate, and we are therefore subject to the effects of actions by our competitors in these markets. Our competitors could:

- offer lower prices, more attractive discount plans or better services and features;
- develop and deploy more rapidly new or improved technologies, services and products;
  - launch bundle offerings of one type of service with others;
  - in the case of the mobile industry, subsidize handset procurement; or
  - expand and enhance their networks more rapidly.

Furthermore, some of our competitors in certain markets have, and some potential competitors may enjoy, in certain markets, competitive advantages, including the following:

- greater brand name recognition;

- greater financial, technical, marketing and other resources;
- dominant position or significant market power;
- better strategic alliances;

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- larger customer bases; and
- well-established relationships with current and potential customers.

To compete effectively with our competitors, we need to successfully market our products and services and to anticipate and respond to various competitive factors affecting the relevant markets, such as the introduction of new products and services by our competitors, pricing strategies adopted by our competitors and changes in consumer preferences and in general economic, political and social conditions. If we are unable to effectively compete, it could result in price reductions, lower revenues, under-utilization of our services, reduced operating margins and loss of market share, any of which could have a material adverse effect on our business, financial condition, results of operations and cash flow.

We operate in a highly regulated industry, which could adversely affect our businesses.

As a multinational telecommunications company that operates in regulated markets, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. Such laws and regulations are promulgated and enforced to varying degrees by supranational regulators such as the European Union and national, state, regional and local authorities. Regulation may be especially strict in the markets of those countries in which we hold a significant market position. In this respect, regulatory authorities regularly intervene in the retail and wholesale offering and pricing of our products and services. Furthermore, such authorities may also adopt further regulations or take additional actions that could adversely affect us, including revocation of or failure to renew any of our licenses, authorizations or concessions, implementation of changes to the spectrum allocated to us or the granting or new licenses, authorizations or concessions to our competitors to offer services in the relevant markets. Furthermore, regulations could require us to reduce roaming prices and termination rates in mobile and fixed line networks, require us to offer access to our network to other operators, and result in the imposition of fines if we fail to fulfill our service commitments. Such regulations and regulatory actions could place significant competitive and pricing pressure on our operations, and could have a material adverse effect on our business, financial condition, results of operations and cash flow.

In addition, since we hold a leading market share in many of the counties where we operate, we could face regulatory actions by antitrust or competition authorities designed to enhance competition in the relevant markets. These authorities could prohibit us from taking further actions such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on us, which, if significant, could result in loss of market share and harm to our financial performance and future growth.

The regulatory landscape in the European Union will change as a consequence of the recent passage of a new common regulatory framework that is to be implemented by Member States before June 2011. We believe based on the principles set forth in such regulatory framework that the regulations adopted by Member States may result in an increased focus on the development and maintenance of competitive markets. This regulatory framework proposes the adoption of measures, under exceptional circumstances and in specific situations, by national authorities to establish functional separation between the retail and wholesale operations of vertically integrated operators with significant market power, by requiring them to offer equal wholesale conditions to related and third party operators. The adoption of such regulatory framework in Spain and the other European Union Members States where we operate could result in requirements to modify our internal organization in the relevant markets, which could result in additional costs to us. Additionally, our industry may face new regulatory initiatives regarding lowering mobile termination rates and the provision of data and audiovisual services.

In addition, we may also face pressure from regulatory initiatives in some European countries in order to reallocate spectrum rights of use and to modify spectrum allocation policies that may result, among other matters, in new tender processes for spectrum allocation in the European Union.

Finally, the recommendation that is being drafted by the European Commission on the implementation of European regulation of new generation broadband networks may reduce the incentives for operators to invest in broadband networks over the short and medium term because operators that invest in broadband networks could be required to provide access to such networks to third parties. This could affect competition and business performance and future growth in such services.

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For further information regarding the matters discussed above and other aspects of the regulatory environments in which our businesses operate, see “Item 4. Information on the Company—Business Overview—Regulation”.

We operate under licenses, authorizations and concessions granted by government authorities.

Most of our operating companies require licenses, authorizations or concessions from the governmental authorities of the countries in which they operate. These licenses, authorizations and concessions specify the types of services permitted to be offered by the operating company holding such license, authorization or concession. The continued existence and terms of our licenses, authorizations and concessions are subject to review by regulatory authorities in each country and to interpretation, modification or termination by these authorities. Moreover, authorizations, licenses and concessions as well as their renewal terms and conditions may be affected by political and regulatory factors.

The terms of these licenses, authorizations and concessions granted to our operating companies and conditions of the renewals of such licenses, authorizations and concessions vary from country to country. Although license, authorization and concession renewal is not usually guaranteed, most licenses, authorizations and concessions do address the renewal process and terms, which is usually related to the fulfillment of the commitments that were assumed by the grantee. As licenses, authorizations and concessions approach the end of their terms, we intend to pursue their renewal to the extent provided by the relevant licenses, authorizations or concessions and, under certain circumstances, we will operate under technically expired licenses, authorizations or concessions under preexisting terms during the renewal process. Failure to complete the renewal process successfully could adversely affect our business, financial condition, results of operations and cash flow.

Many of our licenses, authorizations and concessions are revocable for public interest reasons. The rules of some of the regulatory authorities with jurisdiction over our operating companies require us to meet specified network build-out requirements and schedules. In particular, our existing licenses, authorizations and concessions typically require us to satisfy certain obligations, including, amongst 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 revocation or forfeiture of the license, authorization or concession for the relevant area. In addition, the need to meet scheduled deadlines may require our companies to expend more resources than otherwise budgeted for a particular network build-out.

For further information regarding the licenses and concessions of our operating companies, see “Item 4. Information on the Company—Business Overview—Regulation”.

The industry in which we operate is subject to rapid technological changes, which requires us to continuously adapt to such changes and to upgrade our existing networks. If we are unable to adapt to such changes, our ability to provide competitive services could be materially adversely affected.

Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge on a continuous basis and that existing products and technologies will further develop. These new products and technologies may reduce the prices for our existing services or may be superior to, and render obsolete, the products and services we offer and the technologies we use and may consequently reduce the revenues generated by our products and services and require investment in new technology. In addition, we may be subject to competition in the future from other companies that are not subject to regulation as a result of the convergence of telecommunications technologies. As a result, it may be very expensive for us to upgrade our products and technology in order to continue to compete effectively with new or existing competitors. Such increased costs could adversely affect our business, financial condition, results of operations and cash flow.

In particular, we must continue to upgrade our existing mobile and fixed line telephony networks in a timely and satisfactory manner in order to retain and expand our customer base in each of our markets, to enhance our financial performance and to satisfy regulatory requirements. Among other things, we could be required to upgrade the functionality of our networks to accommodate increased customization of services, to increase coverage in some of our markets, or to expand and maintain customer service, network management and administrative systems.

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Many of these tasks are not entirely under our control and may be affected by applicable regulations. If we fail to execute these tasks successfully, our services and products may be less attractive to new customers and we may lose existing customers to our competitors, which would adversely affect our business, financial condition, results of operations and cash flow.

Spectrum capacity may become a limiting factor.

Our mobile operations in a number of countries may rely on spectrum availability. Failure to obtain sufficient or adequate spectrum coverage and, to a lesser extent, the costs related to obtaining this capacity could have a material adverse impact on the quality of our services and on our ability to provide new services, adversely affecting our business, financial condition, results of operations and cash flow.

Our business could be adversely affected if our suppliers fail to provide necessary equipment and services on a timely basis.

We depend 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. Furthermore, these suppliers may be adversely affected by current economic conditions. If these suppliers fail to deliver products and services on a timely basis, our business and results of operations could be adversely affected. Similarly, interruptions in the supply of telecommunications equipment for our networks could impede network development and expansion, which in some cases could adversely affect our ability to satisfy our license terms and requirements.

We may be adversely affected by unanticipated 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 our service, could result in customer dissatisfaction, reduced revenues and traffic and costly repairs, penalties or other measures imposed by regulatory authorities, and could harm our reputation. We attempt 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 effective under all circumstances and cannot avert every action or event that could damage or disrupt our technical infrastructure. Although we carry business interruption insurance, our insurance policy may not provide coverage in amounts sufficient to compensate us for any losses we may incur.

The mobile industry may be harmed by reports suggesting that radio frequency emissions cause health problems.

Over the last few years, the debate about the alleged potential effects of radio frequency emissions on human health has increased significantly. In many cases, this has hindered the deployment of the infrastructures necessary to ensure quality of service.

Institutions and organizations, such as the World Health Organization (WHO), have stated that exposure to radio frequency emissions generated by mobile telephony, within the limits established, has no adverse effects on health. In fact, a number of European countries, including Spain among others, have drawn up complete regulations reflecting the Recommendation of the Council of the European Union dated July 12, 1999. These add planning criteria for new networks, thus ensuring compliance with the limits on exposure to radio frequency emissions.

Whether or not other research or studies conclude there is a link between radio frequency emissions and health, popular concerns about radio frequency emissions may discourage the use of mobile communication devices and may result in significant restrictions on both the location and operation of cell sites, either or both of which could have a

detrimental impact on our mobile companies and consequently on our financial condition, results of operations and cash flow. While we are not aware of any evidence confirming a link between radio frequency emissions and health problems and we continue to comply with good practices codes and relevant regulations, there can be no assurance of what future medical research may suggest.



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Developments in the telecommunications sector have resulted, and may in the future result, in substantial write-downs of the carrying value of certain of our assets.

We review on an annual basis or more frequently where the circumstances require, the value of each of our assets and subsidiaries to assess whether the carrying values of such assets and subsidiaries can be supported by the future cash flows expected to be derived from such assets and subsidiaries, including in some cases synergies included in their acquisition costs. The current economic environment and changes in the short and medium term, as well as changes in the regulatory, business or political environment may result in the necessity of recognizing impairment charges on our goodwill, intangible assets or fixed assets.

Although the recognition of impairments of tangible, intangible and financial assets result in a non-cash charge on the income statement, such charge would adversely affect our results of operations and consequently, our ability to achieve our growth targets.

### Other Risks

We are involved in disputes and litigation with regulators, competitors and third parties.

We are party to lawsuits and other legal, regulatory and antitrust proceedings in the ordinary course of our business, the final outcome of which is generally uncertain. Litigation and regulatory proceedings are inherently unpredictable. An adverse outcome in, or any settlement of, these or other proceedings (including any that may be asserted in the future) may have a material adverse effect on our business, financial condition, results of operations and cash flow.

For a more detailed description of current legal proceedings, see “Item 8. Financial Information—Legal Proceedings”.

## Item 4. Information on the Company

### A. History and Development of the Company

#### Overview

Telefónica, S.A., is a corporation duly organized and existing under the laws of the Kingdom of Spain, incorporated on April 19, 1924. We are:

- a diversified telecommunications group which provides a comprehensive range of services through one of the world’s largest and most modern telecommunications networks;
- mainly focused on providing fixed and mobile telephony services; and
- present principally in Spain, Europe and Latin America.

The following significant events occurred in 2009:

- On June 23, 2009, our Board of Directors agreed to initiate a process for the purchase of the Telefónica de Argentina S.A. (“Telefónica de Argentina”) shares held by unaffiliated parties, which amounted to 1.8% of Telefónica de Argentina’s share capital. After following the procedures set forth in Argentine Presidential Decree No. 677/01, Chapter VII, on December 3, 2009, the Argentine securities regulator approved the transaction, resulting in our acquisition on January 25, 2010 of these shares for approximately €23 million. As a result of such acquisition we

beneficially own 100% of the share capital of Telefónica de Argentina, and we delisted Telefónica de Argentina's shares and ADSs from the Buenos Aires and New York stock exchanges, respectively.

- On August 31, 2009, we agreed to sell our 32.18% stake in Medi Telecom S.A., or Medi Telecom, together with its outstanding shareholder loans to our local partners for total cash consideration of €400 million. This transaction closed on December 31, 2009.

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- On September 6, 2009 we entered into a strategic alliance with China Unicom (Hong Kong) Limited, or China Unicom, which provides for, among other areas for cooperation, joint procurement of infrastructure and client equipment, common development of mobile service platforms, joint provisions of service to multinational customers, roaming, research and development, sharing of best practices and technical, operational and management know-how, joint development of strategic initiatives in the area of network evolution, joint participation in international alliances and exchanges of senior management. In furtherance of this strategic alliance, on this same date, we entered into a mutual share exchange agreement with China Unicom pursuant to which we agreed to invest the equivalent of \$1,000 million in the shares of China Unicom and China Unicom agreed to invest the equivalent of \$1,000 million in our shares.

On October 21, 2009, we exchanged 40,730,735 of our shares for 693,912,264 newly issued shares of China Unicom in satisfaction of the mutual share exchange agreement described above. As a result of this exchange, our voting interest in the share capital of China Unicom increased from 5.38% to 8.06%, and China Unicom has a 0.87% voting interest in our share capital at that date. As of the date of this Annual Report, and after the capital reduction carried out by China Unicom, we hold shares representing 8.37% of China Unicom's voting share capital and the right to appoint a member to its board of directors.

- On November 25, 2009, we agreed with Promotora de Informaciones, or Prisa, and Sogecable, S.A., or Sogecable, to acquire a 21% stake in DTS Distribuidora de Televisión Digital, S.A., or DTS, which includes the pay TV services (DIGITAL +) of the Prisa Group for a firm value of €2,350 million. After deduction of net debt, we expect that our total investment will be approximately €470 million. In addition, on this same date we entered into a shareholders' agreement with Prisa and Sogecable to govern the management of DTS. The acquisition is subject, among other conditions, to obtaining regulatory authorizations.

- On December 3, 2009, a subsidiary of Telefónica O2 Germany, Telefónica Deutschland GmbH, signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH, or HanseNet. The purchase price agreed by the parties was based on a firm value of HanseNet of €900 million, subject to a series of adjustments upon completion of the transaction. On February 16, 2010, having complied with the terms established in the agreement, we completed the acquisition of 100% of the shares of HanseNet. The final amount paid out by us was approximately €912 million.

Business areas

We have implemented a regional, integrated management model based on three business areas, with each area in charge of the fixed and mobile telephone and other businesses within its borders:

- Telefónica Spain: oversees the fixed and mobile telephone, broadband, Internet, pay TV and valued added services and data businesses in Spain.
- Telefónica Europe: oversees the fixed and mobile telephone, broadband, Internet, pay TV and value added services and data businesses in the United Kingdom, Germany, Ireland, the Czech Republic, Slovakia and the Isle of Man.
- Telefónica Latin America: oversees the fixed and mobile telephone, broadband, Internet, pay TV and value added services and data businesses in Latin America.

We are also involved in the media and contact center segments through Telefónica de Contenidos and Atento, respectively.



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The following chart shows the organizational structure of the principal subsidiaries of the Telefónica Group at December 31, 2009, including their jurisdictions of incorporation and our ownership interest. For further detail, see Exhibit 8.1 to this Annual Report.

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- (1) Ownership in Telefónica Móviles España, S.A.U. is held directly by Telefónica, S.A.
  - (2) 85.5% representing voting interest.
  - (3) Ownership in Telefónica International Wholesale Services. S.L. (Spain) is held 92.51% by Telefónica, S.A. (Spain) and 7.49% by Telefónica Datacorp, S.A.U. (Spain).
  - (4) Ownership in O2 (Europe) Ltd. is held directly by Telefónica, S.A.
  - (5) Companies held indirectly by Telefónica, S.A.

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Telefónica, S.A., the parent company of the Telefónica Group, also operates as a holding company with the following objectives:

- coordinate the Group's activities;
- allocate resources efficiently among the Group;
- provide managerial guidelines for the Group;
- manage the Group's portfolio of businesses;
- foster cohesion within the Group; and
- foster synergies among the Group's subsidiaries.

Our principal executive offices are located at Distrito C, Ronda de la Comunicación, s/n, Las Tablas, 28050 Madrid, Spain, and our registered offices are located at Gran Vía, 28, 28013 Madrid, Spain. Our telephone number is +34 900 111 004.

Capital Expenditures and Divestitures

Our principal capital expenditures excluding acquisitions during the three years ended December 31, 2009 consisted of additions to property, plant and equipment and additions to intangible assets. In 2009, 2008 and 2007, we made capital expenditures of €7,257 million, €8,401 million and €8,027 million, respectively.

Year ended December 31, 2009

Our capital expenditures decreased 13.6% to €7,257 million in 2009 compared to €8,401 million in 2008, mainly as a result of investment containment in our three regions of activity. Our investments in Spain were directed toward further developing the broadband business and expanding mobile third generation, or 3G. In Latin America capital expenditures were directed toward satisfying increased customer demand in broadband and pay TV and increasing coverage and capacity of our second generation, or GSM, and mobile 3G networks. In Europe capital expenditures were directed toward expanding the mobile 3G network coverage, developing the broadband business and undertaking IT projects.

Year ended December 31, 2008

Our capital expenditures increased 4.7% to €8,401 million in 2008 compared to €8,027 million in 2007, mainly as a result of investments made to support the growth in Telefónica Latin America's broadband and pay TV businesses and to further develop ADSL and adapt existing loops to FTTx (fiber optic) technology in order to enhance coverage for new services in Spain and expand the coverage and capacity of our mobile networks in all regions.

Year ended December 31, 2007

Capital expenditures increased 0.2% to €8,027 million in 2007 from €8,010 million in 2006 principally related to our investments in Spain in our growing Internet and broadband businesses, with significant investments related to ADSL and IP services, such as Imagenio, our IPTV business. In Latin America capital expenditures were directed toward satisfying increased customer demand in our fixed line business (particularly in broadband and pay TV) and increasing coverage and capacity of our second generation, or GSM, networks and acquiring spectrum in Venezuela,

Brazil and Panama to expand coverage and guarantee service quality in areas where traffic is heaviest. In 2007, capital expenditures in Europe decreased primarily as a result of Telefónica O2 Germany bringing forward capital investment from 2007 into 2006 as part of our build-out of our mobile third generation, or 3G, network.

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### Financial Investments and Divestitures

Our principal financial investment in 2009 was the acquisition of an additional stake in China Unicom (approximately \$1,000 million as a consequence of a mutual share exchange). Our principal divestiture in 2009 was the sale of Medi Telecom (€400 million) as described above.

Our principal financial investments in 2008 were made by Inversiones Telefónica Internacional Holding, Ltda., which invested €640 million for the acquisition of the additional 51.85% of CTC, and Vivo, which invested Brazilian reais 1,163 million (equivalent to approximately €429 million at the transaction date) for the acquisition of 53.90% of the voting stock and 4.27% of the preferred stock of Telemig Celular Participações, S.A.

Our principal financial investments in 2007 were made by Telefónica (€2,314 million for the acquisition of indirect shareholding in Telecom Italia). Our principal financial divestitures in 2007 were the sale of Airwave and Endemol N.V., or Endemol, for £1,932 million (equivalent to approximately €2,841 million at the transaction date) and €2,629 million, respectively.

### Public Takeover Offers

The principal public takeover offer which occurred in 2009 and in 2010 through the date of this Annual Report was the following:

- On September 17, 2008, we launched a tender offer through our Inversiones Telefónica Internacional Holding, Ltda. subsidiary to acquire all the outstanding shares of Compañía de Telecomunicaciones de Chile, S.A., or CTC, that we did not already control directly or indirectly, amounting to 55.1% of CTC's share capital. This included all CTC shares listed on the Santiago de Chile and New York Stock Exchanges (represented by American Depositary Shares). In January 2009, upon completion of the transaction, our indirect ownership in CTC had increased to 97.89% of the total outstanding shares, representing a total investment by us of approximately €658 million.

### Recent Developments

The principal events that have occurred since December 31, 2009 are set forth below:

- On January 11, 2010, Telco, S.p.A., or Telco, arranged a €1,300 million 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 the Telecom Italia, S.p.A., or Telecom Italia, shares held by Telco. The rest of Telco's financing needs with respect to debt maturities were met with a bridge loan granted by shareholders that was repaid with the proceeds of a bond issuance subscribed by Telco's shareholders, on a pro rata basis in accordance with their interests in Telco, on February 26, 2010 for an aggregate principal amount of €1,300 million. Our subscription amounted to an aggregate principal amount of €600 million.
- On February 16, 2010, having complied with the terms established in the agreement dated December 3, 2009 by the parties, we completed the acquisition of 100% of the shares of HanseNet. The final amount paid was approximately €912 million.
- Following the agreement between Prisa and Gestevisión Telecinco, S.A., or Telecinco, for the sale by Prisa to Telecinco of a 22% stake in DIGITAL+, on January 29, 2010, we signed a new agreement with Prisa raising the percentage stake to be acquired by us in DTS from 21% to 22%. Furthermore, we have undertaken to renegotiate the terms of the shareholders' agreement to reflect the new shareholder structure of DTS.



The estimated total investment to be made by us for the 22% stake in DTS, after deduction of net debt, is expected to be around €495 million, of which approximately €230 million will be covered by the subordinated loan agreement that currently exists between Telefónica de Contenidos, S.A.U. (creditor) and Sogecable (debtor).

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For information related to our significant financing transactions completed in 2009 and through the date of this Annual Report, see “Item 5. Operating and Financial Review and Prospects – Liquidity and Capital Resources – Anticipated Sources of Liquidity”.

## B. Business Overview

We increased our customer base, measured in terms of total accesses, by 2.1% to 264.6 million accesses at December 31, 2009 from 259.1 million accesses at December 31, 2008, which was a 13.3% increase from the 228.7 million accesses we had at December 31, 2007. This growth from December 31, 2008 to December 31, 2009 was primarily driven by a 3.3% increase in mobile accesses, a 8.2% increase in broadband accesses and a 9.8% increase in pay TV accesses, which more than offset our 5.4% loss of fixed telephony accesses and 28.5% loss of narrowband accesses as these technologies continue to be substituted by customers for mobile and broadband technologies, respectively. Growth in our total number of accesses from December 31, 2007 to December 31, 2008 was primarily driven by strong growth in mobile and broadband accesses.

The following table shows our total accesses at the dates indicated. The classifications and explanatory notes below also apply, to the extent applicable, to the tables detailing our accesses by business area and country elsewhere in this section.

	At December 31,		
	2007	2008(1)	2009(1)
	(in thousands)		
Fixed telephony accesses(2)	43,433.6	42,930.8	40,606.0
Internet and data accesses	13,156.6	14,654.3	15,082.5
Narrowband accesses	2,678.7	1,997.2	1,427.5
Broadband accesses(3)	10,320.2	12,472.1	13,492.6
Other accesses(4)	157.7	185.0	162.4
Mobile accesses(5)(6)	167,781.1	195,818.6	202,332.5
Pay TV accesses	1,748.1	2,267.5	2,489.2
Final clients accesses	226,119.4	255,671.1	260,510.2
Unbundled local loop accesses	1,396.5	1,748.1	2,206.0
Shared UL accesses	776.4	602.3	447.7
Full UL accesses	620.1	1,145.8	1,758.3
Wholesale ADSL accesses(7)	571.7	534.7	463.4
Other accesses(8)	656.0	1,150.1	1,426.0
Wholesale accesses	2,624.2	3,433.0	4,095.3
Total accesses	228,743.6	259,104.1	264,605.5

(1) From January 1, 2008, fixed wireless public use telephony accesses are included under the caption “fixed telephony accesses”.

(2) PSTN (including public use telephony) x1; ISDN basic access x1; ISDN primary access; 2/6 access x30. Includes our accesses for internal use. It also includes VOIP and naked ADSL accesses.

(3) Includes ADSL, satellite, fiber optic, cable modem and broadband circuits and naked ADSL accesses.

(4) Includes remaining non-broadband final client circuits.

- (5) Includes accesses of Telemig at December 31, 2008 and going forward. Medi Telecom accesses are excluded at December 31, 2009.
- (6) In 2009 in order to align the criteria for the key performance indicators of our mobile operations, the definition of mobile accesses (and, therefore, of total accesses) was revised to include machine-to-machine accesses. In addition, we revised the accounting criteria for pre-pay mobile accesses at Telefónica O2 Czech Republic and Telefónica O2 Slovakia to conform to the accounting criteria for pre-pay mobile accesses throughout the Group. In order to count a pre-pay mobile access, such access must have been active in the most recent three months prior to counting. As a result of both revisions, we restated 2008 mobile accesses, adding 0.2 million accesses in the aggregate. Our 2007 information is presented based on our prior classifications.
- (7) Includes unbundled lines by Telefónica O2 Germany.
- (8) Includes circuits for other operators.

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### Our Services and Products

#### Fixed business

The principal services we offer in our fixed businesses in Spain, Europe and Latin America are:

- Traditional fixed telecommunication services. Our principal traditional fixed telecommunication services include PSTN lines; ISDN accesses; public telephone services; local, domestic and international long distance and fixed-to-mobile communications services; corporate communications services; supplementary value-added services (including call waiting, call forwarding, voice and text messaging, advanced voicemail services and conference-call facilities); video telephony; business-oriented value-added services; intelligent network services; leasing and sale of terminal equipment; and telephony information services.
- Internet and broadband multimedia services. Our principal Internet and broadband multimedia services include Internet service provider service; portal and network services; retail and wholesale broadband access through ADSL; naked ADSL (a broadband connection without the monthly fixed line fee); narrowband switched access to Internet for universal service, and other technologies; residential-oriented value-added services (including instant messaging, concerts and video clips by streaming video, e-learning, parental control, firewall protection, anti-virus protection, content delivery and personal computer sales); television services such as Imagenio, our IPTV business, cable television and satellite television; companies-oriented value-added services, like puesto integral o puesto informático, which includes ADSL, computer and maintenance for a fixed price and VoIP services. Telefónica Spain is also providing services based on Fiber to the Home (FTTH), including a new range of products and services named “FUTURA”. This line of products includes high speed Internet access (currently up to 30 Mb), which allows Telefónica Spain to provide its customers with advanced IPTV services such as High Definition (HDTV) channels, Multiroom (allowing clients to watch different TV channels in different rooms) and Digital Video Recording (DVR).
- Data and business-solutions services. Our data and business-solutions services principally include leased lines; virtual private network, or VPN, services; fiber optics services; the provision of hosting and application, or ASP, service, including web hosting, managed hosting, content delivery and application, and security services; outsourcing and consultancy services, including network management, or CGP; and desktop services and system integration and professional services.
- Wholesale services for telecommunication operators. Our wholesale services for telecommunication operators principally include domestic interconnection services; international wholesale services; leased lines for other operators’ network deployment; and local loop leasing under the unbundled local loop regulation framework. It also includes bit stream services, bit stream naked, wholesale line rental accesses and leased ducts for other operators’ fiber deployment.

#### Mobile business

We offer a wide variety of mobile and related services and products to personal and business customers. Although the services and products available vary from country to country, the following are our principal services and products:

- Mobile voice services. Our principal service in all of our markets is mobile voice telephony.
- Value added services. Customers in most of our markets have access to a range of enhanced mobile calling features, including voice mail, call hold, call waiting, call forwarding and three-way calling.

- Mobile data and Internet services. Current data services offered include Short Messaging Services, or SMS, and Multimedia Messaging Services, or MMS, which allow customers to send messages with images, photographs and sounds. Customers may also receive selected information, such as news, sports scores and stock quotes. We also provide mobile broadband connectivity and Internet access. Through mobile Internet access, our customers are able to send and receive e-mail, browse the Internet, download games, purchase goods and services in m-commerce transactions and use our other data services.

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- Wholesale services. We have signed network usage agreements with several MVNOs in different countries.
- Corporate services. We provide business solutions, including mobile infrastructure in offices, private networking and portals for corporate customers that provide flexible on line billing. Telefónica Móviles España, S.A.U., or Telefónica Móviles España, offers corporate services through Movistar Corporativo, and other advanced solutions for data developed for specific sectors.
- Roaming. We have roaming agreements that allow our customers to use their mobile handsets when they are outside of our service territories, including on an international basis.
- Fixed wireless. We provide fixed voice telephony services through mobile networks in Venezuela, Argentina, Peru, Mexico, Ecuador, El Salvador, Guatemala and Nicaragua.
- Trunking and paging. In Spain and Guatemala, we provide digital mobile services for closed user groups of clients and paging services.

The following sections provide a description of the main markets in which we operate. Customer information on the markets in which we operate, including our market share based on accesses, are estimates that we have made based on annual reports and press releases made public by our competitors or information from local regulators in the respective markets.

## Telefónica Spain Operations

Telefónica Spain provides fixed and mobile telephony services, Internet and data and pay TV services in Spain.

Telefónica Spain's total accesses decreased 1.2% to 46.8 million accesses at December 31, 2009 from 47.3 million accesses at December 31, 2008. Total accesses at December 31, 2009 included 23.5 million mobile accesses, 14.2 million fixed telephony accesses, 5.7 million Internet and data accesses and 0.7 million pay TV accesses. Additionally, it included 2.2 million unbundled local loop accesses and 0.4 million of wholesale ADSL accesses.

The following table presents, at the dates indicated, selected statistical data relating to our operations in Spain.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	15,918.8	15,326.3	14,200.1
Internet and data accesses	5,321.8	5,670.0	5,722.5
Narrowband accesses	660.8	388.0	219.5
Broadband accesses	4,614.0	5,246.4	5,476.8
Other accesses	47.0	35.6	26.2
Mobile accesses	22,826.6	23,604.8	23,538.6
Pre-pay accesses	9,181.8	9,037.0	8,204.5
Pay TV accesses	511.1	612.5	703.0
Final clients accesses	44,578.2	45,213.6	44,164.2
Wholesale accesses	1,855.5	2,136.1	2,614.0
Total accesses	46,433.6	47,349.7	46,778.2

## Telefónica Spain - Fixed business

Telefónica Spain provides fixed telephony services in Spain through the operator Telefónica de España, S.A., or Telefónica de España.

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## Operations

The following table presents, at the dates indicated, selected statistical data relating to the operations of Telefónica de España:

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	15,918.8	15,326.3	14,200.1
Internet and data accesses	5,321.8	5,670.0	5,722.5
Narrowband accesses	660.8	388.0	219.5
Broadband accesses	4,614.0	5,246.4	5,476.8
Other accesses	47.0	35.6	26.2
Pay TV accesses	511.1	612.5	703.0
Final clients accesses	21,751.6	21,608.8	20,625.6
Wholesale line rental accesses	–	9.5	97.4
Unbundled local loop accesses	1,353.9	1,698.0	2,153.8
Shared UL accesses	776.4	602.3	447.7
Full UL accesses	577.6	1,095.7	1,706.1
Wholesale ADSL accesses	495.5	423.8	359.0
Other accesses	6.0	4.7	3.7
Wholesale accesses	1,855.5	2,136.1	2,614.0
Total accesses	23,607.1	23,744.8	23,239.6

In 2009, the Spanish market for fixed telephony accesses was affected by an unfavorable economic environment and showed an estimated decrease of 0.8% year-on-year based on number of accesses. During the same period, Telefónica Spain's fixed telephony accesses decreased by 7.3% to 14.2 million accesses at December 31, 2009, from 15.3 million accesses at December 31, 2008, outpacing the total market decline as a result of fierce competition. Telefónica Spain had net fixed telephony accesses losses of 1.1 million in 2009, higher than the 0.6 million net fixed telephony accesses losses recorded in 2008.

Estimated net adds in the total Spanish broadband market decreased 47.9% to 0.6 million in 2009 from 1.1 million in 2008. The total estimated Spanish broadband access market was approximately 9.9 million accesses at December 31, 2009. Telefónica Spain's broadband accesses increased 4.4% to 5.5 million at December 31, 2009 from 5.2 million accesses at December 31, 2008.

Unbundled local loops made up approximately 21.1% of the broadband access market in Spain at December 31, 2009 up from approximately 18.3% at December 31, 2008. Unbundled local loops at December 31, 2009 amounted to 2.2 million accesses, of which nearly 21% were shared access loops.

Telefónica Spain's total wholesale ADSL accesses were 0.4 million accesses at December 31, 2009, a decrease of 15.3% compared to the accesses at December 31, 2008, mainly because of the migration to unbundled local loops.

In 2009, Telefónica Spain continued to increase its presence in the pay TV market, achieving a customer base of 0.7 million accesses at December 31, 2009 from 0.6 million accesses at December 31, 2008.

Since 2005 Telefónica Spain has bundled ADSL products with other products in Duo bundles, which include voice and broadband services, and Trio bundles, which include voice, broadband and pay TV services. The total number of Duo and Trio bundles increased by 7.2% to 4.9 million units at December 31, 2009 from 4.5 million units at



December 31, 2008. At December 31, 2009, 88% of Telefónica Spain's broadband accesses were included in Duo or Trio bundles compared to 85% at December 31, 2008.

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### Sales and marketing

One of our main priorities has been to satisfy customer needs and increase customer loyalty by improving the quality of our customer service and offering a wide range of integrated telecommunications services. We have reinforced our strategy of customer segmentation in order to tailor our services to best meet the specific needs of each customer segment.

In 2009 we marketed new products and promotions to strengthen our position in the market for fixed-mobile convergence, both for residential and business customers.

In 2009 we were also very active in capturing new fixed telephony customers (which, in many cases, included broadband customers as well) through “free-connection fee” campaigns. These campaigns stimulated new adds. At the same time, we improved the value of fixed lines creating, for example, Línea 3, a new product that offers our customers free national calls to their three most called numbers.

During 2009 Telefónica Spain continued marketing bundled ADSL products, which included voice and pay TV services, and Quadruple bundles, which include fixed telephony, mobile telephony, broadband access and pay TV services, some of these new bundles include:

- Banda ancha total: bundle of fixed and mobile broadband; and
- ADSL + voz móvil: bundle of fixed broadband and free mobile traffic during the weekends.

In September 2009, the CMT modified the regulatory framework for retail offers allowing Telefónica Spain to carry out promotions to its clients under certain conditions and simplifying the replicability analysis of the quadruple play.

In October 2009 Telefónica Spain launched ADSL Libre, a new product that allows customers to subscribe for a broadband connection without the monthly fixed line fee (naked ADSL).

ADSL commercial campaigns carried out to capture new broadband customers were very intense during 2009. In particular, the Semana Loca campaigns introduced new promotions with more attractive prices that allowed Telefónica Spain to better defend its market share.

In the business segment, we continued to promote our Puesto de Trabajo services, which is a package of services designed to meet the voice, data and IT needs for small- and medium-sized businesses.

The customer service model employed by Telefónica Spain, which is focused on achieving the highest degree of efficiency in customer service, has the following features:

- a 24-hour personal customer service line for purchasing any type of product and service and handling customer queries;
- Telefónica stores (Tiendas Telefónica) where customers can test and buy the products we market, including the opening in 2008 of our flagship store at the historic Telefónica headquarters building on the Gran Vía (Madrid), which is the largest telecommunications store in Spain;
- the Telefónica On Line Store, accessible by Internet ([www.telefonica.es](http://www.telefonica.es)), which offers customers the ability to order and purchase online the majority of services and products we offer; and

- a customer service system for corporate customers, with a dedicated sales force.

#### Competition

Telefónica Spain's main competitors in the fixed telephony market fall within three main categories:

- cable operators, such as Spanish nationwide cable operator ONO, which offers bundles of voice, broadband and pay TV services, and regional cable operators (Euskaltel, Telecable and Grupo R);

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- ULL operators, such as Orange, Jazztel and Vodafone; and
- large-business oriented operators, such as British Telecom and Colt, which offer voice and data virtual private networks (VPNs).

Telefónica Spain's estimated market share at December 31, 2009 was as follows:

- fixed telephony accesses market share amounted to approximately 72% of retail accesses (down from approximately 77% at December 31, 2008);
- broadband market share amounted to approximately 56% of retail accesses (down from approximately 57% at December 31, 2008); and
- pay TV market share amounted to approximately 17% of the market in terms of accesses (up from approximately 14% at December 31, 2008).

In November 2008, the CMT approved "Wholesale Access for Telephone Lines", or AMLT, a new product that allows operators to resell telephone lines to their final customers. During 2009 this product has shown a very slow growth.

#### Network and technology

Telefónica Spain has made significant investments to develop its broadband access business through broadband technology, as well as in capacity and security of its aggregation, transport and data network.

#### Telefónica Spain - Mobile business (Spain)

Telefónica Spain provides mobile services in Spain through the operator Telefónica Móviles España.

#### Operations

The Spanish mobile market exceeded 55.6 million accesses at December 31, 2009, which represented a penetration rate of 121%, an increase of more than 5 percentage points from December 31, 2008. The Spanish mobile market showed growth as a result of data services development.

The following table presents, at the dates or for the periods indicated, selected statistical data relating to Telefónica Spain's mobile business.

	At or for the year ended December 31,		
	2007	2008	2009
Total mobile accesses (in thousands)	22,826.6	23,604.8	23,538.6
Pre-pay accesses (in thousands)	9,181.8	9,037.0	8,204.5
MOU (minutes)	161	156	n.a.
Traffic (millions of minutes)	n.a.	43,568	42,039
ARPU (in euros)	32.3	30.4	27.5

Our mobile customer base in Spain, measured in terms of accesses, stood at 23.5 million accesses at December 31, 2009, a decrease of 0.3% from 23.6 million at December 31, 2008. This evolution was primarily driven by a 9.2% decrease in accesses in the pre-pay segment, which was primarily driven by our decision in December 2009 to

disconnect 715 thousand pre-pay mobile accesses from the customer base as a consequence of lower activity levels.

In the context of an increasingly competitive market, with strong competition in number portability and pressure on pricing, Telefónica Móviles España's main commercial objective was to maintain its market leadership in revenue share, based on its competitive tariff scheme, strong focus on high value customers and effective marketing and advertising strategies. Telefónica Spain's mobile business achieved negative net adds of 66 thousand accesses in 2009, compared to positive net adds of 0.8 million accesses in 2008, with a noteworthy number of net accesses gains in the contract segment, 0.8 million accesses in 2009, down from 0.9 million in 2008.

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In terms of portability, which is customers transferring their number to Telefónica Móviles España from a competitor, Telefónica Móviles España's total net adds was a negative figure of 0.2 million lines in 2009. However, by continuing to focus on the higher value customer segments, net portability adds of contract lines was a positive, though significantly smaller, figure of 8.1 thousand lines in 2009.

At December 31, 2009, approximately 65% of our mobile accesses in Spain were contract, which represents an increase of 3.4 percentage points from December 31, 2008.

ARPU for Telefónica Spain's mobile business decreased 9.7% to €27.5 in 2009 from €30.4 in 2008. The decrease was primarily driven by a decrease in voice ARPU of 12.4% to €22.1 in 2009 from €25.2 in 2008 as a result of increased competition, interconnection price cuts, roaming-out regulation and less usage. Outgoing voice ARPU also decreased 10.3% to €19.0 in 2009 from €21.2 in 2008. These decreases were partially offset by an increase in data ARPU of 3.0% to €5.4 in 2009 from €5.2 in 2008, with outgoing data ARPU growing 3.4% to €4.8 in 2009 from €4.7 in 2008.

Traffic for 2009 decreased 3.5% to 42,039 million minutes compared to 43,568 million minutes in 2008 mainly due to a lower voice usage as customers optimized their consumption.

At December 31, 2009, Telefónica Spain's customers held more than 8.9 million UMTS/HSDPA handsets, an increase of 12 percentage points from December 31, 2008.

### Sales and marketing

Telefónica Spain is focused on key initiatives to preserve its position as a leading mobile operator in the market, leading it to increase commercial efforts with measures including:

- in-depth market segmentation, with a focus on customer value;
- programs to promote customer loyalty; and
- pricing policies to stimulate usage, including launching segmented packages and innovative tariff options.

Since Telefónica Spain began providing mobile services in Spain, its sales and marketing strategy has been to generate increased brand awareness and customer satisfaction to achieve customer growth and increased revenues. Telefónica Spain utilizes several types of marketing channels, including television, radio, exterior billboards, telemarketing, direct mail and Internet advertising. Telefónica Spain also sponsors several cultural and sporting events in order to increase its brand recognition.

During 2009 Telefónica Spain's main marketing campaigns focused on boosting demand for mobile broadband, with the launch of data flat rates for browsing the web by a handset or small screen (to access contents, music, television, etc.) as well as browsing the web with laptops or big screen, developing new concepts and campaigns such as "try and buy". In addition, Telefónica Spain offers access to mobile broadband services with HSPA technology. These favorable data rates and mobile broadband capable devices have been bundled by Telefónica Spain in order to promote an increase in the number of accesses and level of use of mobile broadband services in Spain. In order to help achieve this goal:

- In June 2009, Telefónica launched mobile broadband services for pre-pay customers.
-

In September 2009, Telefónica launched “mstore” with a catalogue of more than 1,000 mobile telephony applications and services, available to all Movistar customers, and ready to download to mobile phones and computers.

- Also, in November 2009, Telefónica launched HSPA+ services and tariffs which allow downloading at peak speeds of 21 Mbs.

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## Competition

Telefónica Spain's main competitors in the Spanish market for mobile communications service are: Vodafone España, a subsidiary of Vodafone plc, Orange, which is the trade name of France Telecom España S.A., Yoigo, whose principal shareholder is TeliaSonera, and other MVNO operators.

Telefónica Spain's estimated market share in Spain in terms of mobile accesses was approximately 42% at December 31, 2009 (down from approximately 44% at December 31, 2008).

## Network and technology

Telefónica Spain's digital network in Spain is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica Spain's international roaming agreements, enable its mobile customers to make and receive calls in more than 200 countries worldwide. Telefónica Spain's GSM/UMTS based network provides its customers with access to many of the most advanced mobile handsets and a full range of services and products.

In 2009, Telefónica Spain invested in building out and enhancing its networks in Spain and developing its technological platforms and information systems. At December 31, 2009, Telefónica Spain's GSM/GPRS digital network in Spain consisted of approximately 22,293 base stations of 2G. In 2009, Telefónica Spain accelerated the expansion of its UMTS network with 1,547 new base stations with a total of more than 10,820 UMTS base stations installed at the end of the year.

## Telefónica Europe

Telefónica Europe's principal activities are the provision of fixed and mobile telephony services, Internet and data services in the United Kingdom, Germany, the Czech Republic and the Isle of Man, mobile telecommunications services in Ireland and Slovakia and pay TV in Czech Republic.

The following table presents, at the dates indicated, selected statistical data relating to our operations in Europe.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	2,130.0	1,952.7	1,827.5
Internet and data accesses	880.0	1,354.5	1,754.7
Narrowband accesses	202.4	163.4	137.3
Broadband accesses	670.3	1,158.7	1,589.1
Other accesses	7.3	32.4	28.3
Mobile accesses	38,263.8	41,401.8	44,095.0
Pay TV accesses	73.2	114.5	137.6
Final clients accesses	41,347.0	44,823.5	47,814.9
Wholesale accesses	706.2	1,237.9	1,425.2
Total accesses	42,053.2	46,061.4	49,240.1

Telefónica Europe's total accesses increased 6.9% to 49.2 million accesses at December 31, 2009 from 46.1 million accesses at December 31, 2008. Total accesses at December 31, 2009 included 44.1 million mobile accesses, 1.8 million fixed telephony accesses, 1.8 million Internet and data accesses and 0.1 million pay TV accesses. Additionally, it included 1.4 million ADSL wholesale accesses.





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## United Kingdom – Telefónica O2 UK

## Operations

The following tables present, at the dates or for the periods indicated, selected statistical data relating to our operations in the United Kingdom.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Internet and data accesses	70.7	340.9	591.5
Broadband accesses	70.7	340.9	591.5
Mobile accesses	18,382.1	20,274.7	21,299.3
Pre-pay accesses	11,573.4	11,862.5	11,740.3
Final clients accesses	18,452.8	20,615.6	21,890.8
Total accesses	18,452.8	20,615.6	21,890.8
	Year ended December 31,		
	2007	2008	2009
MOU (minutes)	190	207	n.a.
Traffic (millions of minutes)	n.a.	46,585	53,856
ARPU (in euros)	34.4	29.0	24.7

The mobile penetration rate in the United Kingdom was approximately 126% at December 31, 2009, an increase of approximately 3 percentage points compared to the penetration rate at December 31, 2008.

Total accesses for Telefónica O2 UK, Telefónica Europe's operating company in the United Kingdom, increased 6.2% to 21.9 million accesses at December 31, 2009 compared to 20.6 million accesses at December 31, 2008 (excluding the Tesco mobile customer base, which is the result of a joint venture in which Telefónica O2 UK holds a 50% stake and whose customers use the Telefónica O2 UK network). Telefónica O2 UK, had net adds of 1.3 million accesses in 2009, 41.0% less than its net additions in 2008.

Telefónica O2 UK added 1.1 million mobile contract accesses in 2009, bringing the total at December 31, 2009 to 9.6 million mobile contract accesses, an increase of 13.6% from December 31, 2008. Pre-pay mobile accesses decreased from 11.9 million accesses from December 31, 2008 to 11.7 million accesses at December 31, 2009. At December 31, 2009 mobile contract accesses made up 44.9% of Telefónica O2 UK's mobile customer base, compared to 41.5% at December 31, 2008. At December 31, 2009 Telefónica O2 UK had 0.6 million broadband accesses compared to 0.3 million broadband accesses at December 31, 2008.

Contract ARPU decreased to €40.8 in 2009 from €48.6 in 2008 (a decrease of 5.9% in local currency). Pre-pay ARPU decreased to €12.3 in 2009 from €15.5 in 2008 (a decrease of 11.0% in local currency). ARPU was €24.7 in 2009 down from €29.0 in 2008 (a decrease of 4.4% in local currency). This decrease in local currency ARPU was caused by MTR regulation (which resulted in an average rate decrease of approximately 11% year-on-year) and customers' usage optimization. Traffic in 2009 increased 15.6% to 53,856 million minutes compared to 46,585 million minutes in 2008.

## Sales and marketing

In the United Kingdom, we use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail, internet advertising and sponsorship to market Telefónica O2 UK's products and services.

In 2009, Telefónica O2 UK continued its focus on high-value customers across various segments and offered a wide range of smart phones such as the iPhone 3GS and the Palm Pre, in addition to mobile and fixed broadband representing one of the key drivers of revenue growth in 2009.

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In 2009 Telefónica O2 UK was voted “Best Network” for the second consecutive year at Mobile Awards 2009.

### Competition

Telefónica O2 UK’s estimated market share was approximately 26.2% at December 31, 2009 compared with approximately 25.9% at December 31, 2008, based on the number of mobile accesses.

In addition to Telefónica O2 UK, there are currently four other network operators in the UK mobile telecommunications market: Vodafone UK, a subsidiary of Vodafone plc, T-Mobile UK, a subsidiary of Deutsche Telekom AG, Orange, owned by France Telecom, and 3, owned by Hutchison Whampoa. MVNOs operating in the UK market include Virgin Mobile and Talk-Talk, owned by Virgin Media and The Carphone Warehouse Group, respectively, which respectively use the T-Mobile UK and Vodafone network, and Tesco Mobile, a joint venture in which Telefónica O2 UK holds a 50% stake, and which uses the Telefónica O2 UK network.

We understand that a proposed joint venture between France Telecom and Deutsche Telekom’s UK operators (Orange UK and T-Mobile UK, respectively) is currently being analyzed by regulators.

At December 31, 2009, Telefónica O2 UK also provides the network infrastructure for LycaMobile, a mobile virtual network operator (MVNO) who competes with us and pays Telefónica O2 UK to use its network.

### Network and technology

Telefónica O2 UK’s digital network in the United Kingdom is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica O2 UK’s international roaming agreements, enables Telefónica O2 UK’s customers to make and receive calls in more than 200 countries worldwide. At December 31, 2009, Telefónica O2 UK’s GSM/UMTS digital network consisted of approximately 11,817 base stations.

Telefónica O2 UK had rolled out ULL capabilities to 1,245 exchanges by the end of 2009, giving its broadband network population coverage of 67.2% in terms of the UK population.

### Germany – Telefónica O2 Germany

#### Operations

The following tables present, at the dates or for the periods indicated, selected statistical data relating to our operations in Germany.

	2007	At December 31, 2008	2009
		(in thousands)	
Internet and data accesses	74.7	214.8	285.1
Broadband accesses	74.7	214.8	285.1
Mobile accesses	12,471.5	14,198.5	15,507.4
Pre-pay accesses	6,235.0	7,231.5	7,807.0
Final clients accesses	12,546.2	14,413.3	15,792.5
Wholesale accesses	596.0	1,128.4	1,316.8
Total accesses	13,142.3	15,541.7	17,109.3

	Year ended December 31,		
	2007	2008	2009
MOU (minutes)	131	138	n.a.
Traffic (millions of minutes)	n.a.	22,313	23,257
ARPU (in euros)	20.4	17.4	15.6

The mobile penetration rate in Germany was approximately 132% at December 31, 2009, similar to the penetration rate at December 31, 2008.

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The total customer base of Telefónica O2 Germany, Telefónica Europe's operating company in Germany, increased by 1.6 million accesses from December 31, 2008 to 17.1 million accesses at December 31, 2009. Telefónica O2 Germany's joint venture with Tchibo Mobile was responsible for 0.1 million of this increase in accesses from December 31, 2008 to 1.4 million accesses at December 31, 2009, while Telefónica O2 Germany's "Fonic" low-cost brand, added 0.6 million accesses from December 31, 2008, giving it a customer base of 1.3 million accesses at December 31, 2009.

Telefónica O2 Germany had net adds of 0.7 million mobile contract accesses and 0.6 million mobile pre-pay accesses in 2009, bringing the contract and pre-pay customer base at December 31, 2009 to 7.7 million accesses and 7.8 million accesses respectively.

At December 31, 2009, Telefónica O2 Germany had a customer base of 0.3 million broadband accesses. Telefónica O2 Germany reported 1.3 million ULL lines at December 31, 2009, an increase of 16.7% from 1.1 million ULL lines at December 31, 2008.

ARPU continued to decline in 2009, decreasing 9.9% to €15.6 in 2009 from €17.4 in 2008, partly as a result of an approximately 14% regulated cut in MTRs in April 2009 and the fierce level of competition in the German market. Contract ARPU decreased 10.0% to €26.1 in 2009 from €29.0 in 2008. Pre-pay ARPU decreased 4.4% to €5.7 in 2009 from €5.9 in 2008. Traffic in 2009 increased 4.2% to 23,257 million minutes compared to 22,313 million minutes in 2008.

### Sales and marketing

During 2009 Telefónica O2 Germany revised its commercial model, replacing existing tariffs such as "Genion S/M/L/XL", with the new and innovative "O2 o" proposition, where customers have contracts with no minimum spend, and a monthly cap for voice and SMS. As a result of this new commercial proposition "My Handy" has been introduced which separates the handset from the traditional subsidized mobile phone contract, with customers acquiring a separate contract for a handset. The "Inklusivpaket" plan continues to be marketed as a data tariff.

Telefónica O2 Germany continued to build on its core strategy of increasing its distribution network, which was broadly in line with target at 940 shops at year end.

### Competition

Telefónica O2 Germany's estimated market share in Germany was approximately 14.3% at December 31, 2009 compared to approximately 13.5% at December 31, 2008, based on number of mobile accesses.

Telefónica O2 Germany competes primarily with three other companies in the German market for mobile telecommunications. These are T-Mobile, which is owned by Deutsche Telecom AG, Vodafone Germany, a subsidiary of Vodafone plc, and E-Plus, which is owned by KPN. Telefónica O2 Germany also competes with several MVNOs.

### Network and technology

Telefónica O2 Germany's digital network in Germany is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica O2 Germany's international roaming agreements, enables Telefónica O2 Germany customers to make and receive calls in more than 200 countries worldwide.

At December 31, 2009, Telefónica O2 Germany's GSM/UMTS digital network consisted of approximately 17,210 base stations.

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## Czech Republic and Slovakia – Telefónica O2 Czech Republic and Telefónica O2 Slovakia

Telefónica Europe provides fixed line, pay TV, and mobile services in the Czech Republic and mobile services in Slovakia, where it launched operations during the first quarter of 2007.

## Operations

The following tables present, at the dates or for the periods indicated, selected statistical data relating to our operations in the Czech Republic (data excludes Slovakia).

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	2,069.2	1,893.4	1,770.6
Internet and data accesses	719.1	779.5	848.7
Narrowband accesses	202.4	163.4	137.6
Broadband accesses	509.4	583.7	683.2
Other accesses	7.3	32.4	28.3
Mobile accesses	5,125.4	4,802.1	4,944.6
Pre-pay accesses	2,881.5	2,282.8	2,130.2
Pay TV accesses	73.2	114.5	137.6
Final clients accesses	7,986.8	7,589.5	7,701.5
Wholesale accesses	110.2	109.5	108.4
Total accesses	8,097.0	7,698.9	7,810.0

  

	Year ended December 31,		
	2007	2008	2009
MOU (minutes)	117	121	n.a.
Traffic (millions of minutes)	n.a.	7,420	8,232
ARPU (in euros)	18.9	22.8	19.3

The mobile penetration rate in the Czech Republic was approximately 134% at December 31, 2009, approximately 3 percentage points higher than the penetration rate at December 31, 2008.

Fixed telephony accesses for Telefónica O2 Czech Republic, Telefónica Europe's operating company in the Czech Republic, decreased by 6.5% to 1.8 million accesses at December 31, 2009 from 1.9 million accesses at December 31, 2008, mainly as the result of fixed-to-mobile substitution.

Telefónica O2 Czech Republic's broadband accesses increased 17.0% compared to December 31, 2008 to 0.7 million accesses at December 31, 2009. The pay TV customer base increased 20.2% to 0.1 million accesses at December 31, 2009. These increases are primarily as a result of increased demand for these services in the Czech Republic.

Telefónica O2 Czech Republic's mobile accesses increased 3.0% to 4.9 million accesses at December 31, 2009, from 4.8 million accesses at December 31, 2008. Contract mobile accesses accounted for 56.9% of these accesses at December 31, 2009, up from 52.5% at December 31, 2008. The number of pre-pay mobile accesses decreased 43.1%, to 2.1 million accesses at December 31, 2009 from 2.3 million accesses at December 31, 2008.



ARPU decreased to €19.3 in 2009 from €22.8 in 2008 (a reduction of 10.5% in local currency). Pre-pay ARPU decreased to €8.5 in 2009 from €11.4 in 2008 (a reduction of 21.9% in local currency), primarily due to customers optimizing their tariffs and calling patterns. Contract ARPU decreased to €28.2 in 2009 from €33.5 in 2008 (a decrease of 12.0% in local currency), primarily due to regulated MTR cuts (approximately 22.7% year-on-year) and customers optimizing their spending. Traffic in 2009 increased 11.0% to 8,232 million minutes compared to 7,420 million minutes in 2008.

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Sales and marketing

During 2009 the dominant mobile proposition of Telefónica O2 Czech Republic remained the “O2 Neon” tariffs launched in 2008, which are designed to stimulate traffic through a simplified, flat tariff structure. In 2009 a new concept was launched in fixed segment, called “O2 Home”, where subscribers can purchase DSL packages without the need to have a fixed line. Within the O2 Home offering are options to subscribe for bundled products, including mobile broadband, mobile tariffs and IPTV at more advantageous prices.

Competition

There are currently two other primary competitors in the Czech Republic mobile telecommunications market, Vodafone Czech Republic, which is owned by Vodafone plc., and T-Mobile, which is part of Deutsche Telecom AG.

Telefónica O2 Czech Republic had an estimated mobile market share of approximately 39.2% at December 31, 2009 compared to approximately 38.6% at December 31, 2008, based on number of mobile accesses.

The fixed telephony market in the Czech Republic consists of six large operators and a number of other smaller providers. In voice the major competitors are U:fon, UPC and other cable operators which also provide integrated voice, Internet and pay TV offers. Internet service is offered by all major mobile operators as well as a large volume of WiFi providers. Pay TV is dominated by a number of cable and satellite companies, the biggest being UPC.

Network and technology

Telefónica O2 Czech Republic’s digital network in the Czech Republic is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica O2 Czech Republic’s international roaming agreements, enables its customers to make and receive calls in more than 200 countries worldwide.

At December 31, 2009, Telefónica O2 Czech Republic’s GSM/UMTS digital network consisted of 4,786 base stations.

Slovakia

At December 31, 2009, Telefónica O2 Slovakia’s total number of mobile accesses amounted to 0.6 million accesses, an increase of 69.9% compared to December 31, 2008. Contract mobile accesses accounted for 35.4% of these accesses at December 31, 2009 compared to 30.4% at December 31, 2008. Throughout 2009, Telefónica O2 Slovakia continued with “O2 Fér” plan, a simple tariff which unifies pre-pay and contract mobile rates and offers SIM-only products without a handset subsidy.

In 2009, Telefónica O2 Slovakia continued to roll out its own network infrastructure, and by December 31, 2009 the company had 917 base stations, which fulfilled its license conditions.

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## Ireland – Telefónica O2 Ireland

## Operations

The following tables present, at the dates or for the periods indicated, selected statistical data relating to our operations in Ireland:

	At December 31,		
	2007	2008	2009
	(in thousands)		
Total mobile accesses	1,646.1	1,727.7	1,714.3
Pre-pay accesses	1,090.9	1,084.6	1,022.5
	Year ended December 31,		
	2007	2008	2009
MOU (minutes)	248	245	n.a.
Traffic (millions of minutes)	n.a.	4,867	4,672
ARPU (in euros)	45.9	43.2	39.6

The mobile penetration rate in Ireland was approximately 120% at December 31, 2009, approximately 1 percentage point lower than the penetration rate at December 31, 2008.

Telefónica O2 Ireland had net losses of 13 thousand mobile accesses in 2009. Telefónica O2 Ireland's customer base, in terms of mobile accesses, decreased 0.8% from December 31, 2008 to 1.7 million mobile accesses at December 31, 2009.

Telefónica O2 Ireland had net adds of 49 thousand contract mobile accesses in its mobile business in 2009, a decrease of 44.6% on December 31, 2008.

ARPU decreased by 8.3% in 2009 to €39.6 from €43.2 in 2008. Contract ARPU decreased 14.6% to €62.0 in 2009 from €72.5 in 2008 due to a different price plan mix. Pre-pay ARPU decreased by 5.7% in 2009 to €25.5 in 2009 from €27.0 in 2008. Traffic in 2009 decreased 4.0% to 4,672 million minutes compared to 4,867 million minutes in 2008 primarily due to voice to text substitution.

## Sales and marketing

During 2009, Telefónica O2 Ireland continued to be the exclusive provider of the iPhone, with the new version 3GS having been launched in June. The second half of the year saw the launch of the new O2 exclusive Palm Pre phone, and pre-pay mobile internet.

## Competition

There are currently three other primary competitors in the Irish mobile telecommunications market: Vodafone Ireland, which is part of Vodafone plc, Meteor, which is part of Eircom, and 3 Ireland, which is part of Hutchison Wampoa.

Telefónica O2 Ireland had an estimated market share of the Irish mobile market of approximately 32.3% at December 31, 2009 compared to approximately 32.5% at December 31, 2008, based on number of mobile accesses.

Network and technology

Telefónica O2 Ireland's digital network in Ireland is based upon the GSM/UMTS standard. The prevalence of the GSM standard, together with Telefónica O2 Ireland's international roaming agreements, enables Telefónica O2 Ireland customers to make and receive calls in more than 200 countries worldwide.

At December 31, 2009, Telefónica O2 Ireland's GSM/UMTS digital network consisted of approximately 1,692 base stations.

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## Telefónica Latin America

Telefónica Latin America provides fixed and mobile telephony, Internet and data services and pay TV services through the operators described in the following sections in the main Latin American markets. In addition, Telefónica Latin America's other members include: Telefónica Empresas, Telefónica International Wholesale Services (TIWS), the business unit responsible for other telecommunications operators and for managing our international services and the network which supports these services, and Terra Networks Latin América.

The following table presents statistical data relating to our operations in Latin America:

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	25,381.0	25,644.5	24,578.3
Internet and data accesses	6,954.8	7,629.8	7,605.2
Narrowband accesses	1,815.6	1,445.8	1,070.6
Broadband accesses	5,035.9	6,067.0	6,426.8
Other accesses	103.4	117.0	107.8
Mobile accesses	100,542.2	123,385.2	134,698.9
Pay TV accesses	1,163.8	1,540.5	1,648.6
Final clients accesses	134,041.8	158,200.1	168,531.1
Wholesale accesses	62.6	59.0	56.1
Total accesses	134,104.4	158,259.0	168,587.2

Telefónica Latin America's total accesses increased 6.5% to 168.6 million accesses at December 31, 2009 from 158.3 million accesses at December 31, 2008. Total accesses at December 31, 2009 include 134.7 million mobile accesses, 24.6 million fixed telephony accesses, 7.6 million Internet and data accesses and 1.6 million pay TV accesses. Additionally, it includes 56 thousand wholesale accesses.

The following table sets forth certain information at December 31, 2009 regarding the principal Latin American operating companies of Telefónica Latin America.

Country	Company	Population (in millions)	Interest (%)
Brazil	Telecomunicações de São Paulo, S.A.—Telesp	41.26(*)	87.95
	Brasilcel, N.V.(1)	192.3	50.00
Mexico	Telefónica Móviles México, S.A. de C.V.	110.6	100.00
Panama	Telefónica Móviles Panamá, S.A.	3.5	100.00
Nicaragua	Telefónica Móviles Nicaragua, S.A.	5.5	100.00
Guatemala	Telefónica Móviles Guatemala, S.A.	13.7	99.98
El Salvador	Telefónica Móviles El Salvador, S.A. de C.V.	5.9	99.08
Venezuela	Telcel, S.A.	28.4	100.00
Colombia	Colombia Telecomunicaciones, S.A. ESP.	45.2	52.03
	Telefónica Móviles Colombia, S.A.		100.00
Peru	Telefónica del Perú, S.A.A.	28.2	98.34
	Telefónica Móviles Perú, S.A.C.		100.00
Ecuador	Otecel, S.A.	14.1	100.00

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Argentina	Telefónica de Argentina, S.A.	40.1	100.00
	Telefónica Móviles Argentina S.A.		100.00
Chile	Telefónica Chile, S.A.	16.7	97.89
	Telefónica Móviles Chile, S.A.		100.00
Uruguay	Telefónica Móviles Uruguay, S.A.	3.4	100.00

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(\*)

Concession area only.

(1) Jointly controlled and managed by Telefónica and Portugal Telecom. Brasilcel is the holding company which controls the mobile operating company Vivo.

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## Brazil

The following table presents, at the dates indicated, selected statistical data relating to our operations in Brazil.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	11,960.0	11,661.9	11,253.8
Internet and data accesses	3,288.6	3,625.8	3,440.2
Narrowband accesses	1,155.9	996.4	723.1
Broadband accesses	2,069.6	2,557.8	2,638.4
Other accesses	63.1	71.6	78.7
Mobile accesses	33,483.5	44,945.0	51,744.4
Pre-pay accesses	27,236.4	36,384.0	41,960.7
Pay TV accesses	230.9	472.2	487.2
Final clients accesses	48,963.1	60,704.9	66,925.7
Wholesale accesses	37.4	34.1	34.2
Total accesses	49,000.5	60,739.1	66,959.8

Telefónica Latin America's accesses in Brazil increased 10.2% to 67.0 million accesses at December 31, 2009 from 60.7 million accesses at December 31, 2008. This growth reflects a 15.1% year-on-year increase in Vivo's (Telefónica Latin America's jointly-controlled Brazilian mobile business) customer base and, to a lesser extent, the expansion of Telecomunicações de São Paulo, S.A.'s, or Telesp's, (Telefónica Latin America's Brazilian fixed line business) broadband and pay TV businesses. These increases were offset by a reduction in the number of fixed telephony accesses at Telesp and a decrease in narrowband Internet accesses primarily as a result of a modest migration to broadband accesses.

## Brazil Fixed Business – Telecomunicações de São Paulo, S.A. – Telesp

## Operations

Telesp provides fixed telephony and other telecommunications services in the Brazilian state of São Paulo under concessions and licenses from Brazil's federal government.

Telesp's fixed telephony, Internet and data and pay TV accesses decreased 3.7% to 15.2 million accesses at December 31, 2009 from 15.8 million accesses at December 31, 2008, primarily due to the reduction in the number of fixed telephony accesses, within the context of increased fixed-to-mobile substitution as a result of the growth in Brazil's mobile sector, and a decrease in narrowband Internet accesses, as a result of migration to broadband solutions, that was not compensated by broadband accesses increase. Telesp's fixed telephony accesses decreased 3.5% to 11.3 million accesses at December 31, 2009 from 11.7 million accesses at December 31, 2008. Of these, 25.8% were pre-pay accesses or accesses with consumption limits.

The Brazilian broadband market continued to grow in 2009. Telesp increased its broadband customer base by 3.2% to 2.6 million accesses at December 31, 2009. This moderate increase was affected by the decision of ANATEL, the Brazilian telecommunications regulator, to suspend the sale of Telesp's broadband products from June 22, 2009 to August 27, 2009 as a result of several technical problems on our network. Telesp offers pay TV mainly through a DTH solution and, since the fourth quarter of 2007 after the acquisition of Navy Tree, also offers MMDS technology,

reaching 0.5 million accesses at December 31, 2009, 15 thousand accesses more than at December 31, 2008.

Telesp's voice traffic, measured in minutes, decreased by 5.0% in 2009 compared to 2008, mainly due to lower local and long distance traffic that was not compensated by higher interconnection traffic coming primarily from mobile networks. Fixed local traffic, measured in minutes, decreased 7.4% due to lower fixed telephony accesses, and the implementation of flat rates and minutes bundles. Fixed-to-mobile traffic, measured in minutes, fell 7.9% in 2009 compared to 2008 as a result of a migration of traffic to mobile networks.



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### Sales and marketing

In Brazil, we employ a differentiated approach to marketing whereby we use a mix of human and technological resources (a specialized team and business intelligence tools, respectively), in addition to specific studies that allow us to target various market segments according to the relevant needs of the customers in each segment. We continuously monitor market trends in an effort to develop new products and services that may address the future needs of our customers.

Telefónica Latin America employs the following strategies to deliver fixed telephony and other telecommunications solutions to residential, small and medium enterprises, or SMEs, and corporate customers in Brazil:

- person-to-person sales: customized sales services to achieve and preserve customer loyalty, customized consulting telecommunication services and technical and commercial support;
  - telesales: a telemarketing channel;
- indirect channels: outsourced sales by certified companies in the telecommunications and data processing segments to provide an adequately sized network for our products and services;
  - Internet: the Telefónica website;
- virtual shop for corporate clients: a “gateway” for our corporate customers to acquaint themselves with our portfolio through the Internet; and
- door-to-door: door-to-door sales of services by consultants in the State of São Paulo in order to approach more SMEs to convert them into Telefónica Negócios clients.

We offer bundled products, which include both local and long-distance traffic and minutes bundled with broadband. We believe that the trend towards bundled offers in Brazil will continue to grow, and that further developing such offers will be important to maintaining our competitiveness in the market. Also, in 2009 Telesp launched its “X-treme” products, based on FTTX technology, and its IPTV services as well.

### Competition

Our fixed telephony business in Brazil currently faces strong competition in the corporate and premium residential segments in respect of several types of services. In the corporate segment, there is strong competition in both voice services (local and long distance) and data transmission, resulting in greater retention costs to maintain client relationships.

Our main competitors in the corporate fixed telephony line segment are Oi, Intelig and Embratel, a subsidiary of Telmex International. In the high-income residential service segment, we compete for long-distance customers with Embratel and for broadband customers with cable TV providers, mainly NET Serviços de Comunicação S.A., or Net. For the local voice and high-income segments, we also face increasing competition from mobile telecommunications services, which have lower rates for certain types of calls, such as mobile-to-mobile calls. Such competition increases our advertising and marketing costs. We are taking several steps to defend ourselves from increasing competition. We are focused on improving our broadband products, by offering bundled services that include voice, broadband and television, and by increasing the access speed offered to our clients. In addition, we are improving our market segmentation and developing more competitive products intended to defend our client base

from our competitors' product offerings and to defend our market share.

In the low-income, local fixed telecommunications segment, we face less direct competition due to the low profitability of this market. The most significant competition is from pre-pay mobile telecommunications providers.

Telesp had an estimated market share in the fixed telephony market in the State of São Paulo of approximately 74.4% at December 31, 2009 based on the number of fixed telephony accesses, down from approximately 83.5%

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at December 31, 2008. This decrease is mainly due to intense competition from Net, which offers its “Net Phone” service as part of its offer of pay TV and broadband.

## Network and technology

During the first half of 2009, Telesp had some problems with its network that affected the quality of the service of some products, particularly broadband. In order to guarantee the stability of the service, ANATEL suspended the sale of “Speedy”, our broadband product, on June, 22, 2009. That suspension was temporary and subject to the implementation by Telesp of an action plan to improve the service. Telesp presented its action plan that included capital expenditures and customer care and network expenses. As a result of this, the suspension was revoked on August, 27, 2009. In addition, Telesp continued through 2009 to develop its ADSL network as long as the deployment of the fiber access network.

## Brazil mobile business – Brasilcel (Vivo)

## Operations

With approximately 174 million mobile accesses, Brazil ranked first in Latin America in terms of number of mobile accesses at December 31, 2009. At December 31, 2009, Brazil had an estimated mobile market penetration rate of approximately 90.5%, compared to approximately 79% at December 31, 2008.

Telefónica and Portugal Telecom are 50:50 shareholders in Brasilcel, a joint venture which combines Telefónica’s and Portugal Telecom’s mobile businesses in Brazil. This joint venture is the leading mobile operator in Brazil in terms of number of mobile accesses at December 31, 2009. All of the operating companies participating in the joint venture have been operating under the brand name “Vivo” since April 2003. The licensed areas of Brasilcel include 20 states in Brazil with an aggregate population of approximately 192.3 million people.

Vivo’s customer base, in terms of number of accesses, increased 15.1% to 51.7 million accesses at December 31, 2009 from 44.9 million accesses at December 31, 2008. Of these, 9.8 million were mobile contract accesses. The primary factors contributing to this growth include the increasing importance of the new mobile broadband accesses, the wider range of handsets available, Vivo’s leadership in terms of brand and distribution chain, ongoing marketing campaigns for pre-pay mobile traffic and an improved capacity to attract contract mobile accesses first with Vivo Escolha plans and with Vivo Voçe. Vivo Voçe, launched to improve Vivo Escolha plans, started to be commercialized at the end of November 2009. These plans are customized plans that allow customers to choose the mix of services with an extra bunch of free voice minutes, messaging, or mobile Internet access. Vivo Voçe also helped to increase customer loyalty by encouraging increased minute consumption and maintaining the perception on the market of Vivo’s lower prices than its competitors. These plans are divided into different categories depending on the number of minutes included as well as additional upgrade features, such as extra SMS, extra minutes of long distance calls and extra MMS, with the improvement of being able to choose two of these upgrades instead of one as in the previous plans and include a 3G Internet upgrade option.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	40,547	52,134
ARPU (in euros)	11.9	11.2	9.9

Traffic in 2009 increased 28.6% to 52,134 million minutes compared to 40,547 million minutes in 2008 due to the characteristics of the promotions offered by Vivo in 2009, which focused on the pre-pay mobile segment and control

lines, which require minimum consumption and a prepaid “recharge” when such consumption is complete.

ARPU was €9.9 in 2009 compared to €11.2 in 2008 (a decrease of 8.6% in local currency). The decrease in local currency reflected the increased proportion of “SIM only” accesses in the pre-pay customer base and control accesses in the contract customer base, despite the growth in data consumption.

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## Sales and marketing

Vivo actively manages its distribution channels, which consisted of approximately 12,070 points of sale at December 31, 2009. Also, pre-pay mobile customers have access to a wide range of “recharge” points. Credit recharges can also be made by electronic transfers through the commercial banking network. At December 31, 2009, approximately 18.9% of Vivo’s customer base were contract mobile accesses and the remaining 81.1% were pre-pay mobile accesses. Contract mobile accesses growth was driven by customer acquisition and retention campaigns focused on high-value customers, with an emphasis on the Vivo Escolha and Vivo Voçe plans.

## Competition

Vivo was the leading mobile operator in Brazil in terms of number of accesses at December 31, 2009. The growth of the Brazilian market was considerable during the past years while being accompanied by an increase in competition due to the introduction of new competitors in the regions in which Vivo operates. Vivo’s major competitors are subsidiaries of Telecom Italia, America Móvil and Oi.

Vivo’s estimated market share in terms of mobile accesses in the Brazilian mobile markets in which it operates was approximately 29.7% at December 31, 2009, down from approximately 30.0% market share at December 31, 2008.

## Network and technology

The licenses granted to the companies integrated under the Vivo brand allow operations over the WCDMA, GSM, CDMA, CDMA 1XRTT, CDMA EVDO and TDMA systems. Vivo offers both analog and digital services in the bands of 800 MHz, 1900 MHz and 2100 MHz. In 2009 migration from the CDMA to the GSM network continued. Vivo’s GSM customer base at December 31, 2009 amounted to 40.7 million accesses, 78.7% of its total customer base.

## Venezuela

Venezuela mobile business – Telcel, S.A. – Telcel

## Operations

The following table presents, at the dates indicated, selected statistical data relating to our operations in Venezuela.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Total mobile accesses	9,434.0	10,584.0	10,531.4
Pre-pay accesses	8,900.3	9,970.7	9,891.1
Fixed wireless accesses	995.9	1,312.8	1,214.3
Pay TV	—	8.5	62.8
Total accesses	10,429.9	11,905.3	11,808.5

The mobile penetration rate in Venezuela stood at an estimated 100.6% at December 31, 2009, an increase of approximately 0.5 percentage points from December 31, 2008.



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Telefónica Latin America operates in Venezuela through Telcel, S.A., or Telcel, whose accesses decreased 0.8% to 11.8 million accesses at December 31, 2009 from 12.0 million accesses at December 31, 2008, mainly due to intense competition.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	14,993	14,951
ARPU (in euros)	16.3	16.9	21.2

Traffic in 2009 decreased 0.3% to 14,951 million minutes from 14,993 million minutes in 2008, due to lower quality pre-pay mobile accesses and lower contract mobile accesses usage.

ARPU for 2009 was €21.2 compared to €16.9 in 2008 (an increase of 19.2% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009). The increase in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009 reflected the increase in tariffs, the increased proportion of contract mobile accesses in the customer base and the continued growth in data revenues.

#### Sales and marketing

In Venezuela, we use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market our products. At December 31, 2009, 6.1% of our mobile accesses in Venezuela were contract mobile accesses, while approximately 93.9% were pre-pay mobile accesses.

In 2009 the company continued implementing its strategy of offering a wider range of exclusive handsets, including the launch of several Blackberry models.

#### Competition

The major competitors in the Venezuela mobile business are Movilnet and Digitel. Movilnet is a mobile services communication provider owned by the public operator CANTV. Movilnet currently uses CDMA and GSM technologies. In late December, it launched 3.5G service. Digitel is a mobile communications provider that uses GSM technology and focuses its strategy on mobile internet services based on 3G.

According to the Comisión Nacional de Telecomunicaciones de la República Bolivariana de Venezuela, or CONATEL, CANTV is the incumbent operator in Venezuela with a 46% share of the mobile market (through Movilnet) as of December 31, 2009. CANTV is controlled by the government of Venezuela.

Telefónica's estimated market share in the Venezuelan mobile market, in terms of mobile accesses, was approximately 36.9% at December 31, 2009, down from approximately 37.8% at December 31, 2008.

#### Network and technology

In Venezuela, we operate a digital network based on the CDMA and GSM standard. In 2009, we deployed an overlay based on UMTS /HSDPA. At December 31, 2009, approximately 66.2% of Telcel's accesses in Venezuela were based on the GSM network. Also, we offer HSUPA technology that offers higher speed to upload data to the web, especially while loading images, e-mails, videos, etc.





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## Argentina

The following table presents, at the dates indicated, selected statistical data relating to our operations in Argentina.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	4,682.5	4,603.1	4,607.7
Fixed wireless accesses	104.3	22.4	36.2
Internet and data accesses	1,149.9	1,284.3	1,351.0
Narrowband accesses	312.2	182.8	112.7
Broadband accesses	819.3	1,082.0	1,238.3
Other accesses	18.4	19.5	—
Mobile accesses	13,629.7	14,829.6	15,931.9
Pre-pay accesses	8,836.0	9,687.6	10,736.8
Final clients accesses	19,462.1	20,717.0	21,890.7
Wholesale accesses	9.3	10.0	9.3
Total accesses	19,471.4	20,726.9	21,900.0

Telefónica Latin America managed a total of 21.9 million accesses in Argentina at December 31, 2009, an increase of 5.7% from December 31, 2008. This increase was underpinned by growth in mobile accesses, which increased by 7.4% to 15.9 million accesses at December 31, 2009 from 14.8 million accesses at December 31, 2008, and in the number of broadband accesses, which increased by 14.4% to 1.2 million accesses at December 31, 2009 from 1.1 million accesses at December 31, 2008.

## Argentina fixed business – Telefónica de Argentina S.A.

## Operations

Telefónica Latin America conducts its Argentine fixed business through Telefónica de Argentina, the leading provider of fixed telephony services in Argentina in 2009 based on number of accesses, according to information provided by its competitors and regulatory authorities.

Telefónica de Argentina's accesses increased 1.2% to 6.0 million accesses at December 31, 2009 from 5.9 million accesses at December 31, 2008. This modest growth was primarily driven by a 14.4% increase in broadband accesses to 1.2 million accesses at December 31, 2009 from 1.1 million accesses at December 31, 2008. The growth in broadband accesses was accompanied by a slight increase in fixed telephony accesses of 0.1% to 4.6 million accesses at December 31, 2009 from December 31, 2008.

Total voice traffic (measured in minutes) declined 5.6% during 2009 as compared to 2008 despite the sharp growth of mobile-to-fixed traffic. Local and interconnection fixed-to-fixed traffic (measured in minutes) decreased 5.9% and 4.5%, respectively, in the year ended December 31, 2009 compared to the year ended December 31, 2008. Public use telephony traffic (measured in minutes) in 2009 decreased by 18.4% compared to the year ended December 31, 2008.

## Sales and marketing

In Argentina, Telefónica de Argentina uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market its fixed telephony products and

services. Telefónica de Argentina continued answering customers' needs through the development of its broadband business and by providing them new value added services. Telefónica de Argentina also focused its product strategy on bundles and packages supported by commercial offerings like flat-rate plans (tarifa plana). In 2009, we continued commercializing long distance flat-rate plans. The flat-rate plan was primarily sold with the bundling of broadband access together with a local traffic plan. At December 31, 2009 approximately 67.0% of the broadband customer base subscribed to broadband through a bundled package.

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## Competition

Telefónica de Argentina is the incumbent provider of fixed telephony services in the southern region of Argentina. However, other licensees currently providing fixed telephony services include Telecom Argentina S.A., Telmex Argentina S.A., Impsat S.A. (acquired by Global Crossing in May 2007) and Port-Hable (Hutchison Telecommunications Argentina S.A.). Claro, a mobile phone company owned by America Móvil, also competes in the fixed telephony market.

Telefónica de Argentina is using its expanded fiber-optic network in the northern region of Argentina to carry long-distance traffic and a multiservice network to provide local service in the three most important cities in the northern region of Argentina where Telecom Argentina, S.A. is the incumbent provider. Telefónica de Argentina expanded and improved its network capacity by the construction of fixed wireless networks and the activation of new lines.

Telefónica de Argentina also competes with Grupo Clarín, a company with a growing broadband and TV businesses as a result of the merger of its affiliate Cablevisión with Multicanal in 2007.

Telefónica had an estimated market share in the Argentine fixed telephony market of approximately 47.8% at December 31, 2009 based on number of fixed telephony accesses, down from approximately 48.1% at December 31, 2008.

## Network and technology

Telefónica de Argentina invested in 2009 to develop its broadband access business through ADSL technology, increasing the network coverage and capacity.

Argentina mobile business – Telefónica Móviles Argentina S.A.

## Operations

The Argentine mobile market continued to grow at a strong pace in 2009, with an increase in its penetration to approximately 120.3% at December 31, 2009, from approximately 109.8% at December 31, 2008, based on number of mobile accesses.

Telefónica Latin America conducts its Argentine mobile business through Telefónica Móviles Argentina S.A., or Telefónica Móviles Argentina, whose accesses increased 7.4% to 15.9 million accesses at December 31, 2009 from 14.8 million accesses at December 31, 2008. Telefónica Móviles Argentina also increased its number of contract mobile accesses by 1.0% to 5.2 million accesses at December 31, 2009 from 5.1 million accesses at December 31, 2008.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	12,941	15,562
ARPU (in euros)	8.5	8.7	8.6

Traffic reached 15,562 million minutes in 2009, an increase of 20.2% compared to 12,941 million minutes in 2008, mainly driven by the growth in on-net traffic.

ARPU was €8.6 in 2009 compared to €8.7 in 2008 (an increase of 10.7% in local currency). The increase in local currency reflected customer adoption of new products and services (upgrades and more consumption), tariff increases and the continued growth in data revenues.

#### Sales and marketing

In Argentina, Telefónica Móviles Argentina uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market its products. At December 31, 2009,

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approximately 32.6% of our accesses in Argentina were contract mobile accesses. During 2009, Telefónica Móviles Argentina offered Internet mobile service with plans with limited or unlimited usage.

### Competition

We currently have three competitors in the Argentine market for mobile communications services, each of which provides services on a nationwide basis: Telecom Personal, which is controlled by Telecom Italia through Telecom Argentina; Claro, controlled by América Móvil; and Nextel, owned by NII Holdings Inc.

Telefónica Móviles Argentina's estimated market share in the Argentine mobile market in terms of mobile accesses was approximately 33.0% at December 31, 2009, down from approximately 34.0% at December 31, 2008.

### Network and technology

In Argentina we operate on digital networks based upon GSM and UMTS technology. At December 31, 2009, GSM accesses represented 98.6% of Telefónica Móviles Argentina's accesses. Also, Telefónica Móviles Argentina developed its mobile broadband business through UMTS technology by increasing coverage.

### Chile

The following table presents, at the dates indicated, selected statistical data relating to our operations in Chile.

	2007	At December 31, 2008	2009
	(in thousands)		
Fixed telephony accesses	2,172.4	2,121.0	2,028.0
Internet and data accesses	686.8	743.8	807.2
Narrowband accesses	31.8	18.7	15.9
Broadband accesses	646.0	716.6	783.2
Other accesses	8.9	8.6	8.1
Mobile accesses	6,282.7	6,875.0	7,524.7
Pre-pay accesses	4,742.2	4,956.0	5,435.9
Pay TV accesses	219.9	263.0	285.1
Final clients accesses	9,361.7	10,002.7	10,645.0
Wholesale accesses	15.4	11.5	8.9
Total accesses	9,377.2	10,014.3	10,653.8

At December 31, 2009 Telefónica Latin America managed a total of 10.7 million accesses in Chile, 6.4% more than at December 31, 2008, underpinned by growth in mobile accesses, which increased by 9.5% to 7.5 million accesses at December 31, 2009 from 6.9 million accesses at December 31, 2008. Growth was also driven, by a 9.3% increase in broadband accesses to 0.8 million accesses at December 31, 2009 and an 8.4% increase in pay TV accesses to 0.3 million accesses at December 31, 2009. Fixed telephony accesses decreased 4.4% to 2.0 million accesses at December 31, 2009 from 2.1 million accesses at December 31, 2008.

Chilean fixed business – Telefónica Chile S.A.

### Operations

Telefónica Latin America conducts its Chilean fixed business through Telefónica Chile S.A., or Telefónica Chile (formerly Compañía de Telecomunicaciones de Chile, or CTC Chile), the leading fixed line telecommunications operator in Chile based on number of accesses, according to information provided by its competitors and regulatory authorities. Telefónica Chile's accesses decreased 0.3% to 3.1 million accesses at December 31, 2009. Telefónica Chile's fixed telephony accesses decreased by 4.4% from December 31, 2008 to 2.0 million accesses at December 31, 2009. Broadband and pay TV accesses continued to grow in 2009, and Telefónica Chile managed 0.8 million broadband accesses at December 31, 2009 compared to 0.7 million at December 31, 2008.

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Telefónica Chile's pay TV business grew to 0.3 million accesses at December 31, 2009. Telefónica Chile established itself as the third pay TV operator in Chile, by number of accesses in 2009.

### Sales and marketing

One of our main priorities is to satisfy customer needs by improving the quality of our customer service. We continued our strategy of segmenting our customers in order to tailor our services to best meet the specific needs of each customer segment. With respect to broadband, Telefónica Chile launched bundle services of broadband and voice to satisfy customer demand. Also double and triple play bundles represented one of the drivers of revenue growth.

The customer service model developed by Telefónica Chile, which is aimed at achieving the highest degree of efficiency in customer service, features the following:

- personal customer service lines for purchasing any type of product and service and handling customer queries;
- Telefónica stores (Tiendas Telefónica) where customers can test and buy products marketed by Telefónica;
- Telefónica's "virtual" store, accessible by Internet, which offers customers the ability to order and purchase online the majority of services and products offered by Telefónica; and
- a sophisticated customer service system for corporate clients, ranging from a telephone help line for small and medium-sized businesses to the assignment of sales managers to address the needs of larger corporate clients.

From October 25, 2009, all fixed and/or mobile businesses products and services are marketed under the brand "Movistar", formerly used exclusively by the mobile business.

### Competition

The competitive landscape in fixed telephony in Chile is marked by a significant fixed-to-mobile substitution effect. The increased sales of Duo and Trio bundles is the cornerstone of Telefónica Chile's strategic focus, which aims to increase the number of revenue generating units per customer and, accordingly, revenue per customer. VTR is our principal competitor in the Chilean fixed telephony market,

Telefónica Chile's estimated market share at December 31, 2009 was as follows:

- approximately 47.1% of retail broadband accesses, down from approximately 49.4% at December 31, 2008;
- fixed telephony accesses market share amounted to approximately 58.4% of retail fixed telephony accesses, down from approximately 62.1% at December 31, 2008; and
- pay TV market share amounted to approximately 16.6% of the market by number of pay TV accesses, down from 17.5% at December 31, 2008.

### Network and technology

Telefónica Chile made improvements on its network to support broadband and TV accesses growth, while updating it, as to be ready for the development of the fiber access network, or FTTX.





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Chilean mobile business – Telefónica Móviles Chile, S.A.

## Operations

The mobile penetration rate in Chile stood at an estimated 105.6% at December 31, 2009, an increase of approximately 9.0 percentage points from December 31, 2008.

Telefónica Latin America conducts its Chilean mobile business through Telefónica Móviles Chile, S.A., or Telefónica Móviles Chile, whose customer base increased 9.5% to 7.5 million accesses at December 31, 2009. The number of contract mobile accesses rose by 8.8% to 2.1 million mobile contract accesses at December 31, 2009 from 1.9 million contract mobile accesses at December 31, 2008.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	9,703	10,521
ARPU (in euros)	12.0	12.3	10.7

Traffic in 2009 increased 8.4% to 10,521 million minutes at December 31, 2009 from 9,703 million minutes at December 31, 2008, mainly driven by outgoing traffic, primarily on-net.

ARPU was €10.7 in 2009 compared to €12.3 in 2008 (a decrease of 10.7% in local currency). The decrease in local currency was largely due to the reduction of tariffs as a consequence of a regulatory decree mandating lower interconnection rates, which went into effect at January 23, 2009 for mobile termination and resulted in an average tariff decrease of approximately 44.6%.

## Sales and marketing

Telefónica Móviles Chile offered promotional campaigns associated with recharges for pre-pay mobile users while developing mobile broadband service.

## Competition

We currently have three primary competitors in the Chilean market for mobile telephony, each of which provides services on a nationwide basis: Entel, Claro and Nextel.

Telefónica Móviles Chile's estimated market share in the Chilean mobile sector in terms of mobile accesses was approximately 42.8% at December 31, 2009, down from approximately 43.3% at December 31, 2008.

## Network and technology

In Chile, Telefónica Móviles Chile operates with GSM and 3G network, launched in December 2007.

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## Mexico

Mexico mobile business – Telefónica Móviles México, S.A. de C.V.

## Operations

The following table presents, at the dates indicated, selected statistical data relating to our operations in Mexico.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Total mobile accesses	12,534.1	15,330.6	17,400.5
Pre-pay accesses	11,833.7	14,432.4	16,328.3
Fixed wireless accesses	3.6	133.6	334.3
Total accesses	12,537.6	15,464.2	17,734.8

The mobile penetration rate in Mexico was approximately 75.2% at December 31, 2009, an increase of approximately 3.6 percentage points from December 31, 2008.

Telefónica Latin America conducts its Mexican mobile business through Telefónica Móviles México, S.A. de C.V., or Telefónica Móviles México. Telefónica Móviles México's customer base increased 14.7% to 17.7 million accesses at December 31, 2009 from 15.5 million accesses at December 31, 2008. This increase was mainly the result of a 13.1% increase of pre-pay mobile accesses in 2009 compared to 2008. At December 31, 2009, approximately 93.8% of our mobile customers in Mexico were pre-pay mobile accesses while 6.2% were contract mobile accesses.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	22,431	23,186
ARPU (in euros)	9.3	8.2	6.9

Traffic for 2009 increased 3.4% to 23,186 million minutes compared to 22,431 million minutes in 2008. This increase was mainly due to commercial promotions focusing on fee-per call (tariff per call rather than per minutes used) that improved usage.

ARPU declined to €6.9 in 2009 compared to €8.2 in 2008 (a decrease of 3.3% in local currency). The decrease in local currency was largely due to the fact that the increase of the customer base was motivated by lower tariff plans, which had the effect of reducing the average consumption.

## Sales and marketing

During 2009, Telefónica Móviles México launched innovative products to maintain current customers and attract additional ones. In addition, Telefónica Móviles México focused on commercial activity and profitability while improving the quality of its network, which enabled the company to maintain robust customer growth during that year.

In Mexico, we use a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market our products and services.

Telefónica Móviles México's offer was completed with "Plan paga menos Xtra" in the pre-pay segment, based on a price-per-call offer. This plan has lower prices but generates consumption.

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## Competition

Telefónica Móviles México is the second largest mobile operator in Mexico based on the number of mobile accesses, and competes with various mobile operators at the national level. Telefónica Móviles México's principal competitor is Telcel, a subsidiary of América Móvil. Other significant competitors are Nextel and Iusacell.

Telefónica Móviles México's estimated market share in the Mexican mobile market in terms of mobile accesses was approximately 20.8% at December 31, 2009, up from approximately 19.5% at December 31, 2008.

## Network and technology

Telefónica Móviles México has 100% of its accesses on its GSM network. Also, Telefónica Móviles México provides UMTS services but spectrum constraints their expansion.

## Peru

The following table presents, at the dates indicated, selected statistical data relating to our operations in Peru.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	2,843.4	2,986.5	2,971.2
Fixed wireless accesses	290.0	485.5	582.7
Internet and data accesses	623.1	728.9	800.6
Narrowband accesses	40.3	17.7	16.9
Broadband accesses	572.1	698.4	768.0
Other accesses	10.7	12.8	15.6
Mobile accesses	8,067.3	10,612.7	11,458.2
Pre-pay accesses	7,238.1	9,575.2	10,214.2
Pay TV accesses	640.0	654.5	686.3
Final clients accesses	12,173.8	14,982.6	15,916.3
Wholesale accesses	0.5	0.4	0.5
Total accesses	12,174.3	14,983.0	15,916.8

At December 31, 2009, Telefónica Latin America had 15.9 million accesses in Peru, which represents an increase of 6.2% from December 31, 2008. This growth in accesses was primarily driven by an 8.0% increase in mobile accesses from December 31, 2008 to 11.5 million mobile accesses at December 31, 2009, mostly in the pre-pay mobile segment. The IRIS project, a collaboration between fixed telephony operators and mobile operators in Peru, which was launched in March 2007 with the aim of increasing fixed telephony and broadband penetration, also contributed to the overall growth in accesses.

Peruvian fixed business – Telefónica del Perú, S.A.A.

## Operations

Telefónica Latin America conducts its Peruvian fixed telephony business through Telefónica del Perú, S.A.A., or Telefónica del Perú, which at December 31, 2009 was the leading fixed line telecommunications operator in Peru based on number of fixed telephony accesses.

Telefónica del Perú had total accesses of 4.5 million at December 31, 2009, an increase of 2.0% from December 31, 2008, due primarily to increases in fixed wireless telephony and broadband accesses. Fixed telephony accesses decreased 0.5% from December 31, 2008 to 3.0 million accesses at December 31, 2009. Broadband accesses grew by 10.0% from December 31, 2008 to 0.8 million at December 31, 2009. In addition, pay TV accesses totaled 0.7 million accesses at December 31, 2009 recording growth of 4.9% from December 31, 2008 primarily due to increased cable pay TV subscriptions.

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## Sales and marketing

Telefónica del Perú's commercial strategy is based on achieving and maintaining high levels of market penetration by offering customized services to different customer segments, with marketing campaigns focused on maintaining customer loyalty and increasing the options available to potential customers. The primary products offered by Telefónica del Perú include fixed telephony, broadband, pay TV, data and IT services.

Telefónica del Perú focuses its commercial strategy on penetration by targeting specific market segments, commercializing Duos and Trios and leveraging on its customer retention campaign.

## Competition

In 2009, Telmex and Americatel, Telefónica del Perú's two primary competitors, focused on offering bundled products (local and long distance telephony together with broadband).

Telmex implemented an aggressive strategy to enter the residential market by offering a "triple play" service. The response from Telefónica del Perú consisted of increasing Trio bundle options at lower prices.

Telefónica del Perú had an estimated market share in the Peruvian fixed telephony market of approximately 93.8% at December 31, 2009, based on number of fixed telephony accesses, down from approximately 94.0% at December 31, 2008.

## Network and technology

Telefónica del Peru invested to develop its broadband business through ADSL technology by increasing coverage and speed. Additionally, it began deploying a new fiber access network, called FTTX, which currently is offered on a limited basis to large customers.

## Peruvian mobile business – Telefónica Móviles Perú, S.A.C.

## Operations

The estimated Peruvian mobile penetration rate reached approximately 64.5% at December 31, 2009, an increase of approximately 3.9 percentage points compared to December 31, 2008.

Telefónica Latin America conducts its Peruvian mobile business through Telefónica Móviles Perú, S.A.C., or Telefónica Móviles Perú, whose customer base increased 8.0% from December 31, 2008 to 11.5 million accesses at December 31, 2009. This increase was primarily driven by a 6.7 % increase in the number of pre-pay mobile accesses from December 31, 2008 to December 31, 2009.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	10,039	11,460
ARPU (in euros)	7.3	6.0	5.5

Traffic carried in 2009 increased 14.1% to 11,460 million minutes compared to 10,039 million minutes in 2008, primarily due to increases in on-net traffic, in line with the strategy of offering better tariffs to this type of traffic as a benefit of belonging to the largest mobile network of the country.

ARPU was €5.5 in 2009 compared to €6.0 in 2008 (a decrease of 11.5% in local currency). The decrease in local currency was largely a consequence of reductions in both contract and pre-pay tariffs.

Telefónica Móviles Perú uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market its products. At December 31, 2009, approximately 89.1% of Telefónica Móviles Perú's mobile accesses were pre-pay mobile accesses, while approximately 10.9% were contract mobile accesses.

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## Sales and marketing

Telefónica Móviles Perú focused its marketing efforts on encouraging migrations from pre-pay to contract services. In May 2009, it started to market mobile broadband and in September 2009 launched the promotion “push to talk”, which allows instant communications from a mobile device. Since November 2009, we changed our marketing focus for the pre-pay segment to better target each of the pre-pay clusters (defined by recharge frequency and money spent) in order to avoid revenue cannibalization.

## Competition

Telefónica Móviles Perú currently has two primary competitors in the Peruvian market for mobile telephony services: Claro, owned by América Móvil, and Nextel Perú.

Telefónica’s estimated market share in the Peruvian mobile market in terms of mobile accesses was approximately 62.9% at December 31, 2009, up from approximately 62.6% at December 31, 2008.

## Network and technology

At December 31, 2009, Telefónica Móviles Perú operated both GSM and CDMA technology. Its digital network is based upon the CDMA/CDMA 1XRTT standard. Telefónica Móviles Perú continued the migration to GSM technology, and at December 31, 2009, GSM accesses accounted for 93.4 % of its total customer base, which represents an increase of 3.8 percentage points from December 31, 2008.

## Colombia

The following table presents, at the dates indicated, selected statistical data related to our operations in Colombia.

	2007	At December 31,	
		2008	2009
		(in thousands)	
Fixed telephony accesses	2,328.5	2,299.2	1,639.8
Internet and data accesses	200.3	395.9	428.4
Narrowband accesses	0.0	0.3	5.9
Broadband accesses	200.3	393.9	420.3
Other accesses		1.7	2.2
Mobile accesses	8,372.1	9,963.1	8,964.6
Pre-pay accesses	6,612.9	8,327.3	7,203.2
Pay TV accesses	72.9	142.3	127.2
Final clients accesses	10,973.8	12,800.5	11,159.9
Wholesale accesses		2.9	3.3
Total accesses	10,973.8	12,803.4	11,163.2

Telefónica Latin America managed a total of 11.2 million accesses in Colombia at December 31, 2009, a decrease of 12.8% from December 31, 2008. This decrease was due to the drop in mobile accesses, which decreased 10.0% to 9.0 million accesses at December 31, 2009 from 10.0 million accesses at December 31, 2008, and by the 28.7% decrease in fixed telephony accesses from December 31, 2009 to December 31, 2008. These decreases were not offset by the 6.7% increase of broadband accesses to reach 0.4 million accesses at December 31, 2009 from 0.4 million accesses at



December 31, 2008.

Colombian fixed business - Colombia Telecomunicaciones, S.A. ESP

Operations

Telefónica Latin America conducts its Colombian fixed telephony business through Colombia Telecomunicaciones, S.A. ESP, or Colombia Telecom, which is present in approximately 1,000 municipalities in Colombia.

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Colombia Telecom had 2.2 million accesses at December 31, 2009, which represents a decrease of 22.6% from 2.8 million accesses at December 31, 2008, primarily due to the decrease of 28.7% in fixed telephony accesses from December 31, 2008 to 1.6 million accesses at December 31, 2009, as a consequence of intense competition and our decision to inactive certain dormant accounts from our customer base. Broadband accesses increased 6.7% to 0.4 million accesses at December 31, 2009 from December 31, 2008.

Colombia Telecom also launched a pay TV product using satellite technology at the beginning of 2007, allowing it to begin offering Trio bundles (voice, broadband and pay TV). As of December 31, 2009, Colombia Telecom had 0.1 million pay TV accesses, a 10.6% decrease compared to December 31, 2008.

Colombia Telecom has a finance lease agreement with PARAPAT. PARAPAT is the consortium which owns the telecommunications assets and manages the pension funds for the entities which were predecessors to Colombia Telecom and regulates the operation of assets, goods and rights relating to the provision of telecommunications services by Colombia Telecom. This finance lease agreement includes the lease of the telecommunications assets and the transfer of these assets to Colombia Telecom once the last installment of the lease has been paid which, in accordance with the payment schedule, is expected to be in 2022.

### Sales and marketing

In Colombia, Colombia Telecom uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market its products. Additionally, Colombia Telecom is currently pursuing a strategy to increase market penetration, by restructuring distribution and communication channels, and by offering bundled products such as “Trio Telefónica”. Also, it restructured the commercial offer to strengthen the quality and quantity of television channels and improving broadband capability.

### Competition

Colombia Telecom’s principal competitors in the Colombian market are Telmex and ETB. Colombia Telecom had an estimated market share in the Colombian fixed telephony market of approximately 22.4% at December 31, 2009 based on number of fixed telephony accesses, down from approximately 29.2% at December 31, 2008. This decrease was mainly driven by a loss of customers as a result of intense competition and our decision to inactivate certain dormant accounts from our customer base.

### Network and technology

Colombia Telecom continued expanding and upgrading the network to support a broader range of product and services in 2009.

Colombian mobile business – Telefónica Móviles Colombia, S.A.

### Operations

At December 31, 2009 the Colombian mobile market had an estimated penetration rate of approximately 92.9%, an increase of 1.8 percentage points from December 31, 2008.

Telefónica Latin America conducts its Colombian mobile business through Telefónica Móviles Colombia, S.A., or Telefónica Móviles Colombia, whose customer base decreased by 10.0% from 10.0 million accesses at December 31, 2008 to 9.0 million accesses at December 31, 2009. At December 31, 2009, approximately 19.6% of our mobile

accesses in Colombia were contract mobile accesses, compared to 16.4% at December 31, 2008.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	13,568	13,665
ARPU (in euros)	8.8	6.8	5.9

Traffic for 2009 increased 0.7% to 13,665 million minutes compared to 2008.

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ARPU was €5.9 in 2009 compared to €6.8 in 2008 (a decrease of 10.2% in local currency). The decrease in local currency was largely due to a reduction in interconnection tariffs and competitive pressure on tariffs.

## Sales and marketing

Telefónica Móviles Colombia uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market its products.

In 2009, Telefónica Móviles Colombia implemented, in the contract segment, commercial promotions to increase customer loyalty, and launched new tariff plans focused on a single tariff to any destination with lower basic charges and other tariff plans with preferential on net prices to attract customers. Additionally, it launched the project “Tecnoferias” (specific sales in strategic areas of major cities) to improve commercial activity and to re-position the “Movistar” brand.

## Competition

Telefónica Móviles Colombia currently has two primary competitors in the Colombian market for mobile communications services: Comcel, which is owned by América Móvil, and Colombia Móvil, who operates under the brand “Tigo” and is owned by Millicom.

Telefónica Móviles Colombia’s estimated market share in the Colombian mobile market in terms of mobile accesses was approximately 21.3% at December 31, 2009, down from approximately 24.5% at December 31, 2008.

## Network and technology

TDMA was switched off during 2008 and our CDMA network was working in 2009. The UMTS network experienced an increase in terms of coverage by installing 504 new GSM sites, accounting for a total of 2,573 sites installed and representing a coverage of 83% of the Colombian municipalities.

## Central America

Telefónica Central America includes Panama, Guatemala, El Salvador and Nicaragua. At the end of 2009, the mobile penetration rate of the Central American market, where we operate, was approximately 89.7%, which represents an increase of approximately 9.3 percentage points from December 31, 2008.

The following table presents, at the dates indicated, selected statistical data related to our operations in Central America.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Fixed telephony accesses	393.4	437.2	444.5
Internet and data accesses	22.0	18.4	14.7
Broadband accesses	19.8	16.5	12.6
Pay TV accesses	—	—	—
Mobile accesses	5,009.9	5,702.0	5,806.5
Total accesses	5,425.3	6,157.6	6,265.8



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Telefónica Central América's customer base increased by 1.8% from December 31, 2008 to 6.3 million accesses at December 31, 2009, mainly due to an increase in mobile accesses in 2009 compared to 2008.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	7,174	6,868
ARPU (in euros)	9.7	7.4	6.9

Traffic decreased by 4.3% compared to 2008 to 6,868 million minutes in 2009. This decrease was due primarily to lower voice usage as customers optimized their consumption.

ARPU was €6.9 in 2009 compared to €7.4 in 2008 (a decrease of 8.7% on a constant euro basis). The decrease on a constant euro basis was largely due to lower consumption.

## Ecuador

Ecuadorian mobile business – Otecel, S.A.

## Operations

The Ecuadorian mobile penetration rate reached approximately 92.8% at December 31, 2009, an increase of approximately 12.2 percentage points from December 31, 2008.

The following table presents, at the dates indicated, selected statistical data relating to our operations in Ecuador.

	At December 31,		
	2007	2008	2009
	(in thousands)		
Total mobile accesses	2,581.1	3,122.5	3,721.8
Pre-pay accesses	2,177.5	2,650.5	3,193.9
Fixed wireless accesses	1.3	89.4	84.7
Total accesses	2,582.4	3,211.9	3,806.4

Telefónica Latin America conducts its Ecuadorian mobile business through Otecel, S.A., or Otecel, which had a customer base of 3.8 million accesses at December 31, 2009, an increase of 18.5% from 3.2 million accesses at December 31, 2008. At December 31, 2009, approximately 85.8% of our mobile accesses in Ecuador were pre-pay mobile accesses, while approximately 14.2% were contract mobile accesses.

	Year ended December 31,		
	2007	2008	2009
Traffic (millions of minutes)	n.a.	2,800	3,744
ARPU (in euros)	6.6	6.7	6.8

Traffic carried in 2009 increased by 33.7% to 3,744 million minutes compared to 2008 mainly due to the increase in the number of both pre-pay and contract accesses.

ARPU was €6.8 in 2009 compared to €6.7 in 2008 (a decrease of 3.8% in local currency). The decrease in local currency was largely due to lower consumption.

#### Sales and marketing

In Ecuador, Otecel uses a broad range of marketing channels, including television, radio, billboards, telemarketing, direct mail and Internet advertising to market their products. In April 2009, Otecel launched “Total Plan” for on-net calls for the contract segment. In the pre-pay segment, Otecel continued with doubled and tripled

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recharges, along with the campaign “Multicolor” for off-net calls. The marketing of mobile broadband and the service “push to talk” (Movitalk) were launched in June 2009 and September 2009 respectively.

### Competition

Otecel currently has two primary competitors in market for mobile communications services in Ecuador, Porta (América Móvil) and Alegro.

Telefónica’s estimated market share in the Ecuadorian mobile market in terms of mobile accesses was approximately 28.4% at December 31, 2009, up from approximately 26.6% at December 31, 2008.

### Network and technology

Otecel operates both analog and digital networks. Its digital network is based upon the GSM standard and CDMA standard. GSM accesses reached 91.8% of the total customer base, representing an increase of 8.7 percentage points from December 31, 2008.

### Atento—Call Center Business

Atento offers integrated telephone assistance services as well as sophisticated customer relationship management services, such as the development and implementation of customer loyalty programs, telemarketing services and market research. In addition, Atento rents call centers and provides staff for such centers to third parties. Atento has sought to diversify its client base and serves companies in the financial, consumer and energy sectors, as well as public institutions. At December 31, 2009, Atento operated more than 100 call centers and had 132,256 call center personnel in 15 countries on three continents, including Europe (Spain and Czech Republic), America (Latin America) and Africa (Morocco).

### Strategic Partnerships

#### China Unicom

Since 2005, we have had a stake in China Unicom and its predecessor company. On September 6, 2009 we entered into a strategic alliance agreement with China Unicom, which provides for, among other areas for cooperation, joint procurement of infrastructure and client equipment, common development of mobile service platforms, joint provisions of service to multinational customers, roaming, research and development, sharing of best practices and technical, operational and management know-how, joint development of strategic initiatives in the area of network evolution, joint participation in international alliances and exchanges of senior management. In furtherance of this strategic alliance we entered into a subscription agreement with China Unicom, pursuant to which we increased our voting interest in the share capital of China Unicom to 8.06% and China Unicom obtained 0.87% voting interest in our share capital in October 2009.

Pursuant to the strategic alliance agreement mentioned above, China Unicom has agreed to use its best endeavors to maintain a listing of all the issued ordinary shares of China Unicom on the Hong Kong Stock Exchange. For so long as the strategic alliance agreement with us is in effect, China Unicom shall not (i) offer, issue or sell any significant number of its ordinary shares (including treasury shares), or any securities convertible into or other rights to subscribe for or purchase a significant number of China Unicom’s ordinary shares (including treasury shares), to any current major competitor of Telefónica or (ii) make any significant investment, directly or indirectly, in any current major competitor of Telefónica. We have made similar undertakings.



The strategic alliance agreement between us and China Unicom terminates on September 6, 2012 subject to automatic annual renewal, subject to either party's right to terminate on six months' notice. Also, the strategic alliance agreement may be terminated by China Unicom if our shareholding in China Unicom drops below 5% of its issued share capital or if China Unicom's shareholding in us drops below 0.5% of our issued share capital. In addition, the strategic alliance agreement is subject to termination in the event either party is in default and automatically terminates on a change in control of China Unicom.

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As of the date of this Annual Report, and after the capital reduction carried out by China Unicom, we hold shares representing 8.37% of China Unicom's voting share capital and the right to appoint a member to its board of directors.

### Portugal Telecom

At December 31, 2007, we held an 8.32% effective interest in Portugal Telecom (or 9.16% if shares held by Portugal Telecom in treasury are not counted as outstanding), our joint venture partner in Brazil.

In December 2008, Portugal Telecom bought back and cancelled 46,082,677 shares in line with its share buyback program. This raised our direct and indirect ownership interest to 10.48%. In accordance with Portuguese securities regulation, which require us to dispose of any shares which bring our ownership stake over 10%, we sold 4,264,394 shares of Portugal Telecom, thereby lowering our stake to 10%. Our effective shareholding in Portugal Telecom at December 31, 2009 was 9.86%.

Within the framework of our business cooperation with Portugal Telecom, we provide mobile services in Brazil (through Brasilcel, in which we hold a 50% interest and share management responsibilities with Portugal Telecom, under the brand name "Vivo").

For more information on these joint ventures, please see "—Telefónica Latin America—Brazil—Brazil mobile business" above.

In addition, Telefónica Spain provided mobile services in Morocco through Medi Telecom, a Moroccan company in which Telefónica Móviles España held a 32.18% interest and shared management responsibilities with Portugal Telecom. On August 31, 2009, we agreed to sell our 32.18% stake in Medi Telecom, together with its outstanding shareholder loans, to our local partners for total cash consideration of €400 million. This transaction closed on December 31, 2009.

### Telecom Italia

Through a series of transactions from 2007 through 2009, we acquired an indirect holding of 10.49% in the voting shares of Telecom Italia (7.21% of the dividend rights) through our holdings in Telco. The Telecom Italia group is principally engaged in the communications sector and, particularly, in telephone and data services on fixed lines for final and wholesale customers, in the development of fiber optic networks for wholesale customers in the provision of broadband services and Internet services, in domestic and international mobile telecommunications (especially in Brazil), in the television sector using both analog and digital terrestrial technology and in the office products sector. Telecom Italia operates primarily in Europe, the Mediterranean basin and in South America.

For more information, please see "Item 4. Information on the Company —History and Development of the Company—Recent Developments", "Item 5. Operating and Financial Review and Prospects —Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Period Under Review" and "Item 10. Additional Information—Material Contracts". Telco, through which we hold our stake in Telecom Italia, is included in our consolidated financial statements using the equity method.

### Regulation

As a telecommunications operator, we are subject to sector-specific telecommunications regulations, general competition law and a variety of other regulations. The extent to which telecommunications regulations apply to us depends largely on the nature of our activities in a particular country, with traditional fixed telephony services usually subject to more extensive regulations, which can have a direct and material effect on our business areas, particularly in countries that favor regulatory intervention.

To operate our networks, we must obtain general authorizations, concessions or licenses from national regulatory authorities, or NRAs, in those countries in which we operate. Licensing procedures also apply to our mobile operations with respect to radio frequencies. The duration of any particular license or spectrum right depends on the legal framework in the relevant country.

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Electronic Communication Regulation in the EU

The EU legal framework for electronic communications services has been developed with the aim of reinforcing the liberalization of the market and improving the functioning of the EU internal market for telecommunications networks and services, which culminated in the adoption of the 2002 EU regulatory framework for electronic communications sector (the “EU Framework”). Such regulatory framework has been subsequently modified in order to take into account technological changes through the adoption of certain new rules by the European Parliament and the Council during the end of 2009. On December 18, 2009 Regulation 1211/2009/EC was published, establishing the framework for the creation of a European regulatory body for the telecommunications industry. The Directive of Better Regulation (Directive 2009/136/EC), which was also published on the same date, modifies the following directives: (i) Directive 2002/21/EC of 7 March 2002 on a common regulatory framework for electronic communications networks and service (“Framework Directive”); (ii) Directive 2002/20/EC of the European Parliament and of the Council of 7 March 2002 on the authorization of electronic communications networks and services (“Authorization Directive”); (iii) Directive 2002/19/EC of the European Parliament and of the Council of 7 March 2002 on access to, and interconnection of, electronic communications networks and associated facilities (“Access Directive”).

The passage and subsequent publication on December 18, 2009 of Directive 2009/140/EC, on citizens’ rights (“Citizens’ Rights Directive”) modifies Directive 2002/22/EC of the European Parliament and of the Council of 7 March 2002 on universal service and users’ rights relating to electronic communications networks and services (“Universal Service Directive”) and the e-Privacy Directive (2002/58/EC) (the “e-Privacy Directive”) complements and supplements the more general provisions of the Data Protection Directive in the area of electronic communications. It provides for basic obligations to ensure the security and confidentiality of communications over EU electronic communications networks and gives consumers a set of tools to protect their privacy and personal data. These Directives set forth the main principles and procedures that NRAs should follow with respect to regulation for the provision of electronic communications services. The EU Framework establishes an authorization regime containing measures to ensure the universal provision of basic services to consumers and sets out the terms on which providers may access each other’s networks and services.

In 2006, the European Union established a new regulation regarding retention of electronic communications data in order to ensure that electronic communication data are available for the purpose of the investigation, detection and prosecution of serious crimes. These data retention rules set minimum standards for the type of data to be retained and the retention period. The initial impact of this new regulation is estimated to be significant, although it will depend on the requirements established at the national level and the extent to which operators will be compensated for the costs associated with its implementation. Some European countries, such as Spain and Germany, have already adopted the new regulation at the national level. In Spain, operators shall retain data from their pre-pay customers and extend the data retention period. In Germany the implementation of such regulations has been legally challenged for constitutional reasons and until a decision is made, it will not be applicable. For further information regarding the matters discussed above and other aspects of the regulatory risks derived from the new regulation, see “Item 3. Key Information—Risk Factors—Risks related to our business”.

Notably, the EU Framework also harmonizes the rules for deciding when regulation may be imposed on electronic communications providers. In particular, it provides that electronic communications providers can generally only be subject to specific regulation in markets in which they have “significant market power”, or SMP. The concept of SMP, for these purposes, has been aligned to the competition law concept of dominance, which essentially means a market position which allows a company to act independently of customers, suppliers and competitors.

Accordingly, the European Commission has identified in a Recommendation a list of relevant markets whose conditions may justify the application of ex ante specific regulation. The Recommendation was published on February 2003 and it has been modified by another Recommendation published in December 2007, which reduces the

relevant markets from 18 to seven. In order to determine whether a company has SMP in any of the markets identified in the Recommendations, NRAs must conduct a market analysis for the relevant market. When an NRA determines a company has SMP in a relevant market, that NRA must impose at least one obligation relating to price control, transparency, non-discrimination, accounting separation or access obligations.

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Regulation with respect to voice roaming tariffs in the EU entered into force on June 30, 2007. The regulation introduces a maximum level for the charges that operators may levy at wholesale level as well as maximum retail ceilings (referred to “Eurotariff”) for making and receiving calls while roaming in the EU. In 2009 Regulation 544/2009 was also adopted, which extended tariff regulation through 2012 and also extended the scope of the previous roaming regulation to cover SMS and data services. The wholesale tariff price cap has been set at €0.26 per minute (excluding VAT) from July 2009 and will continue to decrease to €0.22 and €0.18 from July 2010 and from July 2011, respectively. The retail tariff price cap (excluding VAT) has been set at €0.43 per minute for making a call and €0.19 per minute for receiving a call from July 2009, and these prices will continue to decrease for making a call to €0.39 and €0.35, and for receiving a call to €0.15 and €0.11 from July 2010 and from July 2011, respectively. In addition, the new regulation mentioned above limits the price for sending a text message for wholesale and for customers roaming within the EU at €0.04 and at €0.11, respectively. Moreover, the regulation subjects the cost of data transfers to a maximum wholesale cap of €1.00 per megabyte downloaded from August 2009. This cap will be reduced to €0.80 from July 2010 and to €0.50 from July 2011. Receiving an SMS in another EU country will remain free of charge. The new rules will also require that operators protect consumers from “bill shocks” by introducing a cut-off mechanism once a customer’s bill reaches €50 (unless a customer chose another cut-off limit). This cut-off mechanism, along with per second billing after the first 30 seconds for calls made and immediately for calls received must be implemented by March 31, 2010.

In addition, the European Parliament and the Council approved Directive 372/87/EC amending Council Directive 87/372/EEC on the frequency band 900 MHz in order to allow the use of such band by systems capable of providing electronic communication services not limited to GSM. Finally, the Commission also adopted a Recommendation on termination rates for mobile and fixed networks.

### EU Competition Law

The EU’s competition rules have the force of law in EU Member States and are, therefore, applicable to our operations in EU Member States.

The EC Treaty prohibits “concerted practices” and all agreements for undertakings that may affect trade between Member States and which restrict, or are intended to restrict, competition within the EU. It also prohibits any abuse of a dominant competitive position within the common market of the EU, or any substantial part of it, that may affect trade between Member States.

The EU Merger Regulation requires that all mergers, acquisitions and joint ventures involving participants meeting certain turnover thresholds be submitted to the EU Commission for review, rather than to the national competition authorities. Under the amended EU Merger Regulation, market concentrations will be prohibited if they significantly impede effective competition in the EU common market. European Commission and the EU Competition Commissioner are granted the authority to apply the European Competition framework.

Similar competition rules are set forth in each EU Member State’s legislation and are enforced by each of their national competition authorities, or NCAs. All European countries where we have activities and referred to below are Member States of the EU.

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## Telefónica Spain

## Spain

## General regulatory framework

The legal framework for the regulation of the telecommunications sector in Spain is principally governed by the General Telecommunications Law (32/2003) and several Royal Decrees. The General Telecommunications Law, among other things, sets forth rules regarding the new system of notification for electronic communications services, establishes the terms by which operators interconnect their networks, defines the universal service provision regime and subjects providers with SMP in particular telecommunications markets to specific obligations.

## Regulatory supervision

The Telecommunications Market Commission, or the CMT, is the NRA responsible for regulating the telecommunications and audiovisual service markets in Spain. The CMT supervises the specific obligations imposed on operators in the telecommunications market, and it has the requisite power to enforce its decisions whenever necessary.

The Framework Directive requires that NRAs have the power to issue binding decisions to resolve disputes arising in connection with obligations imposed under the regulatory framework.

The Spanish regulatory framework explicitly acknowledges the right for third parties who are affected by a Spanish NRA decision to challenge this decision before the appeal body.

## Licenses and concessions

Pursuant to the EU Framework, parties intending to operate a telecommunications network or engage in the provision of electronic communication services must notify the CMT prior to commencing such activity. The CMT will register the telecommunications operator in the Public Operator Registry. Every three years, operators must notify the CMT of their intention to continue offering electronic communications services or operating telecommunications networks.

Concessions to use spectrum are awarded on a non-discriminatory basis by way of a competitive procedure. Telefónica Móviles España is entitled to provide mobile services on several spectrum bands. Our main concessions are:

Technology	Duration	Ending Date	Extension Period
GSM 900	5 years	February 3, 2015	--
E-GSM 900	15 years	June 6, 2020	5 years
DCS-1800	25 years	July 24, 2023	5 years
UMTS	20 years	April 18, 2020	10 years

Telefónica Móviles España has obtained the extension of the GSM 900 right of use until February 3, 2015.

## Market analysis

In accordance with the EU Framework, the CMT should identify those markets which lack effective competition, in which case it would impose specific obligations upon operators with SMP. During 2008, the CMT conducted a

second round of market analyses to determine which operators have SMP in which markets, the results of which are described below.

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Fixed markets

Retail access to the public telephone network at a fixed location market; Retail market for calls at a fixed location and Retail lease lines market

In March 2006, and following a market analysis, the CMT concluded that Telefónica de España is an operator with SMP in the provision of retail access to the public telephone network service at a fixed location market. As an SMP operator, Telefónica de España has certain specific obligations and is subject to certain restrictions, the most relevant of which are maximum price caps for installation and monthly fees. Telefónica de España also has obligations regarding carrier selection, cost accounting and accounting separation.

With respect to the retail market for calls at a fixed location market, on December 12, 2008, the CMT has determined that this market is competitive and, thus, it has resolved to withdraw all obligations imposed on Telefónica de España with respect to such market.

In 2006, the CMT identified Telefónica de España as an operator with SMP in the retail lease lines market, and imposed, among other obligations, the duty to provide access to a minimum set of lease lines under price controls.

Wholesale fixed call origination market

On March 22, 2007, the CMT adopted new regulations concerning call origination on the wholesale fixed call origination market, introducing additional obligations for Telefónica de España to provide wholesale access to its fixed network to other operators, allowing competitors to use its networks to provide access services and other associated services to their customers.

In December 2008, the CMT concluded that Telefónica de España is an operator with SMP in this market and it has requested that Telefónica de España offer wholesale service to assist other operators in offering IP telephony services and provide transparent information of migration to Next Generation Networks, or NGN, centrals, which implies the provision of broad information to competitors about network evolution.

Fixed call termination market on individual networks

As an operator with SMP in fixed call termination market on individual networks, Telefónica de España is required to submit an “Interconnection Reference Offer (OIR)” outlining the terms and conditions under which it will interconnect with other operators.

In December 2008, the CMT concluded that Telefónica de España is an operator with SMP in this market. The CMT maintained its obligations for Telefónica de España to submit an Interconnection Reference Offer (OIR). The CMT also added the obligation that Telefónica de España provide transparent information with respect to migration to NGN centrals, which implies the provision of broad information to competitors about network evolution.

Mobile market

Mobile voice call termination

In September 2006, the CMT established a progressive reduction schedule for mobile termination rates (the “glide path”) from October 2006 to September 2009. In July 2009, the CMT established a new glide path for mobile voice call termination rates with an objective price of €0.04 per minute by April 2012, through which the mobile voice call termination rates of the four Spanish mobile operators will converge by 2012.

In December 2008, Telefónica Móviles España was again identified by the CMT as an operator with SMP in mobile voice call termination on individual mobile networks, and therefore continues to be subject to the obligations already imposed on it by the CMT and as well as the additional obligation to charge for seconds of usage according to a single termination price established by the CMT.

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### Mobile voice call origination

MVNOs are mobile operators that are not entitled to use spectrum for the provision of mobile services. Consequently, they must reach an access agreement with a mobile network operator in order to provide mobile access to their customers.

On February 2, 2006, the CMT established that mobile network operators collectively hold a dominant position in the mobile access and voice call origination market. Mobile operators are, therefore, obliged to negotiate reasonable access to their network upon request from an MVNO, charging reasonable prices for access services provided. MVNOs and mobile operators negotiate an access agreement on a commercial basis. If parties are unable to reach an agreement independently, the CMT may intervene to resolve the dispute.

### Wholesale (physical) network infrastructures access

In January 2009, the CMT concluded that Telefónica de España is an operator with SMP in the wholesale (physical) network infrastructures access market, and imposed the following obligations on Telefónica de España: access to full and shared unbundled access to copper loops, sub-loops and ducts, cost oriented tariffs and accounting separation, transparency and non-discrimination obligations including an “Unbundling Reference Offer” and a “Ducts Reference Offer”. In February 2008, the CMT imposed similar obligations with respect to vertical access to buildings.

### Wholesale broadband access

In January 2009, the CMT identified Telefónica de España as an operator with SMP in the wholesale broadband access market, and consequently the CMT has imposed on Telefónica de España the obligation to provide wholesale broadband access service until 30 Mbps to other operators in copper and fiber infrastructure .. The CMT also obliges Telefónica de España to publish a wholesale broadband access reference offer, provide cost-oriented tariffs and accounting separation, non-discrimination in network access and to communicate broadband retail changes in services prior to offering them in the market.

### Universal service obligations

The General Telecommunications Law outlines provisions to ensure that certain basic telecommunications services are guaranteed to all Spanish citizens.

Universal service is defined, under the law, as a set of communication services guaranteed to all end users, irrespective of their geographic location, of a determined quality and at an affordable price. Universal service ensures that all citizens receive a connection to the fixed line public network and network services, a telephone directory service, a sufficient number of public telephones and functional Internet access. Additional provisions are included under the scope of universal service obligation, or USO, in order to ensure that users with disabilities and special social needs, including those with low incomes, have access to the services enjoyed by the majority of users.

In December 2008, following applications by three operators, Telefónica de España was awarded a tender for the provision of directory enquiry services for a period of three years and it has also been designated for the provision of the remaining universal service elements for a period of two years by virtue of Order ITC/3808/2008.

To finance the USO, the General Telecommunications Law stipulates that the CMT must determine whether the net cost to provide universal service implies an unfair burden for the operators. On September 2008, the CMT published a resolution which established net cost of USO for the years 2003, 2004 and 2005, the obligation of operators to contribute to USO funding and the amount of contributions these operators must make. During 2009, the CMT

established the net cost of USO for the years 2006 and 2007.

Protection of consumers

On December 29, 2006, Law 44/2006 regarding the protection of consumers and users was approved. Under this law, users may only be charged for services actually used. Consequently, operators can only charge for the exact seconds of usage. On May 22, 2009 a set of User's Rights was adopted through secondary legislation and it

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constitutes a holistic approach to users' rights. Most of the content has been extracted from the General Telecommunications Law 32/2003 (LGT), Royal Decree 424/2005 of April 15, 2005 (RSU) and Order ITC/912/2006 (Quality Order).

### Service quality

On March 29, 2006, a regulation was approved which established certain quality of service, or QoS, obligations for electronic communications service providers such as including service level agreements, or SLAs, commitments in electronic communication retail contracts. This regulation also requires operators to provide adequate information to customers in relation to service quality levels and detailed billing disclosure to customers. Additionally, a standardized process for billing customers has been implemented under this regulation.

### Data retention for law enforcement purposes

The 2006 Directive 2006/24/EC of the European Parliament and of the Council on the retention of data generated or processed in connection with the provision of publicly available electronic communications services or of public communications networks ("Data Retention Directive") was incorporated into Spanish legislation on November 9, 2007. Electronic communications operators are obliged to ensure the retention of data on electronic communications for a period of twelve months.

Additionally, Spain has implemented a register of pre-pay mobile customers in conjunction with these requirements. Existing pre-pay customers have a period of two years for the registration since the law entered into force and the new clients must be registered immediately.

### Public Broadcasting TV funding mechanism

In August 2009, the Spanish Parliament approved a new funding policy for public television, Radio Televisión Española ("RTVE"), which includes the discontinuation of advertising on public television. The new law includes a tax on telecommunications companies and television stations to help fund the phasing out of advertising on RTVE.

The new law applies a tax of 0.9% on the gross revenue of telecommunications companies providing audiovisual services in Spain and 3.0% in the case of regular TV broadcasters. Pay television stations will pay 1.5% of their gross revenue. Both the Spanish regulator and competition authority have questioned the legality of this funding mechanism in light of the national and European regulatory framework. The EU Directorate General of Competition has already opened an investigation to determine whether such funding mechanism constitutes illegal state aid. Without prejudice to the state aid investigation initiated in December 2009, the European Commission sent on March 18, 2010 a formal request for information to the Spanish government over the new charge imposed on telecommunications operators to offset the discontinuation of advertising on RTVE. The Commission is concerned that this administrative charge, based on authorized operators' gross revenue, may be incompatible with EU law since it does not appear to be related to costs arising from regulatory supervision. The Commission's position takes the form of a "letter of formal notice under EU infringement procedures" and provides the Spanish government with a two-month period to reply. If no reply is received or if the response of the Spanish government is not satisfactory, the Commission may issue a "reasoned opinion" under EU infringement procedures requesting the Spanish government to amend its legislation to ensure full compliance with EU rules.

### Telefónica Europe

### United Kingdom

The EU Regulatory Framework was implemented in the United Kingdom by the Communications Act in 2003. Under this act, responsibility for the regulation of electronic communications networks and services rests with the Office of Communications, or Ofcom.

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### Licenses and concessions

Telefónica O2 UK has provided GSM services since July 1994. Its GSM license is of indefinite duration (GSM 900: 2 x 17.4 MHz and GSM 1800: 2 x 5.8 MHz). In April 2000 Telefónica O2 UK was awarded a UMTS license, which expires on December 31, 2021 (2 x 10 MHz + 5 MHz).

The license can be surrendered by the operator at any time. However, Ofcom can only revoke the license if the licensee does not pay its fees, there has been a breach of the license or for reasons related to the management of the radio spectrum, provided that in such case the power to revoke may only be exercised after one year's notice is given in writing and after Ofcom has considered any pertinent factors. The UK government may also revoke the license for national security reasons or in order to comply with the United Kingdom's EU or other international obligations.

In February 2009, Ofcom published a consultation document setting out Ofcom's proposal to require Vodafone and Telefónica O2 UK to release 2 x 2.5 MHz (each) of 900 MHz spectrum currently held to allow a third operator to have access. Ofcom's consultation also proposed that all 900 MHz and 1800 MHz licenses be enabled for UMTS services in line with the revisions to the GSM Directive, which must be implemented in the United Kingdom by May 9, 2010. Ofcom's consultation has subsequently been superseded by the UK Government's "Digital Britain" process.

In June 2009, the UK government published the "Digital Britain" final report, in which it proposed to issue a Direction to Ofcom to convert UMTS licenses, which currently expire in 2021, to indefinite licenses, subject to a yearly fee to be charged beyond the end of the current term.

Following the Digital Britain final report dated June 2009 and subsequent consultation by the UK government's Department for Business, Innovation and Skills (BIS), BIS published in October 2009 a draft Statutory Instrument ("Draft SI") which provided for the Secretary of State to direct Ofcom to liberalize the 900 MHz and 1800 MHz bands in the hands of the existing licensees, including Telefónica. The Draft SI proposed that Ofcom be directed to include certain wholesale access obligations into the varied 900 MHz licenses. The Draft SI also proposed that Ofcom be directed to convert the UMTS licenses, which currently expire in 2021, to indefinite licenses subject to revised retail service obligations and subject to a yearly fee, to be charged beyond the end of the current term.

### Future spectrum

In June 2009, Ofcom withdrew its decision to auction the 2600 MHz band in light of the government's Digital Britain proposals (see above). As a condition of merger control clearance under the EU Merger Regulation for the Joint Venture between T-Mobile UK and Orange UK, the merging parties have committed to divest 2x15 MHz of spectrum in the 1800 MHz band.

Under the terms of the Draft SI, the Secretary of State will direct Ofcom to hold a Combined Auction of spectrum in the 800 MHz (2x30 MHz in six 2x5 MHz lots) and 2600 MHz bands (2x70 MHz of FDD spectrum in seven lots of 2x10 MHz). Ofcom will be also directed to auction 50 MHz of TDD 2600 MHz spectrum in one lot as soon as possible in advance of the Combined Auction. A future consultation on a combined 800 MHz/2600 MHz auction is awaited. The Draft SI includes provisions on the eligibility requirements for auctioned spectrum (including caps on the amount of spectrum held by any single party) and retail service / wholesale access obligations for certain lots of spectrum. Parties will have the ability to relinquish existing spectrum holdings in the 900 MHz and 1800 MHz bands and this spectrum will be auctioned in the Combined Auction.

### Market reviews

On March 27, 2007, Ofcom published the charge controls to which mobile operators are subject for the provision of mobile call termination services from April 1, 2007 until March 31, 2011. The charge control requires that Telefónica O2 UK's average termination charges should be reduced to 5.1 pence per minute (at 2006-2007 prices) by the final year of the charge control period, and that the reduction should be implemented in four equal steps across the four years. Ofcom's decision imposing the price controls was appealed by British Telecommunications plc and Hutchison 3G UK Limited and, pursuant to those appeals, the UK Competition



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Commission reduced the level of the price cap to 4.0 pence per minute (at 2006-2007 prices) by the final year of the charge control period.

### Germany

The EU Regulatory Framework was implemented in Germany at the end of June 2004 by the Telecommunications Act. Responsibility for regulation of electronic communications networks and services rests with the telecommunications regulator, Bundesnetzagentur, or BNetzA.

### Licenses and concessions

Telefónica O2 Germany was awarded a GSM license for 1800 MHz spectrum in October 1998, and in February 2007 Telefónica O2 Germany was awarded 900 MHz GSM spectrum for GSM use. Accordingly, Telefónica O2 Germany is now licensed to use GSM900 2 x 5 MHz and GSM 1800: 2 x 17.4 MHz. The GSM license expires on December 31, 2016.

Under Section 58 VIII TKG (the “German Telecommunications Act”) frequency assignments are limited in time, although a renewal or extension of the term is possible. The federal network agency has not yet decided on the conditions for renewing the frequency assignments. However, before expiration, we expect there to be a public hearing, and for BNetzA to set out its approach to renewal, including the terms on which the licenses will be extended (pricing, technology neutrality, etc.).

In August 2000, Telefónica O2 Germany was awarded a UMTS license, which expires on December 31, 2020 (2 x 9.9 MHz).

### Market reviews

In August 2006, BNetzA completed its review of voice call termination on individual mobile networks and concluded that, as an operator with SMP, the charges Telefónica O2 Germany made to other operators for terminating calls on Telefónica O2 Germany network had to be reduced, requiring Telefónica O2 Germany to lower its call termination charges from €1.24 per minute to €0.994 per minute. In 2007, Telefónica O2 Germany was required to reduce further its termination charges from €0.994 per minute to €0.880 per minute. Telefónica O2 Germany has brought legal challenges against BNetzA’s 2006 and 2007 decision that Telefónica O2 Germany has significant market power and against the imposition of regulatory remedies. The Federal Administrative Court, as the highest level of appeal, confirmed all regulatory remedies meaning that the price controls stay in force for all mobile operators. All four German mobile operators filed a Constitutional Complaint in order to challenge the decision regarding significant market power. All other actions (regarding the amount of MTRs) are pending and a decision by the Constitutional Court is expected in the first or second quarter of 2010. The new market analysis of BNetzA in 2008 again concluded that all mobile network operators have SMP, and the decision on remedies does not contain changes in comparison to 2006. This 2008 decision has also been challenged by Telefónica O2 Germany.

In March 31, 2009 and as of April 1, 2009, BNetzA approved MTR for Telefónica O2 Germany at €0.714 per minute for a period of 20 months (until November 30, 2010).

### Spectrum

BNetzA decided in February 2006 that Telefónica O2 Germany may use GSM 900 spectrum in exchange for GSM 1800 spectrum. This decision is under the condition that Telefónica O2 Germany provides access to spectrum to German Railways if it is necessary for the European Train Control System (ETCS). Telefónica O2 Germany took

legal action against this condition. In the meantime, this condition was repealed by BNetzA in April 2009, and therefore, Telefónica O2 Germany declared the case as settled. However, German Railways, Airdata and Inquam (providers of local networks) appealed the decision. All cases have been dismissed in the first instance in December 2007 and each party appealed its decision. In the German Railways case, the Higher Administrative Court dismissed the appeal of German Railways on September 16, 2009. German Railways did not appeal this decision at the Federal Administrative Court, and the decision is legally binding. In the Airdata case, the appeal to the Higher Administrative Court has been dismissed. Airdata is now appealing at the Federal Administrative Court. The case

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is still open. In the Inquam case, the Administrative Court dismissed the claim of Inquam on October 21, 2009, and the decision is legally binding with no further challenge possible.

In October 2009, BNetzA decided to auction mobile spectrum at 2.6 GHz (70 MHz FDD / 50 MHz TDD ) together with available spectrum at 2.1 GHz (19,8 MHz FDD [ex. Mobilcom + QUAM] /19.2 MHz TDD) and 1.8 GHz (10 MHz FDD [ex. O2 + eplus]) and 800 MHz (Digital Dividend). In the 800 MHz range, a bandwidth of 30 MHz paired spectrum will be auctioned off in six blocks of 5 MHz. The decision was published on October 21, 2009. BNetzA has separated the refarming and auction in two procedures. Spectrum redistribution is not included in the refarming process. A spectrum cap of 2x20 MHz for spectrum below 1 GHz has been implemented. In favor of the D-Net-Operators, the spectrum cap has been rounded up to 22.4 MHz (for T-Mobile and Vodafone only). Telefónica O2 Germany filed a claim against that decision on November 18, 2009. The Administrative Court of Cologne decided on March 17, 2009 to dismiss the claims of Telefónica O2, Eplus and Airdata against BNetzA's decision regarding the design of the upcoming frequency auction. Appeal to the next instance at the Federal Administrative Court is allowed within one month period. The appeal is currently being considered by the parties. Nevertheless, Telefónica O2 Germany submitted an application for participation at the auction. The auction is most likely to start on April 12, 2010.

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### Czech Republic

The EU Regulatory Framework was implemented in the Czech Republic in 2005 by the Electronic Communications Act. Responsibility for regulation of electronic communications networks and services rests with the Czech Telecommunication Office, or CTO. Governmental responsibility for the area of electronic communications lies with the Ministry of Industry and Trade.

Several changes occurred in the legal environment of the electronic communications market in the Czech Republic in 2007. Act No. 127/2005 Coll. on electronic communications and on amendment of related laws was amended in respect of provisioning special price plans to the disabled as part of universal service and radio and television broadcasting. Furthermore, an amendment to the act on radio and television broadcasting was passed, primarily to unblock the transition to terrestrial digital broadcasting. In 2008, another amendment to the Act No. 127/2005 Coll for the implementation of Directive 2006/24/EC (Data Retention Directive) and the Regulation (EC) No 717/2007 on roaming on public mobile communications networks within the Community.

### Licenses and concessions

Telefónica O2 Czech Republic performs communication activities under the Electronic Communications Act based on a notification to and a certificate from the CTO number 516 as amended by later changes numbers 616/1, 516/2 and 516/3.

### Mobile segment

Telefónica O2 Czech Republic provides mobile electronic communications services in the 900 and 1800 MHz frequency bands under the GSM standard on the basis of radio frequency assignment from CTO valid until February 7, 2016; in the 2100 MHz frequency band under the UMTS standard on the basis of radio frequency assignment from CTO valid until January 1, 2022; and in the 450 MHz frequency band using CDMA 2000 (Code Division Multiple Access, or CDMA) technology on the basis of radio frequency assignment from CTO valid until February 7, 2011.

In March 2009 CTO conducted a tender for 32 free channels in the former E-GSM band with participation of Telefónica O2 Czech Republic, T-Mobile and Vodafone. These 32 free channels were divided according to the conditions of the tender as follows:

- Telefónica O2 Czech Republic - 7 channels
  - T-Mobile - 6 channels
  - Vodafone - 19 channels.

Telefónica O2 Czech Republic was awarded the seven channels in June 2009 with the same conditions as former GSM900 allotment (including date of expiration). The fee for Telefónica O2 Czech Republic's seven channels was CZK 29,654,000.

### Market reviews

In accordance with the market analyses performed by the CTO, Telefónica O2 Czech Republic was designated an SMP entity in 12 Czech markets, both retail and wholesale. The CTO started a second round of market analysis in 2007. In accordance with reviewed Commission Recommendation on relevant product and service markets from December 2007, CTO decreased the number of markets susceptible to ex ante regulation from 18 to seven (one retail

and six wholesale). Regulatory obligations on the remaining markets were withdrawn in 2008 and 2009. Telefónica O2 Czech Republic was designated as an SMP on the wholesale broadband market in 2009. Market reviews of the remaining six relevant markets are in the final phase, and the CTO proposes to designate Telefónica O2 Czech Republic as SMP operator in all of them.

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### Prices and tariffs

In April 2006, price regulations for access at a fixed point to the telephone network and for calls in the fixed network were abolished. Subsequent analyses of the relevant markets showed that no further price regulation was necessary. Additionally, provision of access at a fixed location was taken out of the scope of universal service in 2006. Besides the absence of price controls at the retail level, CTO also refrained from price controls on the wholesale broadband market during both market reviews it has conducted.

### Slovakia

Telefónica O2 Slovakia performs electronic communication activities under Act No. 610/2003 Coll., the Electronic Communications Act, (as amended) and General Authorization (as amended) issued by the Slovak NRA (the Telecommunications Office of Slovak Republic) based on a notification, as well as a number of allocation certificates issued by the NRA.

Responsibility for regulation of electronic communications networks and services rests with the Telecommunication Office of Slovakia. Governmental responsibility for the area of electronic communications lies with the Ministry of Transport, Post and Telecommunications of Slovakia.

### Licenses and concessions

On September 7, 2006, Telefónica O2 Slovakia was granted a license to provide electronic communications services by the means of the public electronic communications network using the GSM and UMTS mobile telephone network standards and became a third mobile operator in Slovakia after 10 years of duopoly of two original mobile operators. The license has been granted for 20 years and expires in September 2026. The commercial operations were launched on February 2, 2007.

### Market analysis

In accordance with the market review performed by the NRA, Telefónica O2 Slovakia has been designated an SMP operator on the wholesale mobile termination market, the only regulated mobile market in Slovakia. Wholesale termination price regulation is effective from August 2009, and since February 2010 the wholesale termination price regulation is based on the EU benchmarking methodology. From September 2009, Telefónica O2 Slovakia as a new entrant and market challenger also benefits from a shorter mobile number portability process, a maximum length of which was set by the regulator to five working days. No retail price regulation is applicable in Slovakia.

### Future mobile spectrum

A tender for 2.6 GHz frequencies, with potential of subsequent long-term operation, is expected during the first half of 2011.

### Ireland

In Ireland responsibility for the regulation of electronic communications networks and services rests with the Commission for Communications Regulation, or ComReg. The main legislation under which Telefónica O2 Ireland operates includes: the Wireless Telegraphy Act 1926, as amended, (45 of 1926), Post and Telecommunications Services Act 1983 as amended, (24 of 1983), Communications Regulation Acts 2002 (20 of 2002) and 2007 (22 of 2007), 3G Mobile Telephony Licensing Regulations (340 of 2003) and GSM Mobile Telephony Licensing Regulations (339 of 2003).

Licenses and concessions

Telefónica O2 Ireland has provided GSM services since March 1997 after having been awarded a license in May 1996. Its GSM900 license has a duration of 15 years (GSM900: 2 x 7.2 MHz) from 1996. In 2000 it was awarded an additional GSM 1800 license (2 x 14.4 MHz), which also has a term of 15 years. In October 2002 Telefónica O2 Ireland was granted a UMTS license, which has duration of 20 years (2 x 15 MHz + 5 MHz).

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The license can be surrendered by the operator at any time. However, ComReg can only revoke the license before its expiration date if the licensee does not pay its fees or if there has been a substantial breach of the terms of the license.

The Minister for Communications, Energy and Natural Resources may also revoke the license for national security reasons, or in order to comply with EU or other international obligations.

### Future mobile spectrum

In March 2008, ComReg published a draft strategy document for spectrum management during the period from 2008 through 2010. ComReg has published three consultation documents in a process to decide the future licenses in the 900 MHz band. At present, ComReg is proposing to auction all of the spectrum in this band in 2010. ComReg has also begun a consultation process to determine how to allocate spectrum in the 2.3 GHz band, and a consultation is expected in 2010 to determine the approach to assignment of the 2.6 GHz band (3G expansion band). ComReg is in favor of licensing the 800 MHz band (Digital Dividend), however, the timing for this is dependent on the government finalizing a date for analogue TV switch-over.

### Market reviews

Telefónica O2 Ireland has been found to have SMP in the market for mobile termination. ComReg has previously decided to forebear from the imposition of regulated pricing so long as it could reach agreement with the main operators for a “glide path” for annual reductions in mobile termination rates. A glide path is currently in place for all operators to cut mobile termination rates to €0.05 per minute by 2012/2013, subject to staying within €0.01 per minute, the European regulators’ group average MTR.

### Telefónica Latin America

#### Brazil

#### Regulatory framework

The delivery of telecommunications services in Brazil is subject to regulation under the regulatory framework provided in the General Telecommunications Law enacted in July 1997.

The National Agency for Telecommunications, ANATEL, is the principal regulatory authority for the Brazilian telecommunications sector.

#### Licenses and concessions

Concessions are granted for services provided in the public regime and authorizations are granted for services provided in the private regime. The only service provided in both regimes is the switched fixed telephone service, or STFC. All other services are provided only in the private regime.

The main differences between the public regime and the private regime relate to the obligations imposed on the companies. The concessionaires in the public regime, such as Telesp, have network expansion obligations (universal services obligations) and continuity of service obligations. These obligations are not imposed on the companies which provide services in the private regime.

In the state of São Paulo, Telesp provides local and long distance STFC under the public regime. In the other Brazilian states, Telesp provides local and long distance STFC under the private regime and broadband services under



the private regime.

Telesp's concession agreements (local and long distance) were extended in December 2005 for an additional period of 20 years. These agreements contemplate possible revisions in their terms by ANATEL in 2010, 2015 and 2020. In 2009, Telesp presented comments and suggestions to ANATEL's public consultation regarding the 2010 concession contract revision, but ANATEL has not presented the final version of the contract yet. Telesp's terms of authorization (local and long distance) were granted for an unlimited period of time.

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Under the renewed concession agreements and during the 20-year renewal period, Telesp will be required to pay a biannual fee equal to 2% of its annual net revenue (excluding taxes and social contributions), for the provision of fixed-line public telecommunications services in its concession area (State of São Paulo) for the prior year.

Brazilian telecommunications regulations require ANATEL to authorize private regime companies to provide local, national, and international long distance STFC.

On November 20, 2008, the Presidential Decree 6,654 altered the General Concessions' Plan, enabling one economic group to hold two of the four existing area concessions for providing STFC services. Thus, the Decree increased the flexibility of telecommunications provider groups as STFC concessionaries by allowing such providers to provide services in up to two General Plan regions. Prior to the Decree telecommunications provider groups could offer STFC services in only one region.

Telesp also has an authorization to provide data and broadband services in the private regime in the State of São Paulo.

On December 4, 2002, ANATEL authorized the migration from the cellular mobile service, or SMC, regime to a new licensing regime, personal mobile service. Brasilcel's operators replaced all their old licensing titles granted under the old SMC regime with new personal mobile service authorization titles. The new personal mobile service licenses include the right to provide mobile services for an unlimited period of time but restrict the right to use the spectrum according to certain schedules included in the licenses. All Telefónica's Brazilian mobile operating companies (the existing ones and some new acquisitions) were renamed "Vivo" with the exception of Telemig Celular. The following licenses are held by our Brazilian mobile operating company, Vivo:

- Vivo-Rio Grande do Sul ("A" Band) until 2022 (renewed in 2006);
- Vivo-Rio de Janeiro ("A" Band) until 2020 (renewed in 2005);
- Vivo-Espírito Santo ("A" Band) until 2023 (renewed in 2008);
- Vivo-Bahia ("A" Band) and Vivo-Sergipe ("A" Band) until 2023 (renewed in 2008);
- Vivo-São Paulo ("A" Band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2008);
  - Vivo-Paraná/Santa Catarina ("B" Band) until 2013;
  - Vivo-Distrito Federal ("A" Band) until 2021, (renewed in 2006);
- Vivo-Acre ("A" Band), Vivo-Rondnia ("A" Band), Vivo-Mato Grosso ("A" Band) and Vivo-Mato Grosso do Sul ("A" Band) until 2024 (renewed in 2008);
  - Vivo-Gois/Tocantins ("A" Band) until 2023 (renewed in 2008);
  - Vivo-Amazonas/Roraima/Amap/Par/Maranho ("B" Band) until 2013;
  - Telemig Celular (Minas Gerais) ("A" Band) until 2023 (renewed in 2007);
- Telemig Celular (for the cities where CTBC Telecom operates in the state of Minas Gerais) ("E" Band) until 2020.

For “A” and “B” Bands, the renewal of licenses must be solicited 30 months before expiration. Spectrum rights may be renewed only once for a 15-year period, after which title to the license must be renegotiated.

For “E” Band, the renewal of licenses must be solicited between 36 and 48 months before expiration. Spectrum rights may be renewed only once for a 15-year period, after which title to the license must be renegotiated. In December 2007, ANATEL auctioned fifteen new licenses in the 1900 MHz radio frequency band, denominated as “L” Band. Vivo acquired 13 spectrum licenses in “L” Band.

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- Vivo-Rio Grande do Sul (“L” Band) until 2022 (renewed in 2006) or 2022 for the cities of the metropolitan area of Pelotas;
  - Vivo-Rio de Janeiro (“L” Band) until 2020 (renewed in 2005);
  - Vivo-Espírito Santo (“L” Band) until 2023 (renewed in 2008);
  - Vivo-Bahia (“L” Band) and Vivo-Sergipe (“L” Band) until 2023 (renewed in 2008);
- Vivo-São Paulo (“L” Band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of So Paulo;
  - Vivo-Paran (excluding the cities of Londrina and Tamarana)/Santa Catarina (“L” Band) until 2013;
  - Vivo-Distrito Federal (“L” Band) until 2021, (renewed in 2006);
- Vivo-Acre (“L” Band), Vivo-Rondnia (“L” Band), Vivo-Mato Grosso (“L” Band) and Vivo-Mato Grosso do Sul (“L” Band) until 2024 (renewed in 2008) or 2022 for the city of Paranaba of Mato Grosso do Sul; and
- Vivo-Gois/Tocantins (“L” Band) until 2023 (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of Gois; and Vivo-Alagoas/Cear/Paraba/Piaui/Pernambuco/Rio Grande do Norte (“L” Band), until 2022.

For “L” Band, the renewal of licenses must be solicited between 36 and 48 months before expiration. Spectrum rights may be renewed only once for a 15-year period, after which title to the license must be renegotiated.

In April 2008, ANATEL auctioned 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses). Vivo was awarded seven spectrum licenses in Band J and Telemig Celular was awarded two licenses.

- Vivo-Rio Grande do Sul (including the cities of the metropolitan area of Pelotas) (“J” Band) until 2023;
  - Vivo-Rio de Janeiro (“J” Band) until 2023;
  - Vivo-Esprito Santo (“J” Band) until 2023;
  - Vivo-Bahia (“J” Band) and Vivo-Sergipe (“J” Band) until 2023;
- Vivo-So Paulo (including the cities of Ribeiro Preto and Guatapar and the cities where CTBC Telecom operates in the state of So Paulo) (“J” Band) until 2023;
  - Vivo-Paran (including the cities of Londrina and Tamarana)/Santa Catarina (“J” Band) until 2023;
  - Vivo-Distrito Federal (“J” Band) until 2023;
- Vivo-Acre (“J” Band), Vivo-Rondnia (“J” Band), Vivo-Mato Grosso (“J” Band) and Vivo-Mato Grosso do Sul (including the city of Paranaba) (“J” Band) until 2023;
- Vivo-Gois (including the cities where CTBC Telecom operates in the state of Gois)/Tocantins (“J” Band) until 2023;

- Vivo-Alagoas/Ceará/Paraíba/Piauí/Pernambuco/Rio Grande do Norte (“J” Band), until 2023;
- Vivo-Amazonas/Roraima/Amapá/Pará/Maranhão (“J” Band) until 2023; and
- Telemig Celular (including the cities where CTBC Telecom operates in the state of Minas Gerais) (“J” Band) until 2023.

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For “J” Band, the renewal of licenses must be solicited between 36 and 48 months before expiration. Spectrum rights may be renewed only once for a 15-year period, after which title to the license must be renegotiated.

### Prices and tariffs

ANATEL regulates rates for the STFC provided in the public regime. Operators with licenses to operate under the personal mobile regime are authorized to increase basic plan tariffs only for inflation and only on an annual basis. Operators are also allowed to establish non-basic tariffs and modify them without ANATEL’s prior approval.

### Interconnection

In July 2005, ANATEL published a new regulation for interconnection among providers of telecommunications services, which require operators to issue a public document disclosing all of the conditions for the establishment of interconnection for all classes and types of services.

The SMP regime allows operators to freely negotiate interconnection rates with other operators. If they fail to reach an agreement, each operator may call upon ANATEL to determine the terms and conditions of interconnection.

### Competition law

Brazilian competition regulation is based on Law No. 8,884 of June 11, 1994 which prohibits any practice aimed at restricting free competition, dominating the relevant market of goods or services, arbitrarily increasing profits, or abusively exercising dominant market position. The Economic Law Office, or SDE, the Secretariat for Economic Monitoring, or SEAE, and the Administrative Council for Economic Defense, or CADE, are the agencies authorized to enforce the competition rules.

## Mexico

### Regulatory framework

The provision of all telecommunication services in Mexico is governed by the Federal Telecommunication Law and various service-specific regulations. The governmental agencies which oversee the telecommunications industry in Mexico are the Secretariat of Communications and Transportation, or SCT, and the Federal Telecommunications Commission, or COFETEL.

### Licenses and concessions

In Mexico, authorizations to provide mobile telephony services (mobile and personal communication services, or PCS, for the 800 MHz and 1.9 GHz bands, respectively) are granted through concessions. Currently, regarding the mobile concessions (800 MHz), only one Band A and one Band B service provider may provide mobile telephony services in each of the nine regions of the country. Regarding PCS concessions, there is no exclusivity in the provision of service, in each region by more than one operator. In fact, there are currently three operators in each region. These concessions were granted in 1998 and 2005 for a period of twenty years, and may be renewed for additional 20-year periods, subject to the fulfillment by the operator of certain terms and conditions.

In total, Telefónica Móviles México, and its subsidiaries and participated companies have 22 licenses granted by SCT, which enable it to provide telecommunications services:

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Telefónica Móviles México's mobile operating companies have been granted concessions to operate mobile telephony services on Band A until 2010. SCT granted licenses to Baja Celular Mexicana, S.A. de C.V., or Bajacel, dated July 17, 1990; Movitel del Noroeste, S.A. de C.V., or Movitel, also dated July 17, 1990; Telefonía Celular del Norte, S.A. de C.V., or Norcel, dated July 23, 1990; and Celular de Telefonía, S.A. de C.V., or Cedetel, dated August 2, 1990. The renewal of these four concessions was requested in 2005. We presented in 2005 four requests for extension of these concessions before SCT. The concessions of Bajacel, Movitel y Norcel have been renewed for 15 years from 2010. The terms and conditions of the renewed concessions are consistent with those concessions that SCT has recently assigned and to those

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terms and conditions that it will establish in future concessions. As of the date of this report, we are expecting the formality of receiving the concessions. In respect of Cedetel, the proposal for renewal was notified by the STC, and it is expected that Cedetel will accept the proposal in due course. Any further delay in the renewal process to obtain the requested extensions will be attributed to the SCT.

- Furthermore, SCT granted to Telefónica Móviles México, through Pegaso Comunicaciones y Sistemas, S.A. de C.V. a concession to provide public telecommunications services, on June 23, 1998, and nine spectrum licenses, dated October 7, 1998, in the 1900 Mhz band to provide personal communication services in each of the nine PCS service region, and valid until 2018. Those licenses may be extended for additional twenty-year periods. For all of these licenses renewal was requested in 2008, the renewal decision is still pending, and we are permitted to continue operating under the terms of the expired licenses until the renewal has been approved. On April 21, 2005, SCT granted Telefónica México four more spectrum licenses in the same 1900 MHz band, to provide the PCS service and have more bandwidth in regions 3, 5, 7 and 8, valid for 20 years, and with the possibility be renewed for up to 20 additional years. On September 7, 2009, a modification to Pegaso's concession was authorized to provide trunked radio services.
- SCT also granted to Grupo de Telecomunicaciones Mexicanas, S.A. de C.V., or GTM, a company in which Telefónica Móviles México has an interest, several licenses:
  - i) on June 24, 1998, to install microwave links in 23 GHz frequencies, for a period of 20 years;
  - ii) on December 13, 1999, to install microwave links in 7 GHz frequencies, for a period of 20 years, and that can be renewed;
  - iii) on June 5, 2003, to install a public telecommunication network to provide domestic and international long distance service granted, for a period of 15 years, and that can be renewed; and
  - iv) on March 28, 2006, GTM was authorized a renewal of the concession to provide fixed telephony and public telephony, nationwide for a period of 15 years, that can be renewed.

## Prices and tariffs

Tariffs charged to customers are not regulated. They are set by mobile operating companies and must be registered with COFETEL. Rates do not enter into force until registered by COFETEL.

## Interconnection

Mexican telecommunications regulations obligate all telecommunications network concessionaires to execute interconnection agreements on specific terms when requested by other concessionaires. Interconnection rates and conditions may be negotiated by the parties. However, should the parties fail to agree, COFETEL must fix the unresolved issues, including tariffs.

## Foreign ownership/restrictions on transfer of ownership

Mexican foreign investment law restricts foreign investment in local fixed service and other telecommunications services to a maximum of 49% of the voting stock, unless the Mexican National Commission of Foreign Investment approves a higher percentage participation, which it can do only in the case of mobile telecommunications companies.



Bajacel, Movitel, Norcel, Cedetel and Pegaso, as mobile telecommunications companies, received the required approvals from the National Commission of Foreign Investment permitting our ownership of more than 49% of their outstanding voting capital.

GTM, a company in which Telefónica México has an interest, provides local fixed and long distance services. This operator complies with Mexican foreign investment law, and has a stock structure that includes the participation of its Mexican partner, Enlaces del Norte. S.A. de C.V., which has 51% of the voting stock.

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### Competition law

The Federal Economic Competition Law enacted in 1992 and amended on June 28, 2006 prohibits monopolies and any practices that tend to diminish, harm or impede competition in the production, processing, distribution or marketing of goods and services. The Federal Competition Commission, or COFECO, is the administrative body empowered to enforce the Law.

### Venezuela

On June 1, 2000, the national legislative commission approved the Telecommunication Law. On February 1, 2006, the national legislative commission approved the Ley Habilitante that grants the President of the Republic capacity to enact decrees in relation to the telecommunication sector, though no formal modification to current law has been made.

On December 2009, a new regulation applicable to all subscription TV service providers was enacted by CONATEL in order to stipulate a new obligation concerning a mandatory percentage of inclusion (12%) of national production services (channels in which both reception and diffusion of sound and images take place in the country to later transmit it by means of subscription TV service providers) in the regular programming packages. The calculation of the mandatory percentage is to be made on the basis of the totality of the TV channels. Qualification of a channel as a “national productions service” is a task of CONATEL, who must keep an updated record of those services.

An Administrative Decision on Services Agreements (Providencia n° 1302 sobre Condiciones Generales de los Contratos de Servicios de Telecomunicaciones) was adopted. As a consequence of this regulation (2009), Telcel proceeded to adapt all of its nine services agreements to fulfill all the conditions and impositions established, mainly related to consumer protection. We have currently received regulator observations of two of the agreements (TV service and radio localization service), and we are in process of including the modifications based on the observations.

### Licenses and concessions

Telcel has been granted a mobile telephony concession to operate and offer mobile services in the 800 MHz band with national coverage, granted in 1991 and expiring on May 31, 2011 that may be extended for a term no longer than 20-year, subject to CONATEL’s discretion. Telcel also holds a private network services concession, granted in 1993 and renewed on November 28, 2007, until December 15, 2025, that allows Telcel to offer point-to-point or point-to-multipoint private telecommunication services to corporations. In 2000, Telcel was granted a general license (Habilitación General) to offer local telephony services, national long distance services and international long distance services and to otherwise operate telecommunications networks for a 25-year period expiring on December 15, 2025. In 2001, Telcel obtained a concession to offer fixed wireless access services nationwide using wireless local loop technology.

On November 28, 2007, the National Telecommunications Commission, or CONATEL, in accordance with the Telecommunications Law, incorporated into the general license the rest of the services provided by Telcel: mobile, private networks, Internet access and transport. On that same date, Telcel was granted a concession to operate in the 1990 MHz band for a period of 15 years, until November 22, 2022, renewable for a period of ten years.

### Prices and tariffs

Under Venezuelan regulations, telecommunications operators are free to determine and set prices for the services that they offer, within the price cap established by the regulator. However, exemptions to the free pricing regime may be applicable to market dominant operators, universal services projects or as a result of market distortions caused by

anti-competitive conduct as determined by the Competition Agency.

Competition law

Venezuelan law governing competition is the Promotion and Protection of Free Competition Act 1992. It prohibits monopolistic and oligarchic practices and other means that could impede, restrict, falsify, or limit the

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enjoyment of economic freedom. The Office of the Superintendent for the Promotion and Protection of Free Competition is the agency empowered to apply the Competition Act.

Chile

Regulatory framework

The General Telecommunications Law No. 18,168 of 1982, as amended, establishes the legal framework for the provision of telecommunications services in Chile.

The main regulatory authority in Chile is the Under-Secretary of Telecommunications, or SUBTEL.

Licenses and concessions

Under the General Telecommunications Law, companies must obtain licenses in order to provide fixed telecommunications services. Licenses granted for public and intermediate services generally have 30-year terms and may be renewed indefinitely for 30-year periods at the request of the operator, though certain licenses held by Telefónica Chile have longer terms.

Telefónica Chile holds the following licenses for the provision of telecommunications services:

- Local telephony public service licenses. Telefónica Chile holds a license for local telephone service in all regions of Chile for a 50-year renewable period which began on December 1982, except Regions X and XI, which were incorporated to such license in 1995. In addition, Telefónica Chile holds various other renewable license for nationwide local telephone services oriented, exclusively, for rural localities. Telefónica Chile also holds a nationwide public service renewable license for data transmission for a 30-year period beginning as of July 1995, and four other public service renewable licenses for data transmission for a 30-year period beginning as of June 2008.
- Multicarrier long-distance licenses. Under the Multicarrier System, Telefónica Chile's former long-distance subsidiary, Telefónica Mundo Larga Distancia S.A. (before Telefónica Mundo), held 30-year renewable licenses, for a period beginning as of November 1989, to install and operate a nationwide fiber-optic network, a network of base stations and other transmission equipment, and to provide domestic and international long-distance services, including voice, data and image transmission, throughout Chile. In addition, Telefónica Mundo Larga Distancia S.A. held 30-year renewable licenses, for a period beginning as of June 1993, to nationwide public service data transmission. Telefónica Chile's other long-distance subsidiary, Globus, also held licenses for an indefinite term to provide domestic and international long-distance services through central switches and cable and fiber-optic networks nationwide. After the merger of these subsidiaries in 2006, all the aforementioned licenses remain under the ownership of the same company, which is now known as Telefónica Larga Distancia.
  - Public service data transmission. In addition to the 30-year data transmission license previously mentioned, Telefónica Chile, through Telefónica Empresas, holds, as of March 1987, nationwide public service data transmission licenses for an indefinite term.
- Public service mobile telephony licenses. Telefónica Móviles Chile holds licenses with indefinite terms, beginning as of November 1989, to provide public service mobile telephony services throughout Chile in the 800 megahertz frequency range. Telefónica Móviles Chile also holds three concessions for the provision of mobile telecommunications services nationwide in the 1900 MHz band. These concessions may be renewed for successive thirty-year periods as of 2002 at the request of the holder.

- Limited television license. Telefónica Chile's subsidiary Telefónica Multimedia, has a license to establish, operate, and use a part of the spectrum of the 2.6 GHz bandwidth in Santiago, Chile, for an intermediate telecommunications service concession, authorizing the frequencies used to communicate voice, data and images, for a 30-year period beginning as of May 2008. Telefónica Multimedia also holds a license authorized by Resolution No. 47 enacted on November 28, 1990, amended by Resolution No. 1536 of 1994, and Resolution 1453 of 2002, to provide limited television service in 2,6 GHz. Since December

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2005, Telefónica Chile, through Telefónica Multimedia, holds a nationwide 10-year renewable license to provide limited satellite television service. Additionally, in January of 2006, Telefónica Chile, through Telefónica Multimedia, was assigned a limited television service license to provide the service nationwide in the main municipalities, except Region III, through Telefónica Chile's xDSL broadband network for an indefinite period. Moreover, in March 2007, a limited television service license was granted in order to provide this service, through the DSL broadband network, in the Santiago Metropolitan area, for an indefinite period.

### Prices and tariffs

Under the General Telecommunications Law, maximum tariffs for telephony services are set every five years by the Ministry of Transport and Telecommunications and the Ministry of Economy. In addition, the Competition Tribunal may subject any telephony service to price regulation, except for mobile telephone services to the public that are expressly exempted under the General Telecommunications Law.

The Competition Tribunal ruled in January 2009 that only some local telephone services were to be subject to tariff regulation (line connections, monthly fixed charges, variable traffics charges, and public payphone services are excluded). Accordingly, it was determined that every local telephone company, within its service zones, would be regulated with respect to tariff levels and structure. In addition, Telefónica Chile, in its capacity as a "dominant operator" (except in regions where other companies are the dominant operators), is regulated on a non-price basis, with requirements that it not engage in discriminatory pricing and that it give previous notice of plans and packages.

### Interconnection

Interconnection is obligatory for all license holders with the same type of public telecommunications services and between telephony public services and intermediate services that provide long distance services. The same requirement applies to holders of those intermediate service licenses, who are required to interconnect their networks to the local telephone network.

A "calling party pays" tariff structure was implemented on February 23, 1999. Under this tariff structure, local telephone companies pay mobile telephone companies an access charge for calls placed from fixed networks to mobile networks. Local telephone companies may pass this interconnection charge on to their customers. Every five years, SUBTEL sets the applicable tariffs for services provided through the interconnected networks.

### Competition law

The principal regulation concerning competition in Chile is Decree No. 211 of 1973, whose current text was established in Decree N° 1 of 2005. Pursuant to the provisions of this law, acts or behavior involving economic activities that constitute abuse of a dominant market position, or limit, restrain, or distort free competition in a manner that injures the common economic interest in the national territory are prohibited. The Competition Tribunal deals with infringements of competition law.

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### Argentina

#### Regulatory framework

The basic legal framework for the provision of telecommunications services in Argentina is set forth in the National Telecommunications Law (No. 19,798) of 1972 and in the specific regulations governing each type of telecommunications service. Also, Decree 264/98 established a transitory period from a monopolistic market towards a free market, promoting the protection of small operators while imposing obligations on basic services licensees. Decree 764/00, established the new and actual regulatory framework rules for a free market, and includes interconnection, licenses, universal service and spectrum rules.

The following regulatory authorities oversee the Argentine telecommunications industry:

- the National Communications Commission, or CNC, supervises compliance with licenses and regulations, and approves changes to mandatory goal and service requirements; and
- the Secretariat of Communications, or SECOM, grants new licenses, regulates the bidding and selection processes for radio-spectrum authorizations, and approves the related bidding terms and conditions.

#### Licenses and concessions

Telefónica de Argentina holds licenses for fixed line services, all granted for an unlimited period of time, which entitle it to provide fixed line telecommunications services; international telecommunications services; local services in the northern and southern regions; long distance, international and data transmission telecommunications services in the northern region; and Internet access and international data transmission services.

Telefónica Móviles de Argentina's licenses for the provision of mobile services include PCS licenses and corresponding authorizations for use of spectrum for different regions, licenses and corresponding authorizations for use of spectrum for mobile telephone services for different regions; and licenses for trunking, or closed user group, services for different cities.

These licenses do not expire, but may be cancelled by the SECOM as the result of failure to comply with the terms of its license.

#### Prices and tariffs

On October 21, 2003, Law No. 25,790 became effective, extending the term for the renegotiation of concession or licensing agreements with public utilities until December 31, 2004, which was subsequently extended until December 31, 2011. This law also established that the decisions made by the Argentine government during the renegotiation process shall not be limited by, nor subject to, the stipulations contained in the regulatory frameworks currently governing concession or licensing agreements for the respective public utilities. Renegotiated agreements may cover some aspects of concession or licensing agreements and may contain formulas to adjust such agreements or temporarily amend them. As an investor in Argentina through Telefónica de Argentina, we commenced arbitration proceedings against the Republic of Argentina based on the Reciprocal Protection of Investments Treaty between Spain and Argentina for damages suffered by us because of the measures adopted by the Argentine government. On August 21, 2009, the parties requested the Tribunal, in accordance with Rule 43 of the ICSID Arbitration Rules, declare a resolution of the termination of the proceedings. The agreement of the parties envisages the possibility of a new request for arbitration under the ICSID Convention being submitted by Telefónica. Such request would be processed in accordance with the ICSID Convention and the Center's normal rules and procedures taking note of the

discontinuance issued by the Tribunal on September 24, 2009.

Additionally, Decree No. 764/00 established that providers of telephone services may freely set rates and/or prices for their service which shall be applied on a non-discriminatory basis. However, until the Secretary of Communications determines that there is effective competition for telecommunications services, the “dominant” providers in the relevant areas (which include Telefónica de Argentina) must respect the maximum tariffs established in the general tariff structure. Providers may freely set their rates by areas, routes, long distance legs and/or customer groups so long as they are below the amounts established by the general tariff structure.



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Also, the guidelines set forth in article 26 of Decree No. 1185/90 continue in effect for operators with significant market power. These guidelines establish information obligations with which operators must comply with respect to tariffs, both toward clients and the national regulator. This Decree also establishes the powers the regulator has to revise or revoke such tariffs.

Tariffs charged to customers for mobile services are not regulated in Argentina.

### Interconnection

Decree No. 764/00 approved new rules for national interconnection and established interconnection standards and conditions with which telephone service providers must comply regardless of pre-existing agreements. The rules for national interconnection set forth that interconnection agreements are to be freely negotiated between the relevant service providers, on a non-discriminatory basis. The regulations also establish the obligation for dominant and significant market operators to unbundle their local loops and to allow competitors to use them on a reasonable basis.

### Competition law

Law 25,156, on Protection of Competition prohibits any acts or behaviors related to the production or trade of goods or services, whose purpose or effect is to prevent, restrict or distort competition or market access, or that constitute abuse of dominant position in a market. The National Commission for the Defense of Competition is the authority entrusted with application of the law.

### Colombia

#### Regulatory framework

In Colombia, telecommunications are a public service, subject to state regulation and oversight. Law 1341/09 reformed the legal framework, establishing the general regime for information and communication technologies. Under this law, providers of network and telecommunications services in Colombia must register with the Information and Communication Technologies Minister. In addition, operators must obtain a concession from the National Television Commission in order to provide television services.

Law 1341/09 established a transition period in which operators can: (i) preserve the original titles (licenses, contracts, permissions, authorizations) until their expiration or (ii) adopt the regime of general authorization stated by the law and the corresponding registration and preserve the necessary permissions in order to use the spectrum.

During 2009 the Colombian telecommunications regulator, Comisión de Regulación de Comunicaciones or CRC, identified the telecommunications relevant markets and operators with dominant position and established some remedies via ex ante regulations.

#### Licenses and concessions

Concessions for mobile services in the Eastern Region, the Caribbean Coast Region and the Western Region were granted in March 1994 for a ten-year period and extended for ten years until March 28, 2014. Before 2014 and because of the transition period set forth under Law 1341/2009, Telefónica Móviles Colombia can renounce its concessions, renew the permission for spectrum use for one period of ten years and subsequently renegotiate an extension. If Telefónica Móviles Colombia continues with its current concessions until 2014, in that year it must register as a telecommunications provider and request permission for spectrum use.

Additionally, Telefónica Móviles Colombia holds concessions for carrier services nationwide, granted in June and November 1998 (initially for ten years and extended once for an additional ten years). Due to decree 2870 of 2007, these concessions were transformed into a convergent title. The Ministry of Communications granted Telefónica Móviles Colombia on November 6, 2008 a convergent title to render carrier services for an additional ten-year period (which can be extended for an additional ten years). Like in the case of concessions for mobile services, these licenses are in force until the end of their validity, or Telefónica Móviles can decide to renounce and register as an operator under the general authorization granted by law.

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With respect to fixed line services, Law 1341/2009 preserves the indefinite permission for all operators to operate as local exchange carriers in the national area that Law 142/94 had established. Colombia Telecom must register as a telecommunication provider before the CRC. This registration also covers the general authorization to provide other telecommunications services like long-distance carrier services, value added services, carrier services nationwide and mobile services, among others.

### Interconnection

Mobile and fixed operators in Colombia have the right to interconnect to other operators' networks. Before the intervention of regulatory authorities, operators must attempt direct negotiations. Interconnection must assure compliance with the objectives of non-discriminatory treatment, transparency, prices based on costs plus a reasonable profit and promotion of competition.

### Prices and tariffs

Mobile tariffs charged to customers are not regulated, although they may not be discriminatory. Nevertheless fixed-to-mobile tariffs are subject to a price cap. Rates are fixed by mobile operating companies and must be registered with the Comisión de Regulación de Telecomunicaciones. The regulator set a price cap of 392 Colombian pesos per minute for fixed to mobile tariffs since November 1, 2006, and in 2009 the CRC reduced the tariff to 198.4 Colombian pesos per minute. Local tariffs are regulated, but operators have the opportunity to offer several alternative plans that are not regulated although they must be registered.

Due to market regulation process, the Telecommunications Commission in December 2008, published a proposed amendment to modify the price cap of 392 to 200 Colombian pesos per minute for fixed to mobile communications. This proposed amendment is currently subject to discussion with operators.

### Television services

In January 2007, Colombia Telecom signed a concession agreement with the Television Commission to provide DTH services for ten years. This is a concession granted with a national scope.

In December 2008, the Television Commission published Agreement No. 006. By this disposition the carry obligations of operators of closed television has been modified to require that regional channels be broadcast only in the cover area of the channel and only if it is possible technically.

### Competition law

The Colombian Competition Law is incorporated in the Law No. 155/59, Decree No 2153/92 and Law 1340/09 on Restrictive Trade Practices. The law prohibits entering in any agreement or engaging in any type of practice, procedure, or system that aims to limit free competition and abuse of a dominant position. The Superintendent of Industry and Commerce is the Colombian competition authority.

### Peru

#### Regulatory framework

The provision of telecommunications services in Peru is governed by the Telecommunications Law and related regulations.

Licenses and concessions

Telefónica del Perú provides fixed line telecommunications services based on concessions granted by the Ministry of Transportation and Communications, or TMC. The concession term is for 20 years, which may be renewed totally or partially at Telefónica del Perú's request. Total renewal is for an additional 20-year period. Partial renewal is for periods of up to five additional years. Three partial renewals have been approved, extending the concession term until 2027.

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Providers of mobile services seeking to operate in Peru must obtain a non-exclusive license from the TMC. Licenses are granted by means of a license agreement entered into between the TMC and the licensee and set forth the licensee's rights and obligations, including the regions where the licensee is authorized to operate. Licenses are granted either by application or through a bidding process.

Telefónica Móviles Perú has a concession for the provision of mobile services on Sub Band A of the 850 MHz Band and Sub Band of 1900 MHz (in these bands, Telefónica Móviles Perú can also provide fixed wireless services) for a 20-year period, renewable upon request for identical periods. It also holds concessions for offering international and domestic long distance carrier services, granted in February 2002 for a 20-year period. Additionally, it has a concession for the provision of wireless fixed telephony services on the 450 MHz and 900 MHz band for a 20-year period. Both concessions were granted on March 3, 2008. It also holds the concessions for local carrier services, which expire between 2016 and 2022. Concessions for domestic and international carrier services expire on February 5, 2019. In addition, it has a concession for local fixed telephony services for national coverage, granted on August 10, 1999 for a 20 year period. These concessions may be renewed for an additional 20-year period.

Under the concessions to provide mobile services, mobile operators are obligated to meet certain quality service requirements with respect to call failure, radio-electric coverage and quality of communications. These requirements are established on a yearly basis and are gradually increased in order to improve the quality of the service provided.

### Prices and tariffs

Tariffs for fixed telephony services must be approved by the National Regulatory Authority, the Organization for Supervision of Private Investment in Telecommunications, or OSIPTEL, in accordance with a price cap formula based on a productivity factor. Rates charged by mobile providers to their customers have been subject to a free tariff regime supervised by OSIPTEL. Tariffs must be reported to OSIPTEL prior to implementation.

### Interconnection

Mobile service providers are required, upon request, to interconnect with other concession holders. According to the principles of neutrality and non-discrimination contemplated in the Telecommunications Law, the conditions agreed upon in any interconnection agreement will apply to third parties in the event that those conditions are more beneficial than terms and conditions agreed upon separately.

### Competition law

The general competition framework in Peru is based on the Legislative Decree No. 1034. This law prohibits any monopolistic practices, controls, and restraints on free competition and it is applied, in the telecommunication sector, by OSIPTEL.

### Ecuador

#### Regulatory framework

The Special Telecommunications Law and the General Regulation to the Special Telecommunications Law establish the regulatory regime applicable to the provision of telecommunications services in Ecuador.

#### Licenses and concessions

After a new agreement with the Ecuadorian government, Otecel renewed its mobile telephony services concession which now allows Otecel to provide advanced mobile services, including 3G services. The concession will expire on November 29, 2023 and may be extended for a subsequent 15-year period.

Beside the above mentioned concession, Otecel holds a concession to provide fixed and mobile services carrier services, which expires on April 22, 2017 and may be extended for a subsequent 15-year period. The different licenses for the provision of mobile value added services and Internet mobile access, each of which expires on

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February 21, 2010, are now under the scope of the new agreement with the Ecuadorian government described in the previous paragraph. It also holds a license to provide conventional Internet services, which expires on January 25, 2011 and may be extended for a subsequent ten-year period.

A monthly fee amounting to 1% of the invoiced revenues of mobile services must be paid by all operators holding concessions to the National Secretary of Telecommunications as a contribution to support universal service. Under its contract, Otecel may cancel such fee by giving services to agreed zones within the National Plan for Universal Service.

## Prices and tariffs

The mobile services concession of Otecel is subject to a maximum rate of \$0.50 per minute for mobile services and a maximum rate of \$0.10 per minute for rural public telephony. Otecel may set rates freely so long as it does not exceed these rates, and provided that it notifies the correspondent regulatory body 24 hours ahead of any price increase.

Otecel may set rates freely under its carrier services concession.

## Other business lines in Latin America

Country	License/Concession and authorizations	Type of service	Spectrum	Band	Expiration
El Salvador	Concession	Telecommunications services (1)	25 MHz/800 MHz	B Band	2018(2)
	Concession	Telecommunications services (1)	30 MHz/1900 MHz	C Band	2021
Guatemala	Concession	Telecommunications services (1)	80 MHz/1900 MHz	B, C, E and F Bands	2014(3)
	Concession	Telecommunications services (1)			2014(3)
	Concession	Telecommunications services (1)			2014(3)
Nicaragua	Concession	Mobile telecommunications services	800 MHz	A Band	2013(4)
	Concession	Mobile telecommunications services	Additional spectrum 1900	D Band	2013
Panama	Concession	GSM/UMTS	800/1900 Mhz	A Band	2016(5)
Uruguay	License	Mobile telephony	25 MHz 800 MHz		2022-2024(6)

(1)According to the Telecommunications Law all of such concessions were granted to provide any telecommunications services.

(2)Concessions for use of spectrum are granted for a 20-year period and may be renewed for additional 20-year periods upon execution of the proceedings set forth in the Telecommunications Law.

- (3) All of such concessions are granted for a 15-year term and may be renewed for subsequent fifteen-year terms at the request of the holder. In order to renew a title, the holder must demonstrate before the regulatory body, that the spectrum was effectively used during the previous 15-year term. All of these titles are set to expire in 2014.
- (4) Telefónica Móviles Nicaragua was granted a concession in 1992 for a ten-year period for the use of 25 MHz of spectrum in the 800 MHz Band A to provide mobile telecommunications services, the regulatory entity granted to Telefónica Nicaragua 10 Mhz of additional spectrum in the 1900 Band D. This concession was renewed for another ten-year period in 1998, and will expire on July 31, 2013. The concession may be renewed for another ten-year period through negotiation with TELCOR two years prior to the expiration of the current concession, subject to the fulfillment of certain terms and conditions by the operator.
- (5) The concession period is for 20 years and expires in 2016. This can be extended for another period in accordance with the concession contract. The Panamanian government granted us the right to use 10 MHz (5+5) in the 1900 MHz Band until 2016, which can be extended for another period.



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(6) The expiration date depends on the spectrum concession: band 800 MHz (12.5 MHz + 12.5 MHz) – 20 years from July 2004; band 1900 MHz (5 MHz + 5 MHz) – 20 years from December 2002; and band 1900 MHz (5 MHz + 5 MHz) – 20 years from July 2004.

### Seasonality

Our main business is not significantly affected by seasonal trends.

### Patents

Our business is not materially dependent upon the ownership of patents, commercial or financial contracts or new manufacturing processes.

### C. Organizational Structure

See “—History and Development of the Company” and “—Business Overview.”

### D. Property, Plant and Equipment

In 2007, we moved to our new central headquarters for the Telefónica Group, “Distrito C”, in Las Tablas (Madrid), Spain.

### Fixed Networks

We own fixed networks in Spain, Latin America and Europe, having an incumbent role in Spain, Argentina (the greater Buenos Aires metropolitan area and the southern portion of the country), Brazil (São Paulo), Chile, Peru, Colombia and the Czech Republic.

Following market trends, competitive environments, evolution of technologies and new multimedia and broadband services demanded by our customers, we have upgraded our networks in recent years in the following manners:

- progressive introduction of broadband access technologies over copper: ADSL, ADSL2+, VDSL2, etc., increasing the bandwidth capacity provided to our broadband clients several times in the last four years;
- introduction of fiber access technologies (xPON) across different deployment scenarios: fiber to the home (FTTH), fiber to the building (FTTB), fiber to the curb (FTTC), fiber to the node (FTTN), etc., increasing the access speed up to 100 Mbps;
- service support based on powerful Internet Protocol/ Multiprotocol Label Switching (IP/MPLS) backbones, providing full connectivity to the rest of the network layers, such as access and control, to support services for business and customer market segments (fixed and mobile);
- migration of the legacy time division multiplexing (TDM) switching networks (PSTN and ISDN) to new generation network (NGN) over all-IP packet networks;
- migration from legacy transport technologies, such as asynchronous transfer mode (ATM), frame relay (FR), low-rate leased lines, plesiochronous digital hierarchy (PDH) and synchronous digital hierarchy (SDH), to the new generation of optical transport ones, such as dense wavelength division multiplexing (DWDM), coarse wavelength division multiplexing (CWDM) and new generation - synchronous digital hierarchy (NG-SDH);

- introduction of IMS (Internet Multimedia Subsystem) in many countries to simplify the control of the network and ease the deployment of new services over the all-IP converged network;
- empowerment of the intelligence of the network to better manage its use, to avoid saturations and frauds and to identify new business opportunities;

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- convergence of fixed and mobile networks, services and support systems from both technological and operational points of view; and
- deployment of new services such as pay TV, under the Imagenio brand, to customers connected through broadband accesses in Spain, Czech Republic, Peru, Chile, Colombia and Brazil.

## Mobile Networks

We operate mobile networks in Spain, the United Kingdom, Germany, Ireland, the Czech Republic, Slovakia, Brazil, Argentina, Venezuela, Chile, Peru, Colombia, Mexico, Guatemala, Panama, El Salvador, Nicaragua, Ecuador and Uruguay. In the case of Brazil (Vivo) the ownership of the networks is shared 50/50 with Portugal Telecom.

We use a number of mobile technologies in the countries in which we operate, namely: GSM and UMTS in Spain, the United Kingdom, Ireland, Germany, Czech Republic, Slovakia and Latin America; CDMA 1X in other countries in Latin America (such as, Brazil, Venezuela and Colombia) and, in the Czech Republic (CDMA 450 Mhz). We continue the work of upgrading our mobile networks in line with market trends, the demand of new services from customers and the evolution of technologies. The main steps we are currently taking include:

- progressive migration from CDMA technologies to GSM or UMTS technologies in markets where we still exploit these legacy technologies;
- introduction of broadband into mobile access using technologies such as UMTS, HSDPA, HSUPA and HSPA+;
- deployment of new services such as mobile television and distribution services for next generation music, video and games;
- exploration of the adequacy of new technologies such as HSPA and LTE (Long Term Evolution) to provide mobile accesses with increased bandwidth, in particular:
  - HSPA: we have been committed to the deployment of this technology in countries in which we have a presence and as of December 31, 2009, we have extended our coverage up to the majority of the urban/suburban areas, and we have increased the capacity of the network by upgrading the network technology to the latest available releases of UMTS standards 3GPP REL 6 and REL 7;
  - LTE: together with main vendors and sharing experience with other operators, we have extensively analyzed the opportunities LTE will bring as 4G mobile technology is used to complement current network technology by creating higher capacity at lower relative cost by user/traffic unit, and, in this regard, we have deployed the first demonstration trials in 2009, which have been successful so far; and
- convergence of fixed and mobile networks, services and support systems from both technological and operational points of view.

## Satellite communications

We hold a 13.23% interest in Hispasat, which leases capacity to Eutelsat, Intelsat, New Sky Satellite and occasionally ArabSat.

The services provided using satellite platforms include television contribution signal to feed cable and IPTV head ends, DTH television, VSAT mainly for telephony and Internet access in rural areas, emergency solutions, corporate

communications and international communications with some countries in Africa and in Asia.

Submarine cables

We are one of the world's largest submarine cable operators. We participate in approximately 25 international underwater cable systems (nine of which are moored in Spain) and own eleven domestic fiber optic cables.

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There are submarine cable connections between Spain and Africa, America, Asia and Europe, respectively, that are jointly owned by us with other telecom operators. The SAM-1 cable, which we own, has a length of approximately 22,000 kilometers underwater and 3,000 kilometers terrestrial and links different countries such as the United States, Puerto Rico, Ecuador, Guatemala, Peru, Chile, Brazil, Argentina and Colombia.

The principal services using the capacity of submarine cables are voice circuits, Internet and dedicated circuits for international traffic and for corporations and business customers.

### Item 4A. Unresolved Staff Comments

Not applicable.

### Item 5. Operating and Financial Review and Prospects

#### A. Operating Results

##### Overview

We have implemented a regional, integrated management model based on three business areas, with each area in charge of the fixed and mobile telephone and other businesses within its borders. Our areas are:

- Telefónica Spain: oversees the fixed and mobile telephone, broadband, Internet, pay TV and valued added services and data businesses in Spain.
- Telefónica Europe: oversees the fixed and mobile telephone, broadband, Internet, pay TV and value added services and data businesses in the United Kingdom, Germany, Ireland, the Czech Republic, Slovakia and the Isle of Man.
- Telefónica Latin America: oversees the fixed and mobile telephone, broadband, Internet, pay TV and value added services and data businesses in Latin America.

We are also involved in the media and contact center segments through Telefónica de Contenidos and Atento, respectively.

##### Presentation of Financial Information

The information in this section should be read in conjunction with our Consolidated Financial Statements and the notes thereto, included elsewhere in this Annual Report. Our Consolidated Financial Statements have been prepared in accordance with IFRS as issued by the IASB.

At its meeting on July 26, 2006, our Board of Directors agreed to restructure the way in which we are managed in order to respond to the increasing convergence of fixed and mobile telephony in the markets in which we operate. In order to adapt to this new environment, we have developed a regional, integrated management model, combining fixed line and mobile telephony services in order to offer customers the best integrated solutions and support in an era of fixed-mobile convergence. We are managed as three business areas: Telefónica Spain, Telefónica Europe and Telefónica Latin America, each of which oversees the integrated fixed and mobile telephone and other businesses in its region. Our three business areas form the basis of our segment reporting in our Consolidated Financial Statements.

##### Non-GAAP financial information

Operating income before depreciation and amortization

Operating income before depreciation and amortization, or OIBDA, is calculated by excluding depreciation and amortization expenses from our operating income in order to eliminate the impact of generally long-term capital investments that cannot be significantly influenced by our management in the short term. Our management believes that OIBDA is meaningful for investors because it provides an analysis of our operating results and our segment profitability using the same measure used by our management. OIBDA also allows us to compare our results with

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those of other companies in the telecommunications sector without considering their asset structure. We use OIBDA to track our business evolution and establish operational and strategic targets. OIBDA is also a measure commonly reported and widely used by analysts, investors and other interested parties in the telecommunications industry. OIBDA is not an explicit measure of financial performance under IFRS and may not be comparable to other similarly titled measures for other companies. OIBDA should not be considered an alternative to operating income as an indicator of our operating performance, or an alternative to cash flows from operating activities as a measure of our liquidity.

The following table provides a reconciliation of our OIBDA to operating income for the periods indicated.

	Year ended December 31,		
	2007	2008	2009
	(in millions of euros)		
Operating income before depreciation and amortization	22,824	22,919	22,603
Depreciation and amortization expense	(9,436)	(9,046)	(8,956)
Operating income	13,388	13,873	13,647

The following tables provide a reconciliation of OIBDA to operating income for us and each of our business areas for the periods indicated.

	Year ended December 31, 2009				
	Telefónica Spain	Telefónica Latin America	Telefónica Europe	Others and Eliminations	Total
	(in millions of euros)				
Operating income before depreciation and amortization	9,757	9,143	3,910	(207)	22,603
Depreciation and amortization expense	(2,140)	(3,793)	(2,895)	(128)	(8,956)
Operating income	7,617	5,350	1,015	(335)	13,647

	Year ended December 31, 2008				
	Telefónica Spain	Telefónica Latin America	Telefónica Europe	Others and Eliminations	Total
	(in millions of euros)				
Operating income before depreciation and amortization	10,285	8,445	4,180	9	22,919
Depreciation and amortization expense	(2,239)	(3,645)	(3,035)	(127)	(9,046)
Operating income	8,046	4,800	1,145	(118)	13,873

	Year ended December 31, 2007				
	Telefónica Spain	Telefónica Latin America	Telefónica Europe	Others and Eliminations	Total
	(in millions of euros)				
Operating income before depreciation and amortization	9,448	7,121	4,977	1,278	22,824
Depreciation and amortization expense	(2,381)	(3,559)	(3,386)	(110)	(9,436)
Operating income	7,067	3,562	1,591	1,168	13,388

Net financial debt and net debt

We calculate net financial debt by deducting the positive mark-to-market value of derivatives with a maturity beyond one year from the relevant balance sheet date and other interest-bearing assets (each of which are components of non-current financial assets in our consolidated statement of financial position), current financial assets and cash and cash equivalents from the sum of (i) current and non-current interest-bearing debt (which includes the negative mark-to-market value of derivatives with a maturity beyond one year) and (ii) other payables (a component of non-current trade and other payables in our consolidated statement of financial position). We calculate net debt by adding to net financial debt those commitments related to financial guarantees, not considered



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as net financial debt, and those related to workforce reduction. We believe that net financial debt and net debt are meaningful for investors because they provide an analysis of our solvency using the same measures used by our management. We use net financial debt and net debt to calculate internally certain solvency and leverage ratios used by management. Neither net debt nor net financial debt as calculated by us should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of our liquidity.

The following table provides a reconciliation of our net financial debt and net debt to gross financial debt at the dates indicated:

	As of December 31,		
	2007	2008	2009
	(in millions of euros)		
Non-current interest-bearing debt	46,942	45,088	47,607
Current interest-bearing debt	6,986	8,100	9,184
Gross financial debt	53,928	53,188	56,791
Other payables	327	477	515
Non-current financial assets(1)	(2,284)	(4,439)	(2,736)
Current financial assets	(1,622)	(2,216)	(1,906)
Cash and cash equivalents	(5,065)	(4,277)	(9,113)
Net financial debt	45,284	42,733	43,551
Commitments related to financial guarantees	365	365	71
Net commitments related to workforce reduction	3,289	2,687	2,261
Net debt	48,938	45,785	45,883

(1) Positive mark-to-market value of derivatives with a maturity beyond one year from the relevant statement of financial position date and other interest-bearing assets.

#### Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review

During the years ended December 31, 2007, 2008 and 2009, various changes occurred in our composition that affect the comparability of our operating results between the periods. See Appendix I to our Consolidated Financial Statements for a detailed description of the principal changes in our composition affecting our financial statements during the periods under review covered by our Consolidated Financial Statements. The most significant factors affecting the comparability of our results of operations in the periods under review are discussed below.

#### Classification of Venezuela as a hyperinflationary economy

Throughout 2009 and in the early part of 2010, a number of factors arose in the Venezuelan economy that led us to reconsider the treatments we follow with the respect to the translation of the financial statements of our investees, as well as the recovery of our financial investments in that country. Within these factors it is worth highlighting the level of inflation reached in 2009 and the cumulative inflation over the last three years, the restrictions to the official foreign exchange market and, finally, the devaluation of the Bolivar fuerte on January 8, 2010.

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As a result, in accordance with IFRS Venezuela must be considered a hyperinflationary economy in 2009. The main implications of this are as follows:

- The 2008 figures should not be restated.
- Adjustment of the historical cost of non-monetary assets and liabilities and the various items of equity of Venezuelan companies from the date of acquisition or inclusion in Telefónica's consolidated statement of financial position to the end of the year to reflect the changes in purchasing power of the currency caused by inflation.

The cumulative impact of the accounting restatement to adjust for the effects of hyperinflation for years prior to 2009 is reflected in the translation differences at the beginning of the 2009 financial year.

- Adjustment of the income statement to reflect the financial loss caused by the impact of inflation in the year on net monetary assets (loss of purchasing power).
- The various components in the income statement and statement of cash flows have been adjusted for the inflation index since their generation, with a balancing entry in net financial results and a reconciling item in the statement of cash flows, respectively.
- All components of the financial statements of the Venezuelan companies have been translated at the closing exchange rate, which at December 31, 2009 was 2.15 Bolivar fuerte per dollar (3.1 Bolivar fuerte per euro).

The main effects on the Telefónica Group's consolidated financial statements for 2009 derived from the items mentioned above are as follows:

	Million of euros
Revenue	267
Operating income excluding the impact of depreciation and amortization cost	64
Net profit	(548)
Translation differences	1,224
Impact on equity	676

Regarding the devaluation of the Venezuelan Bolivar fuerte on January 8, 2010 (see Note 2 to our Consolidated Financial Statements), the two main factors to consider with respect to the Telefónica Group's 2010 financial statements will be:

- The decrease in the Telefónica Group's net assets in Venezuela as a result of the new exchange rate, with a balancing entry in equity of the Group. This effect is estimated at approximately €1,810 million.
  - The translation of results and cash flows from Venezuela at the new devalued closing exchange rate.

Finally, on January 19, 2010, the Venezuelan Authorities announced that they would grant a preferential rate of 2.60 Bolivar fuerte per dollar for new items, among which payment of dividends is included, as long as the request for Authorization of Acquisition of Foreign Exchange was filed before January 8, 2010. To that date, we had in fact requested authorizations related to the distribution of dividends of prior years (see Note 16 to our Consolidated Financial Statements).

Tax amortization of goodwill

In December 2007, the European Commission opened an investigation involving the Kingdom of Spain relating to the potential consideration of the deduction for tax amortization of financial goodwill arising on certain foreign shareholding acquisitions as government aid under the provisions of article 12.5 of the revised Spanish Income Tax Law (“TRLIS”). This investigation led to widespread uncertainties regarding the effect any decision by the European Commission would have on, among others, the Telefónica Group.

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In the case of the Telefónica Group, as a result of this uncertainty we deemed it necessary to recognize a liability as the deduction had been applied in the consolidated financial statements pending completion of the investigation.

In December 2009, the European Commission released its decision regarding the investigation, deeming the deduction as state aid. However, this decision does not affect investments made before December 21, 2007, which is the case with the investments made by the Telefónica Group in companies such as O2, Bellsouth's Latin America operators, Colombia Telecomunicaciones, S.A. ESP and Cesky Telecom. As a result of this decision, and considering the corporate structure of these investments, income tax in our consolidated income statement for the year ended December 31, 2009 is €591 million lower due to the reversal of this liability.

Share exchange between Telefónica, S.A. and China Unicom Limited, and signing of strategic alliance.

On October 21, 2009, pursuant to our previously described strategic alliance agreement with China Unicom, we exchanged 40,730,735 of our shares for 693,912,264 newly issued shares of China Unicom. As a result of this exchange, our voting interest in the share capital of China Unicom increased from 5.38% to 8.06%, and China Unicom has a 0.87% voting interest in our share capital at that date. As of the date of this Annual Report, and after the capital reduction carried out by China Unicom, we hold shares representing 8.37% of China Unicom's voting share capital and the right to appoint a member to its board of directors.

As a result, our investment in China Unicom is now accounted for using the equity method. The cumulative amount of this investment at December 31, 2009 was €2,301 million.

Tender offer for all the remaining outstanding shares of Compañía de Telecomunicaciones de Chile, S.A.

On September 17, 2008, we launched a tender offer through our subsidiary Telefónica Internacional to acquire all the outstanding shares of CTC that we did not already control directly or indirectly, amounting to 55.1% of CTC's share capital.

Once the acceptance period had ended and the transaction had been settled on October 30, 2008 our indirect ownership in CTC increased from 44.9% to 96.75%. This is the percentage that appears as the percentage of ownership as of December 31, 2008 in the accompanying Consolidated Financial Statements.

Subsequently, pursuant to Chilean law, on December 1, 2008, Telefónica Internacional launched a new tender offer for all the shares of CTC that it did not own directly or indirectly after settlement of the first offer, on the same economic terms. The acceptance period for the second offer ended December 31, 2008, but was then extended to January 6, 2009, as allowed by Chilean law.

Upon the end of the acceptance period of the second tender offer, our indirect ownership percentage in CTC's share capital had increased from 96.75% of all CTC's outstanding shares, as reached in the first tender offer, to 97.89%. The total payment for the two tranches was 558.55 million Chilean pesos, equivalent to approximately €658 million.

Sale of shareholding in Airwave O2, Ltd.

In April 2007, Telefónica O2 Europe, Plc, our wholly-owned subsidiary, sold 100% of the share capital of the UK company, Airwave O2, Ltd, for £1,932 million (equivalent to €2,841 million at the transaction date). The sale produced a gain of €1,296 million, recognized under "Other income" in our consolidated income statement for 2007. See Note 19 to our Consolidated Financial Statements.

Sale of shareholding in Endemol Investment Holding, B.V.

In May 2007, we signed an agreement to sell our 99.7% stake in the Dutch company Endemol Investment Holding, B.V. to a consortium owned by Mediacinco Cartera, S.L., Cyrte Fond II, B.V. and G.S. Capital Partners VI Fund, L.P, for €2,629 million. The transaction was completed on July 3, 2007, producing a gain of €1,368 million, recognized under “Other income” in our consolidated income statement for 2007. See Note 19 to our Consolidated Financial Statements.

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### Acquisition of indirect shareholding in Telecom Italia

On April 28, 2007, we, together with our partners Assicurazioni Generali, S.p.A., Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A. and Sintonía, S.A., entered into a co-investment agreement and shareholders' agreement which established the terms and conditions of our acquisition of an indirect shareholding in Telecom Italia through an Italian company, Telco, in which we have a 42.3% interest. Both agreements were modified on October 25, 2007 to include the Assicurazioni Generali Group companies, and the shareholders' agreement was further amended on November 19, 2007.

On October 25, 2007 Telco acquired 100% of Olimpia, S.p.A., which held 18% of the voting shares of Telecom Italia. Also on that date, Assicurazioni Generali S.p.A. (together with its group companies Alleanza Assicurazioni S.p.A., INA Assitalia S.p.A., Volksfürsorge Deutsche Lebensversicherung A.G. and Generali Vie S.A.) and Mediobanca S.p.A. contributed an aggregate of 5.6% of Telecom Italia's voting shares to Telco.

On December 10, 2007, an agreement was reached to merge Olimpia, S.p.A. into Telco, as a result of which Telco's entire stake in the voting shares of Telecom Italia (23.6%) became a direct stake.

In March 2008, Telco acquired an additional 121.5 million shares of Telecom Italia (representing 0.9% of its share capital), bringing its ownership to 24.5% of the voting rights and 16.9% of the dividend rights. As a result, we indirectly hold 10.49% of Telecom Italia voting rights and 7.21% of its dividend rights. We account for our investment in Telco using the equity method.

On December 22, 2009, Telco and Sintonia completed (i) the acquisition in cash by Sintonia of the Telecom Italia shares held by Telco attributable to it on a pro rata basis (approximately 275.1 million Telecom Italia ordinary shares, equal to 2.06% of the ordinary share capital) at a price of €2.2 per share, a total purchase price of approximately €605 million; and (ii) the acquisition by Telco of Sintonia's entire shareholding in Telco (approximately 162.8 million class A shares, equal to 8.39% of Telco's share capital). For additional information on this acquisition see Note 2 to our Consolidated Financial Statements and "Item 10. Additional Information—Material Contracts".

### Significant Changes in Accounting Policies

The accounting policies applied in the preparation of our consolidated annual financial statements as of and for the year ended December 31, 2009 are consistent with those used in the preparation of our consolidated annual financial statements as of and for the year ended December 31, 2008, except for the adoption of new standards, amendments to standards and interpretations published by the International Accounting Standards Board (IASB) and the IFRIC (International Financial Reporting Interpretations Committee), effective as of January 1, 2009, noted below.

#### Amendment to IAS 23: Borrowing Costs

The amendment consists of the elimination of the possibility to immediately recognize in profit or loss the borrowing costs related to the production or development of qualifying assets. This amendment has had no impact on the accounting policies applied by us.

#### Amendment to IAS 1: Presentation of Financial Statements: A Revised Presentation

The revised standard separates owner from non-owner changes in equity. The statement of changes in equity includes only details of transactions with owners, with non-owner changes presented as a single line item. In addition, the standard introduces the "statement of comprehensive income", which can be presented in one single statement or in two linked statements. We elected to present two statements. This change is not mandatory, but we have decided to use the

proposed titles, which are:

- “statement of financial position”, instead of “balance sheet”
- income statement

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- “statement of comprehensive income”, instead of “statement of recognized income and expense”
  - “statement of changes in equity” instead of “movements in equity”
  - “statement of cash flows” instead of “cash flow statement”

### Amendment to IFRS 2: Share-based Payment: Vesting Conditions and Cancellations

This amendment clarifies the definition of vesting conditions and prescribes the accounting treatment of an award that is cancelled because a non-vesting condition is not met. The adoption of this amendment did not have any impact on our financial position or performance.

### Amendments to IAS 32 and IAS 1: Presentation of Financial Statements — Puttable Financial Instruments and Obligations Arising on Liquidation

These amendments include a limited scope exemption for puttable financial instruments to be classified as equity if they fulfill specified criteria. The adoption of these amendments did not have any impact on our financial position or performance.

### Improvements to IFRSs (issued by the IASB in May 2008)

These improvements establish a broad range of amendments to current IFRSs with the primary aim of removing inconsistencies and clarifying wording. These amendments have not had any impact on our financial position or performance.

### Amendments to IFRS 7: Financial Instruments: Disclosures

This amendment enhances the disclosures required about fair value measurements and liquidity risk. The amendment requires the classification of fair value measurements using a three-level hierarchy that reflects the significance of the inputs used in making the measurement, as well as the disclosure of any eventual change in valuation techniques and the reasons for making such change. These amendments have not had any impact on our financial position or performance.

### Amendments to IFRIC 9 and IAS 39: Embedded derivatives

These amendments clarify the impact that a reclassification of a financial asset out of the fair value through profit or loss category has on the assessment of whether an embedded derivative shall be separated from its host contract. Additionally, it prohibits the reclassification when the embedded derivative is not subject to a separate valuation upon the moment of reclassification of a hybrid contract out of the aforementioned category. These amendments have not had any impact on our financial position or performance.

### IFRIC 12: Service Concession Arrangements

This interpretation provides guidance on the accounting by operators for obligations assumed and related rights acquired under service concession arrangements. The adoption of this interpretation did not have any impact on our financial position or performance.

### IFRIC 13: Customer Loyalty Programs



This interpretation establishes that entities that have programs which award points or credits to their customers as the result of a commercial transaction, which in the future will be redeemed for free or discounted products or services, must treat these points as part of the commercial transaction that generates them. In other words, it is a transaction with multiple components, comprising the sale of the product or service itself and the sale of points or credits, therefore such that a part of the amount earned must be allocated to the points awarded and its recognition deferred until their redemption. The portion corresponding to the points will be determined by reference to their fair value. The adoption of this interpretation did not have a significant impact on our financial position or performance.

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## IFRIC 15: Agreements for the Construction of Real Estate

This interpretation refers to agreements for the construction of real estate and addresses two related issues: (i) whether the construction of real estate is within the scope of IAS 11, Construction Contracts, or IAS 18, Revenue and (ii) when revenue from the construction of real estate should be recognized. The adoption of this interpretation did not have any impact on our financial position or performance.

## IFRIC 16: Hedges of a Net Investment in a Foreign Operation

This interpretation establishes the criteria for the recognition of hedges of a net investment in foreign operations, including the foreign currency risks that qualify for hedge accounting in the hedge of a net investment, where within the group the hedging instruments can be held and how an entity should determine the amount of foreign currency gain or loss relating to both the hedging instrument and the hedged item that must be recognized in profit or loss on disposal of the investment. The adoption of this interpretation did not have any impact on our financial position or performance.

## IFRIC 18: Transfers of Assets from Customers

This interpretation applies to deliveries of assets from customers as of July 1, 2009. This interpretation establishes the criteria for accounting for transactions in which an entity receives from a customer an item of property, plant and equipment (or cash for their acquisition or construction) that the entity must use either to connect the customer to a network and/or to provide the customer with ongoing access to a supply of goods or services. The adoption of this interpretation did not have any impact on our financial position or performance.

In addition to this, an amendment to IAS 39 concerning intersegment hedge accounting included in the Improvements to IFRSs issued by the IASB in April 2009 is effective for annual periods beginning on or after January 1, 2009, but is not endorsed by the European Union as of the date of publication of these consolidated financial statements. This amendment clarifies that hedge accounting not be applied to transactions between segments in accordance with the principle in IAS 39, which does not allow hedge of intragroup transactions in the consolidated financial statements. The application of this amendment would not have had any impact on the 2009 consolidated financial statements.

Finally, the following IFRS and IFRIC interpretations were issued but not effective at the date of preparation of our Consolidated Financial Statements:

Standards and amendments		Mandatory application: annual periods beginning on or after
IFRS 9	Financial Instruments	January 1, 2013
Revised IFRS 3	Business Combinations	July 1, 2009
	Consolidated and Separate Financial Statements	July 1, 2009
Amendment to IAS 27		July 1, 2009
Improvements to IFRS (April 2009)		January 1, 2010 (*)
Revised IAS 24	Related Party Disclosures	January 1, 2011
Amendments to IAS 39	Eligible Hedged Items	July 1, 2009
Amendment to IFRS 2	Group Cash settled Share-based Payments	January 1, 2010
Amendment to IFRS 1		January 1, 2010

	Additional Exemptions for First-time adopters	
Amendments to IAS 32	Classification of Rights Issues	February 1, 2010

(\*) The amendments to IFRS 2, IAS 38 (relating to intangible assets acquired in business combinations) IFRIC 9 and IFRIC 16 are effective for all fiscal years beginning July 1, 2009. There is no mandatory application date for the additional guidance to the appendix of IAS 18 on the determination of agent/principal because this appendix is not part of the standard.

Interpretations		Mandatory application: annual periods beginning on or after
IFRIC 17	Distributions of Non-cash Assets to Owners	July 1, 2009
	Extinguishing Financial Liabilities with Equity	
IFRIC 19	Instruments	July 1, 2010
Amendment to IFRIC 14	The limit of a Defined Benefit Asset, Minimum Funding Requirement and their Interaction	January 1, 2011

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We are currently assessing the impact of the application of these standards, amendments and interpretations. From the analyses made, we estimate that their adoption will not have a significant impact on our consolidated financial statements in the initial period of application. However, the changes introduced by the revised IFRS 3 and amendments to IAS 27 will affect future acquisitions and transactions with non-controlling interests carried out on or after January 1, 2010. The changes introduced by IFRS 9 will affect financial assets and future transactions with financial assets carried out on or after January 1, 2013.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions that affect the amounts reflected in the Consolidated Financial Statements and accompanying notes. We base our estimates on historical experience, where applicable, and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from those estimates under different assumptions or conditions.

We consider an accounting estimate to be critical if:

- it requires us to make assumptions because information was not available at the time or it included matters that were highly uncertain at the time we were making our estimate; and
- changes in the estimate or different estimates that we could have selected may have had a material impact on our financial condition or results of operations.

The various policies that are important to the portrayal of our financial condition, results of operations and cash flows include:

- accounting for long-lived assets, including goodwill;
  - deferred taxes;
  - provisions; and
  - revenue recognition.

Accounting for long-lived assets, including goodwill

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. If such assets are acquired in a business combination, the acquisition cost is the estimated fair value of the acquired property, plant and equipment or intangible assets. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives.

Intangible assets with indefinite useful lives are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining: (a) the fair value at the acquisition date in the case of such assets acquired in a business combination, and (b) the useful lives of the assets over which they are to be depreciated or amortized. We believe that the estimates we make to determine an asset's useful life are "critical accounting estimates" because they require our management to make estimates about technological evolution and competitive uses of assets.

When an impairment in the carrying amount of an asset occurs, non-scheduled write-downs are made. We perform impairment tests of identifiable intangible and long-lived assets whenever there is reason to believe that the carrying value may exceed the recoverable amount, which is the higher of the asset's fair value less costs to sell and its value in use. Furthermore, previously recognized impairment losses may be reversed when changes in the estimates used to determine the asset's recoverable amount indicate that an impairment loss recognized in prior periods no longer exists or may have decreased.

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The determination of whether the impairment of long-lived and intangible assets is necessary involves the use of significant estimates and judgment that includes, but is not limited to, the analysis of the cause of potential impairment in value, the timing of such potential impairment and an estimate of the amount of the impairment, which requires the estimation of the future expected cash flows, discount rates and the fair value of the assets.

Specifically, management has to make certain assumptions in respect of uncertain matters, such as growth in revenues, changes in market prices, operating margins, and technology developments and obsolescence, discontinuance of services and other changes in circumstances that indicate the need to perform an impairment test. Management's estimates about technology and its future development require significant judgment because the timing and nature of technological advances are difficult to predict.

Goodwill arises when the cost of a business combination exceeds the acquirer's interest in the net fair value of the identifiable assets acquired and liabilities and contingent liabilities assumed. Goodwill is not amortized, but is, instead, subject to an impairment test on a yearly basis and whenever there is an indication that the goodwill may be impaired.

Non-scheduled write-downs of goodwill are made when an impairment in the carrying amount of goodwill occurs. We review, on a regular basis, the performance of our cash-generating units. We compare the carrying amount of the cash-generating unit to which the goodwill has been allocated with its recoverable amount. The determination of the recoverable amount of the cash-generating unit involves extensive use of estimates and significant management judgment is involved. Methods commonly used by us for valuations include discounted cash flow methods.

A significant change in the facts and circumstances that we relied upon in making our estimates may have a material impact on our operating results and financial condition.

### Deferred taxes

Management assesses the recoverability of deferred tax assets on the basis of estimates of our future taxable profit. The recoverability of deferred tax assets ultimately depends on our ability to generate sufficient taxable profit during the periods in which the deferred tax assets are utilized. In making this assessment, our management considers the scheduled reversal of deferred tax liabilities, projected taxable profit and tax planning strategies.

This assessment is carried out on the basis of internal projections, which are updated to reflect our most recent operating trends. In accordance with applicable accounting standards, a deferred tax asset must be recognized for all deductible temporary differences and for the carry-forward of unused tax credits and unused tax losses to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized. Our current and deferred income taxes are impacted by events and transactions arising in the normal course of business as well as in connection with special and non-recurring items. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting our income tax balances.

### Provisions

Provisions are recorded when, at the end of the period, we have a present obligation as a result of past events, whose settlement requires an outflow of resources that is considered probable and can be measured reliably. This obligation may be legal or constructive, arising from, but not limited to, regulation, contracts, common practice or public

commitments, which have created a valid expectation for third parties that we will assume certain responsibilities. The amount recorded is the best estimation performed by the management in respect of the expenditure that will be required to settle the obligations, considering all the information available at the closing date, including the advice of external experts, such as legal advisors or consultants.

If we are unable to reliably measure the obligation, no provision is recorded and information is then presented in the notes to the Consolidated Financial Statements.

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Because of the inherent uncertainties in this estimation, actual expenditures may be different from the originally estimated amount recognized.

### Revenue recognition

#### Connection fees

Revenues from connection fees originated when customers connect to our network are deferred over the average expected length of the customer relationship.

The expected customer relationship period is estimated based on recent historical experience of customer churn rates. Significant changes in our estimations may result in differences in the amount and timing of revenues recognized.

#### Multiple-element arrangements

Arrangements involving the delivery of bundled products or services are assessed to determine whether it is necessary to separate the arrangement into individual component deliverables, each with its own revenue recognition criteria.

Revenue relating to the bundled contract is allocated to the different deliverables identified, based on their relative fair values (i.e., the fair value of each individual component deliverables in relation to the total fair value of the bundled deliverables). Given that the handsets and airtime are price-sensitive and volatile in a competitive marketplace, the determination of fair values in the mobile phone business is quite complex.

Additionally, a significant change in the facts and circumstances upon which we based our fair value estimates may have an impact on the allocation of revenue among the different deliverables identified and, consequently, on future revenues.

### Operating Environment

Our results of operations are dependent, to a large extent, on the level of demand for our services in the countries in which we operate. Demand for services in those countries is affected by the performance of their respective economies, including changes in gross domestic product, or GDP, inflation, or CPI, external accounts and unemployment rates.

#### Operating environment by country

##### Spain

In 2009, Spanish GDP contracted by 3.6%, compared with a positive average annual growth rate of 3.6% in the period 1998 through 2008. This slowdown was explained by a strong deceleration of internal demand, both household consumption which contracted at an annual rate of 5.0% during 2009 compared to average growth of 3.3% during the period 1998 through 2008, and investment which contracted at an annual rate of 15.0% in 2009 compared to average annual growth of 3.4% during the period 1998 through 2008. Inflation averaged -0.3% in 2009, compared with 4.1% in 2008 and 2.8% in 2007. Despite the lower average annual inflation rate, prices in 2009 experienced a high degree of volatility through the year, reaching a minimum of -1.4% in July and increasing up to 0.8% by the end of the year. The current account deficit for 2009 reached 5.6% of GDP, almost half the percentage in the prior two years (9.5% of GDP in 2008 and 10.0% in 2007). This improvement was mostly explained by the trade balance (imports fell significantly more than exports due to the sharp slowdown in domestic demand). The unemployment rate reached



18.8% at the end of the year, notably higher than the average rate of 13.9% in 2008 and 8.6% in 2007. The increase in the unemployment rate was mostly explained by the poor employment performance during 2009; 1.2 million jobs were lost, twice the number of 2008 (619,000) and a reversal from 2007 when 475,000 jobs were created in Spain.

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## United Kingdom

In 2009, the British economy, measured in terms of GDP, contracted by 4.8%, compared with a positive growth rate of 0.6% in 2008 and 2.6% in 2007. A sharp slowdown in domestic demand in 2009 explained the negative GDP growth. In addition, during 2009, fixed capital investment contracted at an annual rate of 14.6%, compared to a contraction of 3.5% in 2008 and growth of 7.9% in 2007. Private consumption deteriorated less severely, falling at an annual rate of 3.1% in 2009, compared with a positive annual growth rate of 0.9% in 2008 and 2.1% in 2007. The CPI increased by an average annual growth rate of 2.2% in 2009, compared with 3.6% in 2008 and 2.3% in 2007. The deceleration in the rate of average annual CPI growth was partially explained a temporary VAT reduction of 2.5 percentage points (from 17.5% to 15.0%) and worsening consumer demand. During the first ten months of 2009, employment decreased at an annual rate of 1.6%, compared to an annual increase of 0.7% in both 2008 and 2007 (Labor Force Survey). As a result, the unemployment rate reached 7.8% in December 2009, compared to an average annual rate of 5.7% in 2008 and 5.3% in 2007.

## Germany

In 2009, the German economy contracted 5.0%, after growing 1.3% in 2008 and 2.5% in 2007. This significant slowdown was due to a contraction in fixed income investment of 8.6% in 2009, and the negative contribution of the external sector to GDP growth (exports decreased 14.6% while imports contracted just 8.9%). Because of this, the current account balance declined to 4.2% of GDP in 2009, from 6.6% of GDP in 2008 and 8.0% of GDP in 2007. Inflation averaged 0.3% in 2009, which was significantly less than the average in 2008 and 2007 (2.6% and 2.3%, respectively) At the end of 2009, inflation stood at 0.8%. During 2009, the unemployment rate stood at 8.2%, slightly higher than the rate in 2008 (7.8%) but not reaching 2007 levels (9.0%). However, in 2009, 186,000 jobs were lost, compared to a positive job creation of 296,000 in 2008 and 591,000 in 2007.

## Czech Republic

The Czech economy contracted by 4.1% in 2009 as opposed to growth of 2.5% in 2008 and 6.1% in 2007. Internal demand in 2009 underperformed with respect to previous years mainly due to investment, which decreased by 8.3% in 2009 compared to a decrease of 1.5% in 2008 and growth of 10.8% in 2007. Household consumption contracted 0.1% in 2009, compared to growth of 3.5% and 4.9% in 2008 and 2007, respectively. Inflation, as measured by the CPI, grew 1% in December 2009 compared to December 2008, well below the Central Bank objective (2%) and well below the 6.3% and 2.9% levels reached in 2008 and 2007, respectively. The current account had a €1.5 billion deficit for 2009, higher than the €1 billion deficit recorded in 2008 but lower than the €4 billion deficit of 2007. However, net foreign direct investment was clearly lower than in past years. During 2009, net foreign direct investment decreased 35% with respect to 2008 (€1 billion in 2009 compared to €1.5 billion in 2008). The increase in global risk aversion negatively affected the Czech crown, with the average Czech crown to euro exchange rate for 2009 depreciating by 6% against the euro in 2009, contrasting with a 10.1% appreciation in 2008 and 2.1% in 2007.

## Brazil

Brazil's 2009 GDP was negatively affected by the economic downturn, which began in the last quarter of 2008. As expected by economic forecasters surveyed by Focus Economics, positive quarterly growth in GDP since the second quarter of 2009 did not compensate for the contraction in the previous quarters. As a result, Brazilian GDP decreased 0.2% in 2009, after posting growth of 5.1% in 2008 and 6.1% in 2007. The same forecasters expect the expansion of private consumption in 2009 to be 3.0%, less than half of the 7.0% growth rate reached in 2008 and the 6.3% recorded in 2007. Investment decreased by 9.9% in 2009, after rising by 13.4% in the previous year and 13.9% in 2007. Inflation, as measured by the CPI, slowed down to an increase of 4.3% in 2009, below the inflation target established by the Central Bank, of 4.5%, and lower than the 5.9% posted in 2008 and 4.5% in 2007. Due to the deceleration of

economic activity and inflation, the basic interest rate, the SELIC, was reduced from 13.75% to 8.75%. The current account deficit reached \$24.3 billion in 2009, compared to \$28.2 billion in 2008 and a surplus of \$1.6 billion in 2007. This deficit in 2009 was financed by capital inflows, such as foreign direct investments of \$25.9 billion and portfolio investments of \$46.7 billion. As a consequence, international reserves rose by \$32.2 billion in 2009, to a record level of \$239.1 billion. The improvement in domestic economic data, along with increased liquidity in the international capital markets, led to a decrease in country risk. The J.P. Morgan Emerging

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Markets Bond Index Plus (EMBI + Brazil) ended 2009 at 197 basis points, from 428 basis points at the end of 2008 and 221 basis points at the end of 2007. As the risk reduced and capital inflows gained strength, the exchange rate restarted its appreciation trend, as observed since 2004. The Brazilian real appreciated against the U.S. dollar by 25.6% in 2009, reaching an exchange rate of R\$1.74/ \$1.00 on December 31, 2009, from R\$2.34 per \$1.00 by the end of 2008 and R\$1.77 per \$1.00 at the end of 2007.

## Mexico

Mexico's real GDP shrank 6.5% in 2009 compared to a previous growth of 1.4% in 2008 and 3.3% in 2007. Inflation, as measured by the CPI, grew 3.6% in December 2009 compared to December 2008, slightly above the central bank's target of 3% but within its tolerance range of 2% to 4%. Inflation was highly reduced with respect to 2008 (6.5% growth in December 2008 with respect to December 2007) due to a fall in agricultural prices and to the introduction of fuel subsidies by the government during 2009. Mexico has been the country with the most severe contraction in Latin America, suffering from its high exposure to the U.S. economy and from the swine flu epidemic that reduced tourism and the already declining capital inflows. However, this recession differs from previous ones in that Mexico has been better prepared, having sound macroeconomic fundamentals including a solvent fiscal position, a floating exchange rate system and an independent central bank committed to price stability. Moreover, the lines provided by the U.S. Federal Reserve and the International Monetary Fund, or IMF, contributed to greater financial resilience. Despite the harsh economic downturn, the second half of 2009 was promising. The Mexican economy, in terms of GDP, grew 2.9% quarter-on-quarter during the third quarter of 2009 and 2.0% quarter-on-quarter during the fourth quarter of 2009. The trade balance posted a deficit of \$4.7 billion, \$12.9 billion lower than in 2008 due to a higher fall in imports as a consequence of the internal demand collapse. These external imbalances were well financed by capital inflows, which grew in the last quarter, and international reserves held by the central bank reached a new record of \$90.9 billion in 2009 (amounting to 10.2% of GDP). The exchange rate relative to the U.S. dollar reached a maximum in March 2009 of 15.56 Mexican pesos to the U.S. dollar, a level never seen before. However, from that moment the exchange rate relative to the U.S. dollar appreciated. It closed at 13.06 Mexican pesos to the U.S. dollar at the end of 2009, 4.3% more compared to the end of 2008 but 20% less with respect to the end of 2007.

## Venezuela

The Venezuelan economy reversed from the positive results demonstrated during the previous five years. In 2009, GDP contracted approximately 3.3% as a result of lower oil prices in the first part of the year and high inflation. Both factors had a negative impact on private consumption, which decreased by 3.2% in 2009, compared to growth of 7.1% in 2008 and 18.7% in 2007. The rest of the components of aggregate demand, also slowed markedly below the figures recorded in 2008 and 2007. In 2009, investment dropped 20.0% (growth of 2.5% in 2008 and 23.0% in 2007), public consumption grew 2.3% (growth of 6.7% in 2008 and 6.1% in 2007), exports fell 12.9% (decreases of -2.7% in 2008 and -7.0% in 2007), and imports faced dramatic contraction of 19.6% (growth of 3.8% in 2008 and 29.9% in 2007). In terms of inflation, the national CPI rose to 25.1% in 2009, which represents a lower figure in comparison with 30.9% in 2008 and 22.5% in 2007 (The national CPI was created in 2008 and because of that, 2007 variation corresponded to Caracas CPI); however, Venezuela continues with the highest levels of inflation in Latin America. The unemployment rate reached 6.6% at the end of 2009, which was higher than the 6.1% observed in December 2008 and 6.2% in December 2007, because of the fall in economic activity. The external accounts suffered a negative impact as a result of lower oil prices, with the current account surplus decreasing to \$8.6 billion in 2009, in comparison with \$37.4 billion in 2008 and \$18.1 billion in 2007. On the other side, the capital account deficit reached \$14.0 billion, which was lower than the deficit in 2008 (\$24.8 billion) and 2007 (\$22.1 billion). This performance generated a reduction in the central bank's stock of international reserves to \$35.0 billion at the end of 2009. Finally, the parallel exchange rate was 2.8 times over the official exchange rate, as a result of the reduction imposed by CADIVI (the Venezuelan Commission for Currency Administration) on hard currency disbursements during the year.

Chile

Due to the international financial crisis, the Chilean economy, in terms of GDP, contracted by an estimated 1.7% in 2009 compared to growth of 3.1% and 4.7% in 2008 and 2007, respectively. This contraction in 2009 is explained by a 6.8% decrease in domestic demand, mainly caused by a 16.4% decrease in investment and an

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historical reduction in inventories. Employment contracted by an average of 0.7% in 2009 resulting in an average unemployment rate of 9.7% (with a peak of 10.8% in the first half of the year) compared to 7.7% and 7.0% in 2008 and 2007, respectively. In the worst phase of the recession, economic activity plunged 5.1% year-on-year in April 2009. A \$4 billion (2.8% of GDP) stimulus program that included temporary tax cuts, cash bonuses, and employment subsidies was implemented by fiscal authorities to avoid a further decline. The Chilean central bank, on its side, cut its monetary rate by 775 basis points down to 0.5% in an effort to ease local financial conditions. Both, monetary and fiscal measures fueled activity in the second half of 2009. Inflation, as measured by the CPI, which was the main concern in previous years, dropped sharply and decreased by 1.4% compared to 2008, the first negative data in 75 years. Despite a reduction in export volume, the trade balance had a surplus of \$13.3 billion in 2009 (compared to \$8.8 billion in 2008 and \$23.6 billion in 2007), mostly explained by the strong increase in copper prices (a commodity that represents approximately half of Chilean total exports) and a fall in imports (volume and prices). The fears of a sudden stop of financial inflows receded quickly as foreign direct investment net inflows for 2009 reached \$4 billion, an amount that, however, represents less than a half compared to \$9.9 billion and \$9.6 billion in 2008 and 2007, respectively. At the end of 2009, the nominal Chilean peso to U.S. dollar exchange rate was 506.7, an appreciation of 20% with respect to the exchange rate at the end of 2008 (629.1 pesos per U.S. dollar), that was driven by copper prices, growing opportunities derived from the strong recovery of shares and the fiscal funding needs (mostly satisfied with dollar selling in the local market). For the first time since 2003, the country had a public deficit of around 4.5% of GDP, mostly explained by the countercyclical measures implemented to mitigate the recession as previously mentioned. As a proof of its solid financial position the Chilean government financed this deficit almost exclusively with savings, its sovereign Economic and Social Stabilization Fund was reduced by an aggregate amount of \$9 billion, from an initial balance of \$20 billion.

## Argentina

Argentina's GDP grew 0.9% in 2009 according to official statistics, although private estimates suggest that GDP contracted 4.3% in the period. This data contrasts with the average annual growth rates of approximately 8.5% achieved during each of the six preceding years (from 2003 through 2008). The Argentine peso depreciated 10.1% relative to the U.S. dollar, closing at 3.8 Argentine pesos per U.S. dollar at the end of 2009 compared to 3.45 Argentine pesos per U.S. dollar at the end of 2008 and 3.15 Argentine pesos per U.S. dollar at the end of 2007. The official CPI increased 7.7% in 2009 (compared to 7.2% in 2008 and 8.5% in 2007), although private entities estimate that the true increase was 14.3%. The current account balance showed a surplus of \$11.3 billion in 2009, which is 60.5% and 52.9% higher compared to 2008 and 2007, respectively. The trade balance contributed significantly to this result since imports decreased 31.9%, more than the 20.4% decline in exports over the same period. Economic conditions also affected unemployment, which increased to 8.4% at the end of 2009 from 7.3% at the end of 2008 and 7.5% at the end of 2007.

## Colombia

After the deceleration in GDP growth in 2008 (2.5% year-on-year compared with 7.5% year-on-year in 2007), in 2009 the Colombian economy entered into a recession as a result of the global financial crisis, an upsurge in its trade deficit and deterioration of neighboring economies. In particular, industry and retail sales were especially affected. The unemployment rate averaged 12% in 2009, moderately higher than the average rate in the prior two years (11.3% in 2008 and 11.2% in 2007). For 2009 analysts forecast GDP growth near 0.1% which may be explained by a better than expected last quarter. The incipient recovery is dependent upon a recovery in consumer confidence, a strong decrease in the CPI year-on-year (which increases real income), expansionary monetary policy implemented by the Colombian central bank in 2009 and further decreases in imports to lower trade imbalances. The current account deficit dropped from 2.8% of GDP in 2008 (same level in 2007) to 2.0% of GDP in 2009. During 2009, the Colombian peso appreciated relative to the U.S. dollar by 8.9% compared to a depreciation of 11.4% in 2008 and an appreciation of 10% in 2007. This appreciation was supported by a smaller than expected decrease in foreign investment (especially

in the mining and oil sectors) and U.S. dollar inflows from the central government and Ecopetrol. The deceleration in the rate of annual CPI growth was partially explained by the weak aggregate demand in 2009 compared to 2008. In addition, food and regulated sector inflation moved prices below the low band of the Colombian central bank's target of 4.5%. Year-on-year CPI dropped from 7.7% for 2008 compared to 2007 to 2.0% for 2009 compared to 2008.

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## Peru

During 2009, the Peruvian economy, in terms of GDP, grew by 0.9% compared to 9.8% in 2008 and 8.9% in 2007, well-above the region's results. The deceleration in GDP growth was mainly driven by a fall in domestic demand of 2.9%, with a significant decrease in private investment of 15.2%, while private consumption grew at only 1.9%. However, the fiscal stimulus implemented by the Peruvian government in 2009 contributed significantly to economic activity, with government spending growing 16.5% in 2009. Consumer prices, as measured by the CPI, increased by 0.3% in 2009, 0.7 percentage points below the lower limit of the central bank's target, compared with 6.7% in 2008 and 3.9% in 2007. The fiscal deficit was 2.1% of GDP, compared to the surplus of 2.1% in 2008, and a surplus of 3.1% in 2007, while net foreign direct investment decreased by 30%, compared with a gain of 14% in 2008 and 56% in 2007. In the foreign exchange market, the Peruvian nuevo sol appreciated 8% against the U.S. dollar in 2009, reaching 2.89 Peruvian nuevo sol per U.S. dollar at the end of the year, compared with a depreciation of 4.8% in 2008. Country risk, measured by the J.P. Morgan Emerging Markets Bond Index (EMBI Peru), fell 344 basis points to 165 basis points in 2009, explained by a gradual decrease in risk aversion to emerging markets, mainly in the first half of the year. Finally, Moody's Investors Service assigned investment grade status to Peruvian Long Term Foreign Currency Debt (BBB-/outlook stable), due to solid macroeconomic fundamentals, highlighted by sound public finances, financial markets dynamism, and a reduction of external vulnerabilities.

## Ecuador

Ecuador's real GDP growth reached approximately 0.98% in 2009, compared to the growth of 6.5% in 2008 and 2.5% in 2007, as a result of the underperformance of several domestic demand components, primarily private consumption and investment. Consumer prices, as measured by CPI, rose 4.3% in 2009 (8.8% in 2008 and 3.3% in 2007), explained by lower food and beverages prices. In the external sector, the trade balance reached a deficit of \$332 million in 2009, almost \$1,240 million less than the surplus 2008, mainly as a result of the sharp correction in oil prices during the first half of 2009 and due to global economic slowdown, which had a negative effect over the country's non-oil exports. Ecuador's non-oil trade deficit grew by 34% to \$4.9 billion in 2009 from \$7.5 billion in 2008 and \$4.3 billion in 2007. Consequently, the dollarization regime under which the country has operated since 2000 will likely be under stress during the beginning of 2010 and for as long as the still uncertain external environment (volatility in commodity prices and global economic weakness) affects Ecuador's external and fiscal accounts. During 2009, Ecuador lost \$0.7 billion of its free disposable international reserves. Nevertheless, Ecuador's public finances have been supported by an improvement in tax revenues, multilateral agencies' loans and bilateral investment agreements. Finally, country risk, measured by J.P. Morgan Emerging Markets Bond Index (EMBI Ecuador), fell 3,962 points to 769 points during 2009, due to an improvement in the country's external net debt position and to a gradual reduction in the risk aversion to emerging markets.

## Exchange Rate Fluctuations

We publish our Consolidated Financial Statements in euro. Because a substantial portion of our assets, liabilities, revenues and profit are denominated in currencies other than the euro, we are exposed to fluctuations in the values of these currencies against the euro. Currency fluctuations have had and may continue to have a material impact on our financial condition, results of operations and cash flows.

We estimate that in 2009 variations in currencies increased our consolidated cash flows by approximately €269 million and decreased our consolidated revenues by approximately 3.1%. Currency fluctuations can also have a significant impact on our statement of financial position, particularly equity attributable to equity holders of the parent, when translating the financial statements of subsidiaries located outside the euro zone into euro. For example, in 2009 equity attributable to equity holders of the parent increased by €2,238 million due to the translation of the financial statements of our foreign subsidiaries, principally due to the appreciation of the Brazilian real and the pound sterling relative to



the euro, and the effect of the devaluation in Venezuela.

We estimate that in 2008 variations in currencies decreased our consolidated cash flows by approximately €302 million and decreased our consolidated revenues by approximately 3%. Currency fluctuations can also have a significant impact on our statement of financial position, particularly equity attributable to equity holders of the parent, when translating the financial statements of subsidiaries located outside the euro zone into euro. For

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example, in 2008 equity attributable to equity holders of the parent decreased by €3,708 million due to the translation of the financial statements of our foreign subsidiaries, principally due to the depreciation of the pound sterling and Brazilian real relative to the euro.

We estimate that in 2007 variations in currencies decreased our consolidated cash flows by approximately €261 million and decreased our consolidated revenues by approximately 1.2%. In addition, in 2007 equity attributable to equity holders of the parent decreased by €1,427 million due to the translation of the financial statements of our foreign subsidiaries, principally due to the depreciation of the dollar and pound sterling relative to the euro and the appreciation of the Brazilian real and the Czech crown relative to the euro.

The table below sets forth the average exchange rates against the euro of the dollar and the key currencies that impacted our consolidated results of operations for the periods indicated. Positive percentage changes represent a decline in the value of the applicable currency relative to the euro, and negative percentage changes represent increases in the value of the applicable currency relative to the euro.

	2007(1) Average	2008(1) Average	2009(1) Average	% change 2007 to 2008 Average	% change 2008 to 2009 Average
Pound Sterling	0.68	0.79	0.89	16.12%	12.04%
U.S. Dollar	1.37	1.46	1.39	6.94%	(5.00)%
Brazilian Real	2.66	2.66	2.76	(0.09)%	3.68%
Argentine Peso	4.26	4.63	5.17	8.67%	11.70%
Peruvian Nuevo Sol	4.28	4.29	4.18	0.29%	(2.56)%
Chilean Peso	714.64	758.73	775.80	6.15%	2.25%
Mexican Peso	14.95	16.24	18.78	8.60%	15.63%
Venezuelan Bolivar fuerte	2.94	3.15	2.99	6.98%	(5.00)%
Czech Crown	27.76	24.97	26.44	(10.04)%	5.87%
Colombian Peso	2,837.13	2,873.56	2,985.07	1.15%	3.88%
Guatemalan Quetzal	10.50	11.07	11.33	5.40%	2.37%

Source: Central treasury bank of the respective countries.

(1) These exchange rates are used to convert the income statements of our subsidiaries from local currency to euro.

In the comparison below of our results of operations, we have provided certain comparisons at constant exchange rates in order to present an analysis of the development of our results of operations from year-to-year without the effects of currency fluctuations. To make such comparisons, we have converted into euro certain financial items for the relevant year using the prior year's average exchange rate. We refer to such comparisons as being made on a "constant euro basis" or "excluding foreign exchange rate effects".

We also make certain comparisons on a local currency basis. To make comparisons on a local currency basis, we compare financial items in the relevant local currency for the periods indicated as recorded in the relevant local currency for such periods.

We describe certain risks relating to exchange rate fluctuations in "Item 3. Key Information—Risk Factors", and we describe our policy with respect to limiting our exposure to short-term fluctuations in exchange rates under "Item 11. Quantitative and Qualitative Disclosures About Market Risk".

## Regulation

We are subject to regulation in the different markets where we operate, particularly with regard to the prices we can charge for certain of our goods and services in certain jurisdictions as well as our need to comply with certain obligations, which has a significant effect on our profitability. For more information regarding regulation in the markets in which we operate, see “Item 4. Information on the Company—Business Overview—Regulation”.

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## Group Results of Operations

A summary of our results of operations for 2007, 2008 and 2009 and certain consolidated revenue and expense items as a percentage of revenues for the periods indicated is shown below.

	Year ended December 31,					
	2007	2007	2008	2008	2009	2009
	Total	Percentage of revenues	Total	Percentage of revenues	Total	Percentage of revenues
	(in millions of euros, except percentage of revenues)					
Revenues	56,441	100.0%	57,946	100.0%	56,731	100.0%
Other income	4,264	7.6%	1,865	3.2%	1,645	2.9%
Supplies	(17,907)	(31.7)%	(17,818)	(30.7)%	(16,717)	(29.5)%
Personnel expenses	(7,893)	(14.0)%	(6,762)	(11.7)%	(6,775)	(11.9)%
Other expenses	(12,081)	(21.4)%	(12,312)	(21.2)%	(12,281)	(21.6)%
Operating income before depreciation and amortization (OIBDA)(1)	22,824	40.4%	22,919	39.6%	22,603	39.8%
Depreciation and amortization	(9,436)	(16.7)%	(9,046)	(15.6)%	(8,956)	(15.8)%
Operating income	13,388	23.7%	13,873	23.9%	13,647	24.1%
Share of profit (loss) of associates	140	0.2%	(161)	(0.3)%	47	0.1%
Net financial income (expense)	(2,844)	(5.0)%	(2,797)	(4.8)%	(3,307)	(5.8)%
Corporate income tax	(1,565)	(2.8)%	(3,089)	(5.3)%	(2,450)	(4.3)%
Profit for the year from continuing operations	9,119	16.2%	7,826	13.5%	7,937	14.0%
Income (loss) from discontinued operations	—	—	—	—	—	—
Profit for the year	9,119	16.2%	7,826	13.5%	7,937	14.0%
Non-controlling interest	(213)	(0.4)%	(234)	(0.4)%	(161)	(0.3)%
Profit for the year attributable to equity holders of the parent company	8,906	15.8%	7,592	13.1%	7,776	13.7%

(1) For a reconciliation of OIBDA to operating income, see “—Operating Results—Presentation of Financial Information—Non-GAAP financial information—Operating income before depreciation and amortization”.

## Overview

We increased our customer base, measured in terms of total accesses, by 2.1% to 264.6 million accesses at December 31, 2009 from 259.1 million accesses at December 31, 2008, which was a 13.3% increase from the 228.7 million accesses we had at December 31, 2007. This growth from December 31, 2008 to December 31, 2009 was primarily driven by a 3.3% increase in mobile accesses, an 8.2% increase in broadband accesses and a 9.8% increase in pay TV accesses, which more than offset our 5.4% loss of fixed telephony accesses and 28.5% loss of narrowband accesses as these technologies continue to be substituted by customers for mobile and broadband technologies, respectively. Growth in our total number of accesses from December 31, 2007 to December 31, 2008 was primarily driven by strong growth in mobile and broadband accesses.

The growth in our customer base in terms of accesses from December 31, 2008 to December 31, 2009 under difficult economic circumstances did not, however, result in a corresponding increase in revenues, which decreased 2.1% in 2009 compared to 2008. However, excluding foreign exchange rate effects (i.e., by converting into euro relevant items for 2009 using 2008's average exchange rates) and the effects of Venezuela being considered a hyperinflationary economy in 2009, revenues would have increased 0.3% in 2009 compared to 2008. In Spain and Europe, the competitive environment remained intense and continued to put downward pressure on our tariff structures, which resulted in revenue growth not keeping pace with access growth. In addition, further downward pressure was placed on our revenues from mobile accesses as a result of regulatory action in the European Union and certain Latin American countries, which resulted in decreased interconnection and roaming rates during the period. This decrease in revenues led to a 1.4% decrease in OIBDA to €22,603 million in 2009 from €22,919 million 2008. Nonetheless, excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, OIBDA would have increased 0.5% in 2009 compared to 2008.

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Operating income decreased 1.6% to €13,647 million in 2009 from €13,873 million in 2008, while profit for the year attributable to equity holders of the parent company increased 2.4% to €7,776 million in 2009 from €7,592 million in 2008 primarily as a result of our share of profit of associates and lower corporate income tax primarily related to the reversal of a tax liability.

At December 31, 2008, our customer base, measured in terms of total accesses, increased 13.3% to 259.1 million accesses from the 228.7 million accesses we had at December 31, 2007. Growth in our total number of accesses from December 31, 2007 to December 31, 2008 was primarily driven by strong growth in mobile and broadband accesses. The strong growth in our customer base from December 31, 2007 to December 31, 2008 under difficult economic circumstances translated into a moderate increase of 2.7% in revenues in 2008 compared to 2007. Negative exchange rate effects resulted in a reduction of our revenue growth by 3.0 percentage points. This modest increase in revenues led to a small increase in OIBDA to €22,919 million in 2008 from €22,824 million in 2007, which amount in 2007 included non-recurring gains on the sales of Airwave (€1,296 million) and Endemol (€1,368 million). Operating income rose 3.6% to €13,873 million in 2008 from €13,388 million in 2007, while profit for the year attributable to equity holders of the parent company decreased 14.8% to €7,592 million in 2008 from €8,906 million in 2007. This decrease in profit for the year attributable to equity holders of the parent company was primarily the result of the inclusion in 2007 of non-recurring gains on the sales of Airwave and Endemol and an increase in corporate income tax from €1,565 million in 2007 to €3,089 million in 2008.

By geographic area, Telefónica Europe had the largest percentage increase in accesses with an increase of 6.9% to 49.2 million accesses at December 31, 2009 from 46.1 million accesses at December 31, 2008, primarily driven by a 6.5% increase in mobile accesses. Telefónica Latin America had the largest percentage increase in accesses from December 31, 2007 to December 31, 2008, with an increase of 18.0% to 158.3 million accesses at December 31, 2008 from 134.1 million accesses at December 31, 2007, primarily driven by strong growth in its mobile business, increased broadband sales and an expanding pay TV customer base.

By access type, we increased mobile accesses by 3.3% to 202.3 million (excluding 9.0 million accesses of Medi Telecom, which we sold in December 2009) at December 31, 2009 from 195.8 million at December 31, 2008, which was a 16.7% increase from the 167.8 million mobile accesses we had at December 31, 2007. Contributions to mobile net adds from December 31, 2008 to December 31, 2009, by country, were led by Brazil (6.8 million additional mobile accesses), Mexico (2.1 million additional mobile accesses), Germany (1.3 million additional mobile accesses), Argentina (1.1 million additional mobile accesses) and the United Kingdom (1.0 million additional mobile accesses). In the same period, Colombia was the worst performer with negative mobile net adds of 1.0 million. Contributions to mobile net adds from December 31, 2007 to December 31, 2008, by country, were also dominated by countries in Latin America, with the highest growth in Brazil (7.5 million additional mobile accesses, excluding mobile accesses of Telemig), Mexico (2.8 million additional mobile accesses), and Peru (2.5 million additional mobile accesses). In Europe, Germany was a strong contributor to the growth in mobile accesses with 1.7 million additional mobile accesses from December 31, 2007 to December 31, 2008. We also increased broadband accesses by 8.2% to 13.5 million at December 31, 2009 from 12.5 million at December 31, 2008, which was a 20.9% increase from the 10.3 million broadband accesses we had at December 31, 2007. We increased our number of broadband accesses from December 31, 2007 to December 31, 2009 primarily as a result of robust demand for Duo and Trio bundles, including broadband, pay TV and fixed telephony, which have made a significant contribution to the development of the broadband market and to increased customer loyalty. From December 31, 2008 to December 31, 2009, we increased broadband accesses by 4.4% in Spain to 5.5 million, by 5.9% to 6.4 million in Latin America and by 37.1% to 1.6 million in Europe. At December 31, 2009, in Spain 88% of our broadband accesses were included in Duo or Trio bundles, while in Latin America the weight of packaged products continued to grow, with 56% of broadband accesses bundled in Duo and Trio bundles at the same date. This growth in broadband accesses more than offset the continued decrease in narrowband accesses from 2.7 million accesses at December 31, 2007 to 2.0 million accesses at December 31, 2008 to 1.4 million accesses at December 31, 2009.

Finally, we increased pay TV accesses by 9.8% to 2.5 million at December 31, 2009 from 2.3 million at December 31, 2008, which was a 29.7% increase from the 1.7 million pay TV accesses we had at December 31, 2007. The continued growth in pay TV accesses from December 31, 2007 to December 31, 2009 was primarily as a result of further market penetration in the areas in which this service is available, which as of December 31, 2009,

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included Spain, the Czech Republic, Peru, Chile, Colombia, Brazil and Venezuela, and the success of bundling this service with others.

The inflation index reached in 2009, the cumulative inflation index over the last three years, restrictions in the official foreign exchange market, and the devaluation of the Bolivar fuerte on January 8, 2010, led us to consider Venezuela a hyperinflationary economy for 2009. Such classification had several effects on our Consolidated Financial Statements as explained in more detail under “—Significant Factors Affecting the Comparability of our Results of Operations in the Period Under Review—Classification of Venezuela as a hyperinflationary economy” and Note 2 to our Consolidated Financial Statements.

Year ended December 31, 2009 compared to year ended December 31, 2008

Revenues

Revenues decreased 2.1% to €56,731 million in 2009 compared to €57,946 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, revenues would have increased 0.3% in 2009 compared to 2008.

By geographic area, Telefónica Latin America contributed the greatest percentage to our revenues in 2009, accounting for 40.5% of the total, which represents an increase of 2.2 percentage points from 2008. Telefónica Spain contributed 34.7% of our 2009 revenues (36.0% in 2008) and Telefónica Europe contributed 23.9% (24.7% in 2008).

Other income

Other income decreased 11.8% to €1,645 million in 2009 compared to €1,865 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, other income would have decreased 9.7% in 2009 compared to 2008. Other income in 2009 included a €220 million gain on the sale of our stake in Medi Telecom. In 2008, other income included a €143 million gain on the sale of our stake in Sogecable.

Total expenses

Total expenses include supplies, personnel expenses and other expenses (mainly external services and taxes). Total expenses do not include depreciation and amortization.

Our total expenses decreased 3.0% to €35,773 million in 2009 compared to €36,892 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, total expenses would have decreased 0.4% in 2009 compared to 2008.

Supplies. Supplies decreased 6.2% to €16,717 million in 2009 compared to €17,818 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, supplies would have decreased 3.1% from 2008 to 2009. This decrease is primarily due to lower interconnection costs associated with lower fixed-mobile traffic and the reduction of mobile termination rates.

Personnel expenses. Personnel expenses increased 0.2% to €6,775 million in 2009 compared to €6,762 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, personnel expenses would have increased 2.7% from 2008 to 2009. This increase was primarily due to increases in our work force and wages over the period. The average workforce during 2009 reached 255,151 employees, with a net increase of 3,376 employees compared to 2008, mainly due to the workforce



increases within Atento. Excluding employees of Atento, our average number of employees in 2009 would have increased by 381 employees to 125,266 employees compared to 2008.

Other expenses. Other expenses are mainly comprised of external services, which consist of commercial expenses related to our business (such as commissions to distributors of services, marketing and advertising expenses and customer service related expenses), network maintenance expenses, general administrative expenses and subcontracted services expenses, as well as certain types of taxes. Other expenses also include changes in

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operating allowances and other operating expenses. Other expenses decreased 0.2% to €12,281 million in 2009 from €12,312 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, other expenses would have increased 2.0% in 2009 compared to 2008. This increase was principally driven by higher customer, network and IT management expenses in Telefónica Latin America.

### Operating income before depreciation and amortization (OIBDA)

As a result of the foregoing, our OIBDA decreased 1.4% to €22,603 million in 2009 compared to €22,919 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, OIBDA would have increased 0.5% from 2008 to 2009.

Of our 2009 OIBDA, Telefónica Spain contributed 43.2% (44.9% in 2008), while Telefónica Latin America and Telefónica Europe contributed 40.5% (36.8% in 2008) and 17.3% (18.2% in 2008), respectively.

Our OIBDA margin increased to 39.8% in 2009 compared to 39.6% in 2008. For a reconciliation of OIBDA to operating income, see “—Presentation of Financial Information—Non-GAAP financial information—Operating income before depreciation and amortization”.

### Depreciation and amortization

Our depreciation and amortization decreased 1.0% to €8,956 million in 2009 compared to €9,046 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, depreciation and amortization would have increased 1.3% from 2008 to 2009, principally driven by Telefónica Latin America and Telefónica Europe depreciation and amortization increases. Telefónica Europe depreciation and amortization in 2009 includes the amortization of the purchase price allocation made following the acquisitions of the O2 Group (€635 million in 2009 compared to €689 million in 2008) and Telefónica O2 Czech Republic (€89 million in 2009 compared to €131 million in 2008).

### Operating income

As a result of the foregoing, our operating income decreased 1.6% to €13,647 million in 2009 from €13,873 million in 2008. Excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009, operating income would have remained constant in 2009 compared to 2008.

### Share of profit (loss) of associates

Our share of profit (loss) of associates amounted to a gain of €47 million in 2009 compared to a loss of €161 million in 2008, primarily as a result of share of profits we recorded in respect to our interest in Portugal Telecom and lower share of loss we recorded in respect to our interest in Telco. In 2008, the loss in our share of profit (loss) of associates was primarily the result of the net adjustment Telco made to the valuation of its investment in Telecom Italia. To estimate the adjustment to be recorded by the Telefónica Group, we took the value of the estimated synergies that we expected to achieve by improving certain processes in our operations in Europe as a result of certain alliances reached with Telecom Italia. As a result of this revaluation, we recorded a loss of €209 million in 2008, which more than offset the share of profits we recorded in respect of our interest in Portugal Telecom in that year.

### Net financial income (expense)

Net financial expense increased 18.2% to €3,307 million in 2009 compared to €2,797 million in 2008. The average cost of net debt of the Group, which we measure as net financial expense divided by our average net debt, was 7.3% in 2009 compared to 5.95% in 2008. The effects derived from the consideration of Venezuela as a hyperinflationary economy as described in “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Classification of Venezuela as a Hyper inflationary Economy”, resulted in an increase in net financial expense of €630 million in 2009. Excluding such effects in 2009 and the negative

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exchange differences, our average cost of net debt in 2009 would have been 5.54% and net financial expense would have decreased 4.3% in 2009 compared to 2008 primarily as a result of:

- A decrease of €298 million in 2009 compared to 2008 due to a decrease in the average interest rates applicable to our outstanding debt (mainly in European currencies) over the period.
- A decrease of €104 million in 2009 compared to 2008 due to a 3.7% decrease in our average debt outstanding over the period.
- A decrease of €85 million in 2009 compared to 2008 as a result of a decrease in the actual value of commitments (principally related to pre-retirement plans).
- Changes in the foreign exchange gains and losses for 2009 with respect to the same period in 2008 yielded a higher cost of about €197 million.

Corporate income tax

Corporate income tax decreased to €2,450 million in 2009 compared to €3,089 million in 2008, implying an effective tax rate of 23.6% compared to 28.3% in 2008. This decrease was primarily the result of the reversal of a €591 million tax liability recorded in 2007 with respect to an investigation by the European Commission involving the Kingdom of Spain with respect to the tax treatment of goodwill. In December 2009, the European Commission released its decision regarding the investigation, deeming certain deductions for the amortization of goodwill as state aid. However, this decision (and considering the corporate structure of these investments) did not apply to investments made before December 21, 2007, such as our investments in O2, BellSouth's Latin American operators, Colombia Telecomunicaciones, ESP and Telefónica O2 Czech Republic.

Non-controlling interests

Our non-controlling interests amounted to a negative figure of €161 million in 2009 compared to a negative figure of €234 million in 2008, primarily as a result of lower profits at Telesp and Telefónica Chile and higher loss at Colombia Telecom, which we account for as non-controlling interests.

Profit for the year attributable to equity holders of the parent company

As a result of the above, our profit for the year attributable to equity holders of the parent company increased 2.4% to €7,776 million in 2009 compared to €7,592 million in 2008.

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## Results of Operations by Business Area for 2008 and 2009

The table below sets forth the contribution to our results of operations by each of our three principal business areas and other companies for 2008 and 2009. Revenues and related expenses for each of the business areas are presented after elimination of sales to other members of the Telefónica Group belonging to the same business area. See Note 4 to our Consolidated Financial Statements.

	Year ended December 31,		
	2008	2009	% Change
	(in millions of euros)		
Revenues	57,946	56,731	(2.1)%
Telefónica Spain	20,838	19,703	(5.4)%
Telefónica Europe	14,309	13,533	(5.4)%
Telefónica Latin America	22,174	22,983	3.6%
Other companies & eliminations	625	512	(18.1)%
Other income	1,865	1,645	(11.8)%
Telefónica Spain	348	497	42.8%
Telefónica Europe	395	234	(40.8)%
Telefónica Latin America	609	646	6.1%
Other companies & eliminations	513	268	(47.8)%
Expenses(1)	(36,892)	(35,773)	(3.0)%
Telefónica Spain	(10,901)	(10,443)	(4.2)%
Telefónica Europe	(10,524)	(9,857)	(6.3)%
Telefónica Latin America	(14,338)	(14,486)	1.0%
Other companies & eliminations	(1,129)	(987)	(12.6)%
Depreciation and amortization	(9,046)	(8,956)	(1.0)%
Telefónica Spain	(2,239)	(2,140)	(4.4)%
Telefónica Europe	(3,035)	(2,895)	(4.6)%
Telefónica Latin America	(3,645)	(3,793)	4.1%
Other companies & eliminations	(127)	(128)	0.8%
Operating income	13,873	13,647	(1.6)%
Telefónica Spain	8,046	7,617	(5.3)%
Telefónica Europe	1,145	1,015	(11.4)%
Telefónica Latin America	4,800	5,350	11.5%
Other companies & eliminations	(118)	(335)	—

(1) Expenses as used in this table and in the below discussion include supplies expenses, personnel expenses and other expenses. It does not include depreciation and amortization.

In the discussion that follows revenues and related expenses for each business included within a particular business area are presented gross of any eliminations due to sales to other businesses in such business area or other members of the Telefónica Group.

## Results of Operations by Business Area for 2008 and 2009

## Telefónica Spain

## Revenues

Telefónica Spain's revenues decreased 5.4% to €19,703 million in 2009 from €20,838 million in 2008.

Revenues from Telefónica Spain's fixed business decreased 3.3% to €12,167 million in 2009 from €12,581 million in 2008 principally due to the decrease in the revenues of traditional voice service and accesses.

- Revenues from traditional accesses include all revenues from our customers for rental and connection to public switched telephone network (PSTN) lines (for basic telephony service), ISDN lines (for integration of voice, data and video services), corporate services, PUT, additional recharges and advertising in

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telephone booths. Revenues from traditional accesses decreased 5.2% to €2,792 million in 2009 compared to €2,944 million in 2008, as a result of the reduction in the number of accesses which was partially offset by revenues derived from recognizing receipt of universal service for the period 2006 to 2008 (€223 million).

- Revenues from traditional voice services decreased 10.2% to €3,983 million in 2009 compared to €4,436 million in 2008. This evolution is mainly affected by lower fixed-to-mobile traffic, the decrease of international traffic and the increasing importance of traffic included in national flat tariff plans.
- Revenues from Internet and broadband services decreased 1.9% to €2,960 million in 2009 compared to €3,017 million in 2008. Retail broadband service revenues decreased 1.7% in 2009 compared to 2008, due to a reduction in the average revenue per customer that was not offset by accesses growth. Wholesale broadband service revenues increased 3.3% in 2009 compared to 2008 reflecting growth in the customer base for unbundled local loop in 2009.
- Revenues from data services grew 8.7% to €1,294 million in 2009 from €1,190 million in 2008, driven by increased revenues from leased circuits to mobile operators, mainly Telefónica Móviles España, as a result of the rapid growth in mobile broadband.
- Revenues from information technology services grew 14.7% to €508 million in 2009 from €443 million in 2008.

Revenues from Telefónica Spain's mobile business decreased 7.4% to €8,965 million in 2009 from €9,684 million in 2008, due to lower minutes used by customers and lower prices. Customer revenues decreased 5.4% to €6,571 million in 2009 from €6,943 million in 2008 due to lower usage patterns. Interconnection revenues decreased 19.5% to €1,001 million in 2009 from €1,243 million in 2008, due primarily to regulated interconnection price cuts. Roaming-in revenues fell 22.8% to €153 million in 2009 from €198 million in 2008 due to the downward trend in roaming consumption and wholesale prices. Revenues from handset sales decreased 7.3% to €1,137 million from €1,227 million in 2008.

## Expenses

Telefónica Spain's total expenses decreased 4.2% to €10,443 million in 2009 from €10,901 million in 2008 principally due to lower supplies expenses, as described below.

- Supplies decreased 6.7% to €4,293 million in 2009 from €4,604 million in 2008, mainly due to lower interconnection expenses.
- Personnel expenses decreased 3.0% to €2,305 million in 2009 from €2,375 million in 2008, principally due to the revision of the estimates of redundancy program provision accounts made in previous years, which resulted in lower expenses of €90 million.
- Other expenses decreased 2.0% to €3,845 million in 2009 from €3,922 million in 2008, principally due to a 3.4% decrease in external expenses to €3,102 million in 2009 from €3,212 million in 2008, as a result of containment in commercial expenses. This decrease was partially offset by an increase in other expenses in 2009 due to expenses related to the provision of universal service (€155 million).

In the fixed business, total expenses decreased 3.4% to €6,567 million in 2009 from €6,799 million in 2008 principally due to lower expenses across categories, as described below.

- Supplies decreased 6.0% to €2,786 million in 2009 from €2,962 million in 2008 mainly due to lower interconnection expenses as a result of lower fixed-to-mobile traffic usage and a reduction in mobile termination rates.

- Personnel expenses decreased 0.9% to €2,052 million in 2009 from €2,071 million in 2008, mainly due to the revision of redundancy program provision accounts made in previous years, which resulted in lower



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personnel expenses of €58 million. The average number of employees for the fixed business in 2009 was 31,111, a 0.4% reduction in comparison with the average number of employees in 2008.

- Other expenses decreased 2.1% to €1,729 million in 2009 from €1,766 million in 2008, principally due to a 2.7% decrease in external expenses to €1,300 million in 2009 from €1,336 million in 2008. This decrease was partially offset by an increase in expenses related to the provision of universal service.

Telefónica Spain's total expenses related to its mobile business decreased 4.0% to €5,281 million in 2009 from €5,502 million in 2008 principally due to lower supplies expenses, as described below.

- Supplies decreased 8.9% to €2,430 million in 2009 from €2,667 million in 2008 due to decreases in interconnection and roaming expenses as result of lower traffic and to a reduction in mobile termination rates.
- Personnel expenses decreased 16.3% to €250 million in 2009 from €299 million in 2008, mainly due to the revision of redundancy program provision accounts made in previous years, which resulted in lower expenses of €32 million. The average number of employees for the mobile business in 2009 was 4,199, a 6.0% reduction in comparison with the average number of employees in 2008.
- Other expenses increased 2.5% to €2,601 million in 2009 from €2,537 million in 2008 mainly due to higher customer management expenses and expenses related to the provision of universal service in 2009.

### Operating income before depreciation and amortization (OIBDA)

As a result of the foregoing, Telefónica Spain's OIBDA decreased 5.1% to €9,757 million in 2009 from €10,285 million in 2008. Telefónica Spain's OIBDA, as a percentage of Telefónica Spain's revenues, was 49.5% in 2009 compared to 49.4% in 2008.

### Depreciation and amortization

Telefónica Spain's depreciation and amortization decreased 4.5% to €2,140 million in 2009 from €2,239 million in 2008, principally due to variations in the useful lives of assets subject to depreciation in 2009 compared to 2008 in line with the periodic revision of the Group's policies, based on historical experience.

### Operating income

As a result of the foregoing, Telefónica Spain's operating income decreased 5.3% to €7,617 million in 2009 from €8,046 million in 2008.

## Telefónica Europe

### Revenues

Telefónica Europe's revenues decreased 5.4% to €13,533 million in 2009 from €14,309 million in 2008. Telefónica Europe's 2009 revenue were negatively affected by lower mobile termination rates (MTRs), the adverse economic environment and the decline of the average pound sterling to euro exchange rate.

- Revenues derived from Telefónica O2 UK decreased to €6,512 million in 2009 from €7,052 million in 2008 (an increase of 3.5% in local currency). The local currency increase in revenue was primarily driven by an increase in Telefónica O2 UK's customer base and partially offset by a decrease in ARPU.

- Revenues derived from Telefónica O2 Germany increased 4.2% to €3,746 million in 2009 from €3,595 million in 2008. The positive evolution was mainly the result of an increase in the customer base due to new offerings (O2o, My O2 Handy and broadband), but was adversely impacted by lower MTRs.
- Revenues derived from Telefónica O2 Czech Republic, including Slovakia operations, decreased by 12.4% to €2,260 million in 2009 from €2,581 million in 2008 (a decrease of 7.3% in local currency). Slovakia continued to grow mobile revenues while Czech revenues from fixed and mobile services decreased (9.3%

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and 6.3% in local currency, respectively) due to MTR cuts, customers reducing spending and fixed-to-mobile substitution.

- Revenues derived from Telefónica O2 Ireland decreased 5.5% to €905 million in 2009 compared to €957 million in 2008. The decrease was mainly the result of lower customer spending and lower usage in terms of traffic.

### Expenses

Telefónica Europe's total expenses decreased 6.3% to €9,857 million in 2009 from €10,523 million in 2008.

- Supplies decreased 6.4% to €6,189 million in 2009 from €6,611 million in 2008, mainly due to the decline of the pound sterling to euro exchange rate over the period and lower MTRs.
- Personnel expenses decreased 2.6% to €1,304 million in 2009 from €1,340 million in 2008 despite increased expenses associated with restructuring programs in Telefónica O2 UK and Telefónica O2 Germany. The decline of the pound sterling to euro exchange rate over the period also contributed to the decrease.
- Other expenses decreased 8.1% to €2,364 million in 2009 from €2,573 million in 2008, mainly due to the decrease in external services as a result of cost efficiencies. The decline of the pound sterling to euro exchange rate over the period also contributed to the decrease.

### Operating income before depreciation and amortization (OIBDA)

As a result of the foregoing, Telefónica Europe's OIBDA decreased 6.4% to €3,910 million in 2009 from €4,180 million in 2008. OIBDA in 2008 included €174 million as the result of the release in 2008 of provisions made in respect of potential contingencies which were not realized once these risks had dissipated.

- OIBDA in Telefónica O2 UK decreased 8.7% to €1,680 million in 2009 from €1,839 million in 2008 (an increase of 2.3% in local currency).
  - OIBDA in Telefónica O2 Germany increased 19.3% to €918 million in 2009 from €770 million in 2008.
- OIBDA in Telefónica O2 Czech Republic, including Slovakia operations, decreased 9.2% to €1,053 million in 2009 from €1,159 million in 2008 (a decrease of 3.8% in local currency).
  - OIBDA in Telefónica O2 Ireland increased 0.3% to € 302 million in 2009 from €301 million in 2008.

### Depreciation and amortization

Telefónica Europe's depreciation and amortization decreased 4.6% to €2,895 million in 2009 from €3,035 million in 2008 mainly due to the decline of the average pound sterling to euro exchange rate.

### Operating income

As a result of the foregoing, Telefónica Europe's operating income decreased 11.3% to €1,015 million in 2009 from €1,145 million in 2008. The decrease was the result of the 6.4% decrease in OIBDA which was not offset by the lower decrease (4.6%) in depreciation and amortization.

### Telefónica Latin America

Revenues

Revenues at Telefónica Latin America increased 3.7% to €22,983 million in 2009 from €22,174 million in 2008 (an increase of 5.6% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009). On a constant euro basis and excluding the effects of Venezuela

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being considered a hyperinflationary economy in 2009, the countries contributing most to this revenue growth were Venezuela (2.5 percentage points), Argentina (1.7 percentage points) and Mexico (0.7 percentage points).

In 2009, Brazil continued to make the largest contribution to Telefónica Latin America's revenues (36.4%) followed by Venezuela (16.4%) and Argentina (11.4%).

- Telefónica Latin America's revenues from Brazil decreased to €8,376 million in 2009 from €8,606 million in 2008 (an increase of 0.9% in local currency). The local currency increase was primarily due to mobile businesses and broadband and pay TV business growth. With respect to Vivo, Telefónica Latin America's mobile business in Brazil, revenues increased to €3,036 million in 2009 from €2,932 million in 2008 (an increase of 7.4% in local currency), driven by growth in the customer base, increasing outgoing revenues focused on on-net tariffs, and data business. With respect to Telesp, Telefónica Latin America's fixed line business in Brazil, revenues decreased to €5,766 million in 2009 from €6,085 million in 2008 (a decrease of 1.8% in local currency). This decrease was due to lower traditional business revenues that were not offset by the growth of new services. Broadband, pay TV and data/IT services revenues increased as a percentage of total revenues (19.2% in 2009 compared to 16.3% in 2008). Traditional fixed line revenues decreased (5.9% in local currency), mainly driven by lower local and long distance traffic that was not compensated by higher interconnection traffic revenues coming primarily from mobile networks. Telesp's performance was also negatively affected by the decision of ANATEL, the Brazilian regulator, to suspend the commercialization of Speedy, Telesp's broadband service, from June 22, 2009 to August 27, 2009 as a result of quality problems.
- Telefónica Latin America's revenues from Venezuela increased to €3,773 million in 2009 from €2,769 million in 2008 (an increase of 20.4% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), primarily driven by higher growth in service revenues in 2009 (an increase of 24.2% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009). This growth in local currency was due mainly to an integrated telecommunication offer (mobile, fixed, pay TV and broadband) and tariff increases.
- Telefónica Latin America's revenues from Argentina increased to €2,609 million in 2009 from €2,527 million in 2008 (an increase of 15.3% in local currency) with both fixed and mobile businesses contributing. Of this, Telefónica Móviles Argentina's revenues increased to €1,643 million in 2009 from €1,585 million in 2008 (an increase of 15.8% in local currency). This increase was primarily driven by an increase of 5.7% in service revenues in 2009 (an increase of 18.1% in local currency). This growth in local currency was mainly due to data revenue growth and tariff increases. Revenues in the fixed line business increased to €1,047 million in 2009 from €1,027 million in 2008 (an increase of 13.9% in local currency), with the traditional fixed line business contributing 3.9 percentage points to this growth, the Internet business contributing 6.7 percentage points and data and IT businesses contributing 2.8 percentage points.
- Telefónica Latin America's revenues from Chile decreased to €1,831 million in 2009 from €1,936 million in 2008 (a decrease of 3.3% in local currency) as a result of the reduction of tariffs as a consequence of a regulatory decree affecting interconnection rates, which went into effect at January 23, 2009 for mobile termination (an average tariff decrease of 44.6%), while on May 7 the decree governing fixed telephony accesses/operator charges was also enacted. This entailed an additional reduction in fixed telephony termination rates. With respect to Telefónica Móviles Chile, Telefónica Latin America's mobile business in Chile, revenues decreased to €1,010 million in 2009 from €1,051 million in 2008 (a decrease of 1.8% in local currency) largely due to a tariff decree established from January 23, 2009. Service revenues decreased 5.3% in 2009 (a decrease of 3.2% in local currency), because of this tariff decree. With respect to Telefónica Chile, Telefónica Latin America's fixed line business in Chile, revenues in 2009 decreased to €893 million in 2009 from €974 million in 2008 (a decrease of 6.3% in local currency). Broadband, pay TV, data and IT businesses growth did not offset the decrease in revenues from the traditional fixed telephony

business.

- Telefónica Latin America's revenues from Mexico decreased to €1,552 million in 2009 from €1,631 million in 2008 (an increase of 10.0% in local currency). This growth in local currency was underpinned by service revenues growth of 17.8% in 2009 as a result of the customer base increase and new tariff plans.

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This increase in local currency was greater than the 14.7% rate of growth in the customer base over the same period.

- Telefónica Latin America's revenues from Peru increased to €1,716 million in 2009 from €1,627 million in 2008 (an increase of 3.0% in local currency). Revenue growth was primarily driven by outgoing revenues in the pre-pay mobile segment and broadband services and pay TV and IT services in the fixed line business. With respect to Telefónica Móviles Perú, Telefónica Latin America's mobile business in Peru, revenues increased to €840 million in 2009 from €773 million in 2008 (an increase of 6.1% in local currency), driven primarily by revenue growth in the pre-pay mobile segment as a result of the increase in accesses and higher consumption. Service revenues increased 5.4% in 2009 (an increase of 3.0% in local currency). With respect to Telefónica del Perú, Telefónica Latin America's fixed line business in Peru, revenues increased to €1,006 million in 2009 from €977 million in 2008 (an increase of 0.6% in local currency). This increase was primarily due to broadband and pay TV businesses revenues growth (6.2% and 9.2% in local currency, respectively). Also revenues of the public telephony business increased (2.3% in local currency) in 2009 principally due to an increase in usage caused by tariff reductions, especially to fixed lines.
- Telefónica Latin America's revenues from Colombia decreased to €1,269 million in 2009 from €1,490 million in 2008 (a decrease of 11.6% in local currency). This evolution is the consequence of a highly competitive environment both in mobile and fixed telephony. With respect to Telefónica Móviles Colombia, Telefónica Latin America's mobile business in Colombia, revenues decreased to €685 million in 2009 from €815 million in 2008 (a decrease of 12.7% in local currency), primarily as the result of the loss of 1.0 million mobile accesses. Service revenues decreased 13.6% in 2009 compared to 2008 (a decrease of 10.3% in local currency). With respect to Colombia Telecom, Telefónica Latin America's fixed line telephony business in Colombia, revenues decreased to €615 million in 2009 from €710 million in 2008 (a decrease of 10.0% in local currency) primarily due to the lower revenues from traditional fixed telephony services as a result of lower accesses and a decrease in traffic, not compensated by increased broadband and pay TV revenues.
- Telefónica Latin America's revenues from Central America decreased to €565 million in 2009 from €568 million in 2008 (a decrease of 2.5% on a constant euro basis). This decrease on a constant euro basis was mainly due to a highly competitive environment, that also affected service revenues that decreased 1.4% in constant euro terms.
- Telefónica Latin America's revenues from Ecuador increased to €337 million in 2009 from €318 million in 2008 (an increase of 0.6% in local currency). Service revenues increased 14.2% in 2009 (an increase of 9.5% in local currency).

Expenses

Telefónica Latin America's total expenses increased 1.0% in 2009 to €14,486 million from €14,338 million in 2008 (an increase of 3.1% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009).

- Supplies decreased 2.9% to €6,188 million in 2009 from €6,371 million in 2008 (a decrease of 1.4% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), mainly due to a decrease in supplies in Chile, Mexico and Colombia, which offset the increase in Venezuela, as described below.

Supplies for Telefónica Latin America in Brazil decreased to €2,440 million in 2009 from €2,479 million in 2008 (an increase of 2.0% in local currency). The local currency increase was principally due to higher interconnection costs.

Supplies for Telefónica Latin America in Venezuela increased to €978 million in 2009 from €770 million in 2008 (an increase of 6.6% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), principally due to higher content providers expenses, equipment costs



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and expenses associated with value added services such as RIM licenses, TV licenses and mobile SMS premium applications as a result of higher exchange rates.

Supplies for Telefónica Latin America in Argentina decreased to €613 million in 2009 from €650 million in 2008 (an increase of 5.3% in local currency). This increase in local currency was principally due to higher interconnection costs in the fixed line business, as a result of higher traffic and capacity needs, and equipment costs in the mobile business.

Supplies for Telefónica Latin America in Chile decreased to €416 million in 2009 from €503 million in 2008 (a decrease of 15.5% in local currency), principally due to lower mobile interconnection costs caused by the previously described tariff decree.

Supplies for Telefónica Latin America in Mexico decreased to €584 million in 2009 from €716 million in 2008 (a decrease of 5.8% in local currency). This decrease in local currency was primarily driven by lower equipment costs as a consequence of lower commercial activity.

Supplies for Telefónica Latin America in Peru increased to €414 million in 2009 from €413 million in 2008 (a decrease of 2.0% in local currency). This decrease in local currency was primarily driven by a reduction in equipment costs in the mobile business as a consequence of lower commercial activity.

Supplies for Telefónica Latin America in Colombia decreased to €298 million in 2009 from €394 million in 2008 (a decrease of 21.4% in local currency), principally due to, in the mobile business, a lower equipment cost as a consequence of lower commercial activity, and lower interconnection costs in both fixed and mobile businesses.

Supplies for Telefónica Latin America in Central America reached €178 million in 2009.

Supplies for Telefónica Latin America in Ecuador decreased to €101 million in 2009 from €112 million in 2008 (a decrease of 14.6% in local currency), due to lower equipment costs as a consequence of lower commercial activity and to lower interconnection costs.

- Personnel expenses for Telefónica Latin America increased 3.1% to €1,789 million in 2009 from €1,735 million in 2008, (an increase of 5.8% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), principally due to increases in Venezuela and Argentina as a result of the effects of higher inflation on wages as described below.

Personnel expenses for Telefónica Latin America in Brazil decreased to €439 million in 2009 from €513 million in 2008 (a decrease of 11.3% in local currency), primarily as a result of a decrease in the fixed line business average number of employees following the 2008 restructuring program and the revision of contingencies related to employees.

Personnel expenses for Telefónica Latin America in Venezuela increased to €203 million in 2009 from €131 million in 2008 (an increase of 36.8% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009). This increase in local currency was principally due to the effects of higher inflation on wages.

Personnel expenses for Telefónica Latin America in Argentina increased to €321 million in 2009 from €303 million in 2008 (an increase of 18.4% in local currency). This increase in local currency was principally due to the effects of higher inflation on wages.

Personnel expenses for Telefónica Latin America in Chile stood at €182 million in 2009, the same as in 2008 (an increase of 1.8% in local currency). This evolution in local currency was primarily driven by the increase of compensation expenses due to the integration of fixed-mobile structures.

Personnel expenses for Telefónica Latin America in Mexico decreased to €82 million in 2009 from €96 million in 2008 (a decrease of 1.3% in local currency) principally due to a lower average number of employees and wage containment.

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Personnel expenses for Telefónica Latin America in Peru increased to €171 million in 2009 from €159 million in 2008 (an increase of 4.9% in local currency), mainly due to the increase in the variable remuneration associated with both the fixed and mobile businesses' financial performance.

Personnel expenses for Telefónica Latin America in Colombia decreased to €115 million in 2009 from €122 million in 2008 (a decrease of 1.5% in local currency), primarily driven by a lower average number of employees at the fixed line business.

Personnel expenses for Telefónica Latin America in Central America reached €41 million in 2009.

Personnel expenses for Telefónica Latin America in Ecuador increased to €30 million in 2009 from €26 million in 2008 (an increase of 8.7% in local currency), principally due to an increase in the average number of employees.

- Other expenses for Telefónica Latin America increased 4.4% to €6,508 million in 2009 from €6,232 million in 2008 (an increase of 6.9% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), mainly due to Venezuela and to a lesser extent to Brazil, as described below.

Other expenses for Telefónica Latin America in Brazil increased to €2,628 million in 2009 from €2,543 million in 2008 (an increase of 7.1% in local currency). This increase in local currency was primarily driven by higher sales and commissions in the mobile business due to commercial activity and higher FISTEL (a regulatory tax linked to net adds of customers) costs due to customer base growth in Vivo. Other expenses also increased in the fixed line business mainly due to higher call center and maintenance expenses, primarily as a result of the action plan put in place in the second half of the year to deal with network quality problems.

Other expenses for Telefónica Latin America in Venezuela increased to €787 million in 2009 from €553 million in 2008 (an increase of 23.8% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), driven primarily by increased network expenses and higher operational taxes.

Other expenses for Telefónica Latin America in Argentina increased to €715 million in 2009 from €678 million in 2008 (an increase of 17.9% in local currency), principally as a result of higher inflation affecting the prices of external services.

Other expenses for Telefónica Latin America in Chile decreased to €516 million in 2009 from €556 million in 2008 (a decrease of 5.2% in local currency). This decrease in local currency was principally due to cost containment, particularly network maintenance, and lower commissions.

Other expenses for Telefónica Latin America in Mexico decreased to €381 million in 2009 from €430 million in 2008 (an increase of 2.4% in local currency). This increase in local currency was principally due to higher commissions and customer services costs.

Other expenses for Telefónica Latin America in Peru decreased to €459 million in 2009 from €467 million in 2008 (a decrease of 4.1% in local currency). This decrease in local currency was principally due to cost containment.

Other expenses for Telefónica Latin America in Colombia increased to €531 million in 2009 from €515 million in 2008 (an increase of 7.1% in local currency), principally due to higher bad debt provisions in both mobile and fixed businesses.

Other expenses for Telefónica Latin America in Central America reached €126 million in 2009.

Other expenses for Telefónica Latin America in Ecuador increased to €114 million in 2009 from €93 million in 2008 (an increase of 17.1% in local currency), principally due to higher commission costs driven by the increase of top ups.

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## Operating income before depreciation and amortization (OIBDA)

As a result of the foregoing, Telefónica Latin America's OIBDA, increased 8.3% to €9,143 million in 2009 from €8,445 million in 2008 (an increase of 10.3% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009). By country, (excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009), Venezuela contributed most to OIBDA growth (4.0 percentage points), followed by Mexico (2.7 percentage points) and Argentina (2.2 percentage points). In absolute terms, in 2009 Brazil was the largest contributor to Telefónica Latin America's OIBDA, accounting for 34.3% of the total, followed by Venezuela at 20.0%, Argentina at 10.8% and Mexico at 6.2%.

Telefónica Latin America's OIBDA in 2009 as a percentage of Telefónica Latin America's revenues for the same period was 39.8%, 1.7 percentage points higher than in 2008.

- Telefónica Latin America's OIBDA in Brazil decreased to €3,139 million in 2009 from €3,359 million in 2008 (a decrease of 3.1% in local currency).
- Telefónica Latin America's OIBDA in Venezuela increased to €1,818 million in 2009 from €1,328 million in 2008 (an increase of 25.4% in local currency and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009).
- Telefónica Latin America's OIBDA in Argentina increased to €986 million in 2009 from €919 million in 2008 (an increase of 19.9% in local currency).
- Telefónica Latin America's OIBDA in Chile increased to €763 million in 2009 from €740 million in 2008 (an increase of 5.5% in local currency).
- Telefónica Latin America's OIBDA in Mexico increased to €564 million in 2009 from €420 million in 2008 (an increase of 55.2% in local currency).
- Telefónica Latin America's OIBDA in Peru increased to €712 million in 2009 from €621 million in 2008 (an increase of 12.0% in local currency).
- Telefónica Latin America's OIBDA in Colombia decreased to €397 million in 2009 from €515 million in 2008 (a decrease of 20.0% in local currency).
- Telefónica Latin America's OIBDA in Central America increased to €241 million in 2009 from €217 million in 2008 (an increase of 9.0% on a constant euro basis).
- Telefónica Latin America's OIBDA in Ecuador increased to €100 million in 2009 from €92 million in 2008 (an increase of 3.0% in local currency).

## Depreciation and amortization

Telefónica Latin America's depreciation and amortization increased 4.1% to €3,793 million in 2009 from €3,645 million in 2008, (an increase of 5.3% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009) primarily as a result of increases in Venezuela and Brazil.

## Operating income

As a result of the foregoing, Telefónica Latin America's operating income increased 11.5% to €5,350 million in 2009 from €4,800 million in 2008, (an increase of 14.1% excluding foreign exchange rate effects and excluding the effects of Venezuela being considered a hyperinflationary economy in 2009).

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### Atento

#### Revenues

Atento's revenues increased by 1.6% to €1,321 million in 2009 from €1,301 million in 2008. The increase in revenues was primarily driven by an increase in the activity of its main customers, other members of the Telefónica Group and BBVA, and in the activity of the financial sector in Brazil.

#### Expenses

Atento's expenses increased 4.4% to €1,169 million in 2009 from €1,120 million in 2008 primarily due to the increase in structural costs from the leasing of capacity and the increase of personnel expenses in many Latin American countries, where the majority of Atento's employees are allocated.

#### Operating income before depreciation and amortization

Atento's OIBDA decreased 17.4% to €154 million in 2009 from €186 million in 2008, due to margin shrinkage and higher personnel expenses.

#### Operating income

Atento's operating income decreased 20.9% to €122 million in 2009 from €154 million in 2008.

Year ended December 31, 2008 compared to year ended December 31, 2007

#### Revenues

The strong growth in our customer base translated into a mild increase of 2.7% in revenues to €57,946 million in 2008 compared to €56,441 million in 2007. Negative exchange rate effects resulted in a reduction of our revenue growth by approximately 3.0 percentage points, while changes in our consolidation perimeter reduced such growth by another 1.2 percentage points. Revenue growth was also affected by a high level of competition in every market in which we operate.

By geographic area, Telefónica Latin America contributed the greatest percentage to our revenues in 2008, accounting for 38.3% of the total, which represents an increase of 2.7 percentage points from 2007. Telefónica Spain contributed 36.0% of our 2008 revenues and Telefónica Europe contributed the remaining 24.7%.

#### Other income

Other income decreased to €1,865 million in 2008 compared to €4,264 million in 2007. Other income in 2008 included the €143 million gain on the sale of our stake in Sogecable. In 2007, other income mainly included the gains on the sales during the year of our holdings in Airwave and Endemol for €1,296 million and €1,368 million, respectively.

#### Total expenses

Total expenses include supplies, personnel expenses and other expenses (mainly external services and taxes). Total expenses do not include depreciation and amortization.

Our total expenses decreased 2.6% to €36,892 million in 2008 compared to €37,881 million in 2007. On a constant euro basis, total expenses would have increased 0.9% from 2007 to 2008, less than the growth in revenues over the same period, primarily as a result of our efficiency initiatives and a general downward trend in expenses.

Supplies. Supplies decreased 0.5% to €17,818 million in 2008 compared to €17,907 million in 2007. On a constant euro basis, supplies would have grown 3.6% from 2007 to 2008, primarily as a result of higher interconnection expenses at Telefónica Latin America and Telefónica O2 UK.



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Personnel expenses. Personnel expenses decreased 14.3% to €6,762 million in 2008 compared to €7,893 million in 2007 (a decrease of 12.4% on a constant euro basis). Our 2007 personnel expenses were affected by non-recurring personnel reorganization expenses of €1,199 million. The average workforce during 2008 reached 251,775 employees, with a net increase of 7,723 employees compared to 2007, mainly due to the workforce increases within Atento. Excluding employees of Atento, our average number of employees in 2008 would have decreased by 2,218 employees to 124,885 employees compared to 2007, partly due to the exclusion of Airwave and Endemol from our 2008 consolidation perimeter.

Other expenses. Other expenses are mainly comprised of external services, which consist of commercial expenses related to our business (such as commissions to distributors of services, marketing and advertising expenses and customer service related expenses), network maintenance expenses, general administrative expenses and subcontracted services expenses, as well as certain types of taxes. Other expenses also include changes in operating allowances and other operating expenses. Other expenses increased 1.9% to €12,312 million in 2008 from €12,081 million in 2007, principally driven by higher other expenses from Telefónica Latin America, mainly in Brazil, Venezuela and Chile due to outsourcing activities and commissions, as well as the increased costs associated with the acquisition and retention of customers in Telefónica Europe due to fierce competition.

## Operating income before depreciation and amortization (OIBDA)

As a result of the foregoing, our OIBDA increased 0.4% to €22,919 million in 2008 compared to €22,824 million in 2007.

Telefónica Spain contributed 44.9% of our 2008 OIBDA, while Telefónica Latin America and Telefónica Europe contributed 36.8% and 18.2%, respectively.

Our OIBDA margin decreased to 39.6% in 2008 compared to 40.4% in 2007. OIBDA for 2007 was affected by the inclusion of non-recurring capital gains recorded on the disposition of Airwave and Endemol. For a reconciliation of OIBDA to operating income, see “—Presentation of Financial Information—Non-GAAP financial information—Operating income before depreciation and amortization”.

## Depreciation and amortization

Our depreciation and amortization decreased 4.1% to €9,046 million in 2008 compared to €9,436 million in 2007, with Telefónica Europe and Telefónica Spain primarily responsible for the decrease as a result of exchange rate effects and a decrease in the average value of plant subject to depreciation, respectively. Depreciation and amortization in 2008 includes the amortization of the purchase price allocation made following the acquisitions of the O2 Group (€689 million) and Telefónica O2 Czech Republic (€131 million).

## Operating income

As a result of the foregoing, our operating income increased 3.6% to €13,873 million in 2008 from €13,388 million in 2007.

## Share of profit (loss) of associates

Our share of profit (loss) of associates amounted to a loss of €161 million in 2008 compared to a gain of €140 million in 2007, primarily as a result of the net adjustment Telco made to the valuation of its investment in Telecom Italia. To estimate the adjustment to be recorded by the Telefónica Group, we took the value of the estimated synergies we expect to achieve by improving certain processes in our operations in Europe as a result of certain alliances reached

with Telecom Italia. As a result of this revaluation, we recorded a loss of €209 million in 2008, which more than offset share of profits we recorded in respect of our interest in Portugal Telecom.

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Net financial income (expense)

Net financial expense decreased 1.6% to €2,797 million in 2008 compared to €2,844 million in 2007, primarily as a result of a €240 million reduction in financial expenses due to the decrease of average total debt outstanding in 2008 compared to 2007, which was partially offset by an increase in financial expenses of €218 million in 2008 compared to 2007 as a result of an increase in the average interest rate on our average net debt for 2008 to 5.95% (6.00%, excluding positive exchange rate differences) compared to 5.59% in 2007. Management of the present value of pre-retirement plan commitments and other positions associated to mark-to-market positions, also had a positive impact of €93 million, which was €9 million more than in 2007. Positive exchange rate differences were €24 million in 2008 compared to €7 million in 2007, reflecting the impact of higher profit on the U.S. dollar positions at December 31, 2008 compared to December 31, 2007. Excluding the impact of positive exchange rate differences, net financial expense was €2,821 million in 2008 and €2,851 million in 2007.

Corporate income tax

Corporate income tax increased to €3,089 million in 2008 compared to €1,565 million in 2007, implying an effective tax rate of 28.3%, while our cash outflow with respect to taxes was lower than the provision in 2008 due to our application of tax losses generated in previous years and pending deductions. The primary reason for our significantly lower tax provision in 2007 was our disposal of Endemol in 2007, which generated a loss for tax purposes.

Non-controlling interests

Our non-controlling interests increased by 10.2% to a negative figure of €234 million in 2008 compared to a negative figure of €213 million in 2007, primarily as a result of higher profits at Telesp and Telefónica O2 Czech Republic, which we account for as non-controlling interests.

Profit for the year attributable to equity holders of the parent company

As a result of the above, our profit for the year attributable to equity holders of the parent company decreased 14.8% to €7,592 million in 2008 compared to €8,906 million in 2007. One of the major factors contributing to our lower profit for the year attributable to equity holders of the parent company in 2008 compared to 2007 was our inclusion of non-recurring capital gains from the dispositions of Airwave and Endemol in our 2007 profit for the year attributable to equity holders of the parent company.

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## Results of Operations by Business Area for 2007 and 2008

The table below sets forth the contribution to our results of operations by each of our three principal business areas and other companies for 2007 and 2008. Revenues and related expenses presented for each of the business areas are presented after elimination of sales to other members of the Telefónica Group. See Note 4 to our Consolidated Financial Statements.

	Year ended December 31,		
	2007	2008	% Change
	(in millions of euros)		
Revenues	56,441	57,946	2.7%
Telefónica Spain	20,683	20,838	0.7%
Telefónica Europe	14,458	14,309	(1.0)%
Telefónica Latin America	20,078	22,174	10.4%
Other companies & eliminations	1,222	625	(48.9)%
Other Income	4,264	1,865	(56.3)%
Telefónica Spain	466	348	(25.3)%
Telefónica Europe	1,518	395	(74.0)%
Telefónica Latin America	648	609	(6.0)%
Other companies & eliminations	1,632	513	(68.6)%
Expenses (1)	37,881	36,892	(2.6)%
Telefónica Spain	11,701	10,901	(6.8)%
Telefónica Europe	10,999	10,524	(4.3)%
Telefónica Latin America	13,605	14,338	5.4%
Other companies & eliminations	1,576	1,129	(28.4)%
Depreciation and amortization	9,436	9,046	(4.1)%
Telefónica Spain	2,381	2,239	(6.0)%
Telefónica Europe	3,386	3,035	(10.4)%
Telefónica Latin America	3,559	3,645	2.4%
Other companies & eliminations	110	127	15.5%
Operating income	13,388	13,873	3.6%
Telefónica Spain	7,067	8,046	13.9%
Telefónica Europe	1,591	1,145	(28.0)%
Telefónica Latin America	3,562	4,800	34.8%
Other companies & eliminations	1,168	(118)	—

(1) Expenses as used in this table and in the below discussion include supplies expenses, personnel expenses and other expenses. It does not include depreciation and amortization.

In the discussion that follows revenues and related expenses for each business included within a particular business area are presented gross of any eliminations due to sales to other businesses in such business area or other members of the Telefónica Group.

## Telefónica Spain

## Revenues

Beginning January 1, 2008, Telefónica Spain changed the business model for its PUT service and related contracts in order to maximize its operations within the scope of the applicable regulatory framework (PUT revenues were 0.7% of

Telefónica Spain's 2007 revenues). As a result, this business is now managed on a pure wholesale basis, and net margin is recorded as revenues. During 2007, this business was managed on a retail basis and we recorded both gross revenues and the associated sales and marketing expenses required to promote PUT traffic through resellers as separate line items.

Telefónica Spain's revenues increased 0.7% to €20,838 million in 2008 from €20,683 million in 2007.

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Revenues from Telefónica Spain's fixed business increased 1.4% to €12,581 million in 2008 from €12,401 million in 2007 principally due to the growth of Internet and broadband service revenues.

- Revenues from traditional accesses include all revenues from our customers for rental and connection to public switched telephone network (PSTN) lines (for basic telephony service), ISDN lines (for integration of voice, data and video services), corporate services, PUT, additional recharges and advertising in telephone booths. Revenues from traditional accesses increased 6.2% to €2,944 million in 2008 compared to €2,772 million in 2007, partially as a result of revenues derived from recognizing the Universal Service Cost provided for the period 2003 through 2005, which we accounted for in 2008 as revenues of €182.8 million.
- Revenues from traditional voice services decreased 7.4% to €4,436 million in 2008 compared to €4,792 million in 2007. Excluding the impact of the change in the business model applicable to PUT services, as described above, traditional voice revenues would have decreased by 3.5%. This evolution is mainly affected by lower fixed-to-mobile traffic, the decrease of effective prices in international traffic and the increasing importance of traffic included in national flat tariff plans.
- Revenues from Internet and broadband services increased 8.7% to €3,017 million in 2008 compared to €2,775 million in 2007. Retail broadband service revenues increased 11.6% in 2008 compared to 2007, and accounted for 2.2 percentage points of Telefónica Spain's, fixed business revenues growth. At the same time, wholesale broadband service revenues increased 2.6% in 2008 compared to 2007, mainly due to revenues associated with our larger customer base for unbundled local loop in 2008.
  - Revenues from data services grew 2.6% to €1,190 million in 2008 from €1,160 million in 2007.
  - Revenues from information technology services grew 1.2% to €443 million in 2008 from €437 million in 2007.

Revenues from Telefónica Spain's mobile business decreased 0.1% to €9,684 million in 2008 from €9,693 million in 2007, due to lower consumption by customers in terms of MOU and lower incoming revenues in terms of ARPU. Customer revenues increased 1.2% to €6,943 million in 2008 from €6,863 million in 2007, while interconnection revenues decreased 9.4% to €1,243 million in 2008 from €1,372 million in 2007, due primarily to the reduction in interconnection rates. Roaming-in revenues fell 9.9% to €198 million in 2008 from €220 million in 2007 due to the downward trend in roaming and wholesale prices. Revenue from handset sales increased 3.6% to €1,227 million from €1,184 million in 2007.

## Expenses

Telefónica Spain's total expenses decreased 6.8% to €10,901 million in 2008 from €11,701 million in 2007, principally due to lower personnel expenses, as described below.

- Supplies decreased 0.7% to €4,604 million in 2008 from €4,639 million in 2007, mainly due to lower interconnection expenses.
- Personnel expenses decreased 23.7% to €2,375 million in 2008 from €3,111 million in 2007. Personnel expenses were affected in 2007 by non-recurring reorganization costs of €667 million.
- Other expenses decreased 0.7% to €3,922 million in 2008 from €3,951 million in 2007, principally due to a 2.3% decrease in external expenses to €3,212 million in 2008 from €3,287 million in 2007. This decrease in external expenses was mainly as a result of the change in the business model applicable to PUT services, as well as the fact that external expenses were affected in 2007 by Telefónica Spain's recording of an EU fine provision of €151.9

million in that year. This decrease was partially offset by an increase in other expenses in 2008 primarily due to the recognition in 2008 of the Universal Service Cost for the period 2003 through 2005.

In the fixed business, total expenses decreased 9.7% to €6,799 million in 2008 from €7,532 million in 2007, principally due to a decrease in personnel expenses.

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- Supplies decreased 1.5% to €2,962 million in 2008 from €3,008 million in 2007 mainly due to lower interconnection expenses and fewer equipment purchases.
- Personnel expenses decreased 21.6% to €2,071 million in 2008 from €2,642 million in 2007, principally due to the non-recurrence in 2008 of personnel restructuring charges recorded in 2007. The average number of employees for the fixed business in 2008 was 31,243, a 6.0% reduction in comparison with the average number of employees in 2007.
- Other expenses decreased 6.1% to €1,766 million in 2008 from €1,881 million in 2007, principally due to a 5.4% decrease in external expenses to €1,336 million in 2008 from €1,413 million in 2007 partially as a result of the change in the business model applicable to PUT services as well as the inclusion in 2007 of the non-recurring EU fine provision described above. This decrease was partially offset by an increase in other expenses in 2008 primarily due to the recognition of the Universal Service Cost in 2008 for the period 2003 through 2005 in an amount of €73 million.

Telefónica Spain's total expenses related to its mobile business decreased 0.7% to €5,502 million in 2008 from €5,541 million in 2007. Total expenses in 2007 were affected by the provision of €154 million related to a personnel reorganization program. Excluding this provision in 2007, Telefónica Spain's expenses related to its mobile business would have increased by 2.1% from €5,387 million in 2007 to €5,502 million in 2008:

- Supplies decreased 0.4% to €2,667 million in 2008 from €2,677 million in 2007 due to decreases in interconnection and roaming expenses.
- Personnel expenses decreased 34.6% to €299 million in 2008 from €457 million in 2007, principally due to the non-recurrence in 2008 of personnel restructuring charges recorded in 2007. Excluding the aforementioned provision, personnel expenses would have decreased by 1.5% to €299 million in 2008 from €304 million in 2007.
- Other expenses increased 5.4% to €2,537 million in 2008 from €2,407 million in 2007 due to higher customer management expenses, the growth in network costs and the impact of the recognition in 2008 of the Universal Service Cost for the period 2003 through 2005.

### Operating income before depreciation and amortization

As a result of the foregoing, Telefónica Spain's OIBDA increased 8.9% to €10,285 million in 2008 from €9,448 million in 2007. Telefónica Spain's OIBDA, as a percentage of Telefónica Spain's revenues, was 49.4% in 2008 compared to 45.7% in 2007.

### Depreciation and amortization

Telefónica Spain's depreciation and amortization decreased 6.0% to €2,239 million in 2008 from €2,381 million in 2007, principally due to a decrease in the average value of assets subject to depreciation in 2008 compared to 2007.

### Operating income

As a result of the foregoing, Telefónica Spain's operating income increased 13.9% to €8,046 million in 2008 from €7,067 million in 2007. The decrease was the result of the 16% decrease in OIBDA, primarily due to the previously described sale of Airwave in 2007, which was offset by a decrease of 10.4% in depreciation and amortization.





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### Telefónica Europe

#### Revenues

Telefónica Europe's revenues decreased 1.0% to €14,309 million in 2008 from €14,458 million in 2007. Telefónica Europe's 2008 revenues were negatively affected by the decline of the pound sterling to euro exchange rate.

- Revenues derived from Telefónica O2 UK decreased to €7,052 million in 2008 from €7,403 million in 2007 (an increase of 10.6% in local currency). The local currency increase in revenues was primarily driven by an increase in Telefónica O2 UK's customer base and ARPU growth.
- Revenues derived from Telefónica O2 Germany increased 1.5% to €3,595 million in 2008 from €3,541 million in 2007. The increase was mainly the result of the increase of broadband revenues in 2008.
- Revenues derived from Telefónica O2 Ireland decreased 3.4% to €957 million in 2008 compared to €991 million in 2007. The decrease was mainly the result of a lower customer spending in terms of euros and lower usage in terms of minutes.
- Revenues derived from Telefónica O2 Czech Republic, including Slovakia operations, increased by 14.4% to €2,581 million in 2008 from €2,257 million in 2007 (an increase of 2.9% in local currency) driven by growth in Slovakia in the year after launch of mobile services in that market. Revenues in the Czech fixed line segment increased 0.2% in local currency compared to 2007, while the mobile business was the key driver of growth with an increase in revenues of 2.8% in local currency.

#### Expenses

Telefónica Europe's total expenses decreased 4.3% to €10,523 million in 2008 from €10,999 million in 2007.

- Supplies decreased 2.6% to €6,611 million in 2008 from €6,787 million in 2007, mainly due to the decline of the pound sterling to euro exchange rate over the period.
- Personnel expenses decreased 14.9% to €1,340 million in 2008 from €1,575 million in 2007 principally due to the non-recurrence in 2008 of personnel restructuring charges recorded in 2007.
- Other expenses decreased 2.4% to €2,573 million in 2008 from €2,637 million in 2007, mainly due to the decrease in external services.

#### Operating income before depreciation and amortization

As a result of the foregoing, Telefónica Europe's OIBDA decreased 16.0% to €4,180 million in 2008 from €4,977 million in 2007. OIBDA in 2007 included non-recurring capital gains from the sale of Airwave of €1,296 million and personnel reorganization and other non-recurring charges totaling €338 million related to the UK, Irish and German businesses. OIBDA in 2008 included €174 million as the result of the release in 2008 of provisions made in respect of potential contingencies which were not realized once these risks had dissipated.

- OIBDA in Telefónica O2 UK decreased 4.3% to €1,839 million in 2008 from €1,923 million in 2007 (an increase of 11.1% in local currency).

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OIBDA in Telefónica O2 Germany increased 62.9% to €770 million in 2008 from €473 million in 2007. The increase was the result of cost reduction measures and the inclusion in 2007 of non-recurring personnel reorganization expenses.

- OIBDA in Telefónica O2 Ireland decreased 4.7% to €301 million in 2008 from €316 million in 2007.
- OIBDA in Telefónica O2 Czech Republic, including Slovakia operations, increased 14.7% to €1,159 million in 2008 from €1,010 million in 2007 (an increase of 3.2% in local currency).

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### Depreciation and amortization

Telefónica Europe's depreciation and amortization decreased 10.4% to €3,035 million in 2008 from €3,386 million in 2007 mainly due to exchange rate effects.

### Operating income

As a result of the foregoing, Telefónica Europe's operating income decreased 28.1% to €1,145 million in 2008 from €1,591 million in 2007.

### Telefónica Latin America

#### Revenues

Revenues at Telefónica Latin America increased 10.4% to €22,174 million in 2008 from €20,078 million in 2007 (an increase of 14.2% on a constant euro basis). On a constant euro basis, the countries contributing most to this revenue growth were Brazil (4.7 percentage points), Venezuela (2.8 percentage points) and Argentina (2.4 percentage points).

In 2008, Brazil continued to make the largest contribution to Telefónica Latin America's revenues (38.8%) followed by Venezuela (12.5%) and Argentina (11.4%).

- Telefónica Latin America's revenues from Brazil increased to €8,606 million in 2008 from €7,662 million in 2007 (an increase of 12.2% in local currency), with both fixed and mobile businesses contributing (increases of 8.2% and 22.3%, respectively, in local currency). With respect to Vivo, Telefónica Latin America's mobile business in Brazil, revenues increased to €2,932 million in 2008 from €2,396 million in 2007 (an increase of 22.3% in local currency), driven by strong growth in the customer base, an increase in outgoing revenues as a result of plan upgrades by existing customers, increased focus on mobile broadband, and by the acquisition of Telemig in the second quarter of 2008. With respect to Telesp, Telefónica Latin America's fixed line business in Brazil, revenues increased to €6,085 million in 2008 from €5,619 million in 2007 (an increase of 8.2% in local currency). This increase was due to the growth of broadband, pay TV and data/IT services, which have increased as a percentage of total revenues (16.3% in 2008 compared to 12.9% in 2007). Traditional fixed line revenues also grew (2.7% in local currency), mainly driven by higher fixed-to-mobile traffic and more value added services, which helped to offset the decrease in accesses and public telephony revenues.
- Telefónica Latin America's revenues from Venezuela increased to €2,769 million in 2008 from €2,392 million in 2007 (an increase of 23.9% in local currency), primarily driven by higher growth in service revenues of 14.6% (an increase of 22.6% in local currency). This growth in local currency was greater than the 14.1% rate of growth in the customer base over the same period.
- Telefónica Latin America's revenues from Argentina increased to €2,527 million in 2008 from €2,264 million in 2007 (an increase of 21.3% in local currency). Of this, Telefónica Móviles Argentina's revenues increased to €1,585 million in 2008 from €1,353 million in 2007 (an increase of 27.3% in local currency). This increase was primarily driven by an increase of 18.0% in service revenues (an increase of 28.2% in local currency). Revenues in the fixed line business increased to €1,027 million in 2008 from €984 million in 2007 (an increase of 13.5% in local currency), with the traditional fixed line business contributing 3.1 percentage points to this growth, the Internet business contributing 5.8 percentage points and data and IT businesses contributing 3.0 percentage points.

Telefónica Latin America's revenues from Chile increased to €1,936 million in 2008 from €1,814 million in 2007 (an increase of 13.3% in local currency). Growth was primarily driven by the mobile, broadband and pay TV businesses, which offset the decline in the traditional fixed telephony business. With respect to Telefónica Móviles Chile, Telefónica Latin America's mobile business in Chile, revenues increased to €1,051 million in 2008 from €930 million in 2007 (an increase of 20.0% in local currency). Service revenues increased 13.4% in 2008 (an increase of 20.3% in local currency), driven by growth in ARPU. This trend was underpinned by migration to GSM technology, growth in the contract customer base (27.9%

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of Telefónica Móviles Chile's mobile accesses were contract access at December 31, 2008 compared to 24.5% at December 31, 2007), plan upgrades and the sale of minute bundles and value added services. With respect to Telefónica Chile, Telefónica Latin America's fixed line business in Chile, revenues in 2008 remained relatively unchanged from 2007 at €974 million (an increase of 6.1% in local currency). Pay TV services growth and increased broadband penetration drove the local currency increase in Internet and broadband revenues, offsetting a decrease in revenues from the traditional fixed telephony business.

- Telefónica Latin America's revenues from Mexico increased to €1,631 million in 2008 from €1,431 million in 2007 (an increase of 23.8% in local currency). This growth was underpinned by service revenues growth of 21.6% in 2008 (an increase of 32.1% in local currency). This increase in local currency was greater than the 22.8% rate of growth in the customer base over the same period.
- Telefónica Latin America's revenues from Peru increased to €1,627 million in 2008 from €1,513 million in 2007 (an increase of 7.6% in local currency). Revenue growth was primarily driven by outgoing revenues in the pre-pay segment of the mobile business and broadband services and by pay TV in the fixed line business. With respect to Telefónica Móviles Perú, Telefónica Latin America's mobile business in Peru, revenues increased to €773 million in 2008 from €603 million in 2007 (an increase of 28.4% in local currency), driven primarily by revenue growth in the pre-pay segment. Service revenues increased 20.0% in 2008 (an increase of 20.1% in local currency). With respect to Telefónica del Perú, Telefónica Latin America's fixed line business in Peru, revenues decreased to €977 million in 2008 from €1,031 million in 2007 (a decrease of 5.1% in local currency). This decrease was primarily due to a decrease in revenues from public use telephony and fixed telephony as a consequence of Telefónica del Perú no longer being the default provider of long distance services as well as the continued migration of customers to mobile rather than fixed services. In the second half of 2008, Telefónica del Perú lowered the rates on calls from public use telephony to mobile, which slowed the pace of revenue decreases from public use telephony. In contrast, revenues from broadband and pay TV increased over the same period (21.0% and 6.0% in local currency, respectively).
- Telefónica Latin America's revenues from Colombia decreased to €1,490 million in 2008 from €1,569 million in 2007 (a decrease of 3.9% in local currency). The growth in Internet and broadband revenues in the fixed business and service revenues derived from the mobile business did not offset the reduction of interconnection tariffs implemented in December 2007. With respect to Telefónica Móviles Colombia, Telefónica Latin America's mobile business in Colombia, revenues decreased to €815 million in 2008 from €869 million in 2007 (a decrease of 5.1% in local currency). Service revenues decreased 6.6% in 2008 (a decrease of 5.5% in local currency) primarily due to a regulated reduction of interconnection tariffs. Revenues for the fixed line telephony business decreased to €710 million in 2008 from €739 million in 2007 (a decrease of 2.9% in local currency) primarily due to the lower revenues from traditional fixed telephony services not compensated by increased broadband and pay TV revenues.
- Telefónica Latin America's revenues from Central America decreased to €568 million in 2008 from €585 million in 2007 (an increase of 4.2% on a constant euro basis). This growth on a constant euro basis was primarily driven by improved commercial performance in the region. Service revenues grew 5.2% on a constant euro basis in 2008 compared to 2007.
- Telefónica Latin America's revenues from Ecuador increased to €318 million in 2008 from €291 million in 2007 (an increase of 16.8% in local currency). Service revenues increased 13.1% in 2008 (an increase of 20.8% in local currency).

## Expenses

Telefónica Latin America's total expenses increased 5.4% in 2008 to €14,338 million from €13,605 million in 2007.

- Supplies increased 7.0% to €6,371 million in 2008 from €5,953 million in 2007, mainly due to higher interconnection costs and an increase in the cost of handsets driven by growth of gross adds and upgrades.

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Supplies for Telefónica Latin America in Brazil increased to €2,479 million in 2008 from €2,045 million in 2007 (an increase of 21.1% in local currency), principally due to the increase of interconnection mobile costs as a result of outgoing traffic growth and higher co-billing costs in the fixed line business as a result of higher services traffic and more data services out of São Paulo.

Supplies for Telefónica Latin America in Venezuela decreased to €770 million in 2008 from €780 million in 2007 (an increase of 5.5% in local currency), principally due to lower handsets costs (generally, GSM handsets are less expensive than CDMA handsets) that partially compensated for higher roaming interconnection costs.

Supplies for Telefónica Latin America in Argentina increased to €650 million in 2008 from €556 million in 2007 (an increase of 27.0% in local currency), principally due to higher interconnection costs as a result of higher traffic and capacity needs as well as higher inflation.

Supplies for Telefónica Latin America in Chile increased to €503 million in 2008 from €472 million in 2007 (an increase of 13.0% in local currency), principally due to higher inflation, mobile interconnection costs, mobile handsets upgrades, purchases of pay TV content and the construction of increased broadband capacity.

Supplies for Telefónica Latin America in Mexico decreased to €716 million in 2008 from €732 million in 2007 (an increase of 6.3% in local currency). This increase in local currency was primarily due to an increase in interconnection costs driven by the growth of traffic and an increase in contract segment commercial activity.

Supplies for Telefónica Latin America in Peru increased to €413 million in 2008 from €386 million in 2007 (an increase of 6.9% in local currency). This increase was primarily driven by increased marketing efforts in both the mobile and fixed line businesses, and an increase in mobile traffic and interconnection tariffs.

Supplies for Telefónica Latin America in Colombia decreased to €394 million in 2008 from €530 million in 2007 (a decrease of 24.8% in local currency), principally due to a reduction in interconnection tariffs implemented by Colombian regulation in December 2007.

Supplies for Telefónica Latin America in Ecuador increased to €112 million in 2008 from €109 million in 2007 (an increase of 9.5% in local currency), principally due to an increase in interconnection costs driven by a growth of traffic.

- Personnel expenses for Telefónica Latin America decreased 8.0% to €1,735 million in 2008 from €1,886 million in 2007, principally due to the non-recurrence in 2008 of personnel restructuring charges recorded in 2007.

Personnel expenses for Telefónica Latin America in Brazil decreased to €513 million in 2008 from €547 million in 2007 (a decrease of 6.3% in local currency), primarily as a result of the non-recurrence in 2008 of expenses associated with Telesp's program for restructuring its workforce in 2007.

Personnel expenses for Telefónica Latin America in Venezuela increased to €131 million in 2008 from €108 million in 2007 (an increase of 30.4% in local currency), principally due to the effects of higher inflation on wages.

Personnel expenses for Telefónica Latin America in Argentina decreased to €303 million in 2008 from €323 million in 2007 (an increase of 2.0% in local currency). This increase in local currency was due to higher expenses in the mobile business which offset reduced expenses in the fixed line business due to reduced headcount as a result of restructuring of the workforce realized during 2007.



Personnel expenses for Telefónica Latin America in Chile increased to €182 million in 2008 from €169 million in 2007 (an increase of 14.7% in local currency). This increase was primarily driven by the implementation in 2008 of new labor legislation in Chile and higher inflation.

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Personnel expenses for Telefónica Latin America in Mexico increased to €96 million in 2008 from €86 million in 2007 (an increase of 20.7% in local currency) principally due to an increase in the average number of employees in 2008 compared to 2007 and an increase in average wages.

Personnel expenses for Telefónica Latin America in Peru decreased to €159 million in 2008 from €251 million in 2007 (a decrease of 36.7% in local currency). 2007 personnel expenses were affected by a non-recurring €108 million charge related to workforce restructuring.

Personnel expenses for Telefónica Latin America in Colombia decreased to €122 million in 2008 from €123 million in 2007 (an increase of 0.4% in local currency), primarily driven by workforce restructuring costs in both the mobile and fixed line businesses.

Personnel expenses for Telefónica Latin America in Ecuador increased to €26 million in 2008 from €24 million in 2007 (an increase of 16.4% in local currency), principally due to an increase in the average number of employees.

- Other expenses for Telefónica Latin America increased 8.1% to €6,232 million in 2008 from €5,767 million in 2007, principally due to an increase in customer service activities and higher costs associated with the retention and acquisition of customers.

Other expenses for Telefónica Latin America in Brazil increased to €2,543 million in 2008 from €2,354 million in 2007 (an increase of 9.3% in local currency). This increase was primarily driven by higher sales and recharge commissions in the mobile business due to commercially aggressive offers and higher FISTEL (a regulatory tax linked to net adds of customers) costs due to stronger customer base growth in Vivo. Other expenses also increased in the fixed line business mainly due to higher call center and maintenance expenses, primarily as a result of the growth of broadband and pay TV clients.

Other expenses for Telefónica Latin America in Venezuela increased to €553 million in 2008 from €449 million in 2007 (an increase of 31.7% in local currency), driven primarily by increased network expenses due to the launch of a GSM network and higher operational taxes and acquisition costs.

Other expenses for Telefónica Latin America in Argentina increased to €678 million in 2008 from €626 million in 2007 (an increase of 17.1% in local currency), principally as a result of higher inflation and a broader range of services offered.

Other expenses for Telefónica Latin America in Chile increased to €556 million in 2008 from €477 million in 2007 (an increase of 18.6% in local currency), principally due to increased customer service activities and network upgrades and repairs.

Other expenses for Telefónica Latin America in Mexico decreased to €430 million in 2008 from €468 million in 2007 (a decrease of 1.1% in local currency), due to the implementation of measures to control commissions and marketing and logistics costs.

Other expenses for Telefónica Latin America in Peru increased to €467 million in 2008 from €404 million in 2007 (an increase of 11.2% in local currency), principally due to the higher commission expenses, increased customer service activities and mobile advertising as a result of higher commercial activity.

Other expenses for Telefónica Latin America in Colombia increased to €515 million in 2008 from €476 million in 2007 (an increase of 9.6% in local currency), principally due to higher bad debt allowances in the mobile business.

Other expenses for Telefónica Latin America in Ecuador increased to €93 million in 2008 from €86 million in 2007 (an increase of 15.4% in local currency), principally due to an increase in commercial activity and the tax paid for the renewal of the mobile license.

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### Operating income before depreciation and amortization

As a result of the foregoing, Telefónica Latin America's OIBDA, increased 18.6% to €8,445 million in 2008 from €7,121 million in 2007 (an increase of 22.5% on a constant euro basis). By country, Venezuela contributed most to OIBDA growth (5.1 percentage points), followed by Brazil (4.0 percentage points) and Mexico (3.9 percentage points). In absolute terms, in 2008 Brazil was the largest contributor to Telefónica Latin America's OIBDA, accounting for 39.7% of the total, followed by Venezuela at 15.7% and Argentina at 10.9%.

Telefónica Latin America's OIBDA in 2008 as a percentage of Telefónica Latin America's revenues for the same period was 38.1%, 2.6 percentage points higher than in 2007.

- Telefónica Latin America's OIBDA in Brazil increased to €3,359 million in 2008 from €3,056 million in 2007 (an increase of 9.8% in local currency).
- Telefónica Latin America's OIBDA in Venezuela increased to €1,328 million in 2008 from €1,060 million in 2007 (an increase of 34.0% in local currency).
- Telefónica Latin America's OIBDA in Argentina increased to €919 million in 2008 from €788 million in 2007 (an increase of 26.7% in local currency).
- Telefónica Latin America's OIBDA in Chile increased to €740 million in 2008 from €716 million in 2007 (an increase of 9.7% in local currency).
- Telefónica Latin America's OIBDA in Mexico increased to €420 million in 2008 from €179 million in 2007 (an increase of 154.2% in local currency). The increase was the result of cost control measures and revenue growth.
- Telefónica Latin America's OIBDA in Peru increased to €621 million in 2008 from €482 million in 2007 (an increase of 29.0% in local currency).
- Telefónica Latin America's OIBDA in Colombia increased to €515 million in 2008 from €503 million in 2007 (an increase of 3.6% in local currency).
- Telefónica Latin America's OIBDA in Central America decreased to €217 million in 2008 from €236 million in 2007 (a decrease of 1.5% on a constant euro basis).
- Telefónica Latin America's OIBDA in Ecuador increased to €92 million in 2008 from €73 million in 2007 (an increase of 35.0% in local currency).

### Depreciation and amortization

Telefónica Latin America's depreciation and amortization increased 2.4% to €3,645 million in 2008 from €3,559 million in 2007.

### Operating income

As a result of the foregoing, Telefónica Latin America's operating income increased 34.8% to €4,800 million in 2008 from €3,562 million in 2007.

### Atento

Revenues

Atento's revenues increased by 10.8% to €1,301 million in 2008 from €1,174 million in 2007. The increase in revenues was primarily driven by an increase in the customer activity of Telefónica, primarily in Brazil, Peru, Morocco and Central America, partially offset by a lower activity in Spain.

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## Expenses

Atento's expenses increased 10.0% to €1,120 million in 2008 from €1,018 million in 2007 primarily due to the increase in structural costs from the leasing of capacity associated with the growth of the business. This growth in expenses was partially offset by migrating services from the Spanish market to Latin American markets, which limited the growth of personnel expenses.

## Operating income before depreciation and amortization

Atento's OIBDA increased 15.4% to €186 million in 2008 from €161 million in 2007, driven by an increase in activity and a slower growth rate for operational expenses.

## Operating income

Atento's operating income increased 17.4% to €154 million in 2008 from €131 million in 2007.

## B. Liquidity and Capital Resources

## Cash Flow Analysis

The table below sets forth consolidated cash flow information for the periods indicated. Positive figures refer to cash inflows and those in parenthesis refer to cash outflows.

IFRS	Year ended December 31,		
	2007	2008	2009
	(in millions of euros)		
Net cash from operating activities	15,551	16,366	16,148
Net cash used in investing activities	(4,592)	(9,101)	(9,300)
Net cash used in financing activities	(9,425)	(7,765)	(2,281)

## Net cash from operating activities

Net cash from operating activities decreased 1.3% to €16,148 million in 2009 from €16,366 million in 2008. In 2008, the increase was 5.2% from €15,551 million in 2007.

In 2009, we had cash received from customers (€67,358 million) less cash paid to suppliers and employees (€46,198 million) totaling €21,160 million, 2.9% more than the €20,560 million generated in 2008. This increase was largely driven by our extensive business diversification, our execution skills in a challenging environment and efficient management of both operating expenses and capital expenditure. Our strong commercial efforts also helped to drive modest growth in total accesses (primarily in mobile and broadband accesses). In 2008, cash received from customers less cash paid to suppliers and employees (€20,560 million) rose 2.3% compared to €20,105 million in 2007, due mostly to our strong position in our main markets, extensive business diversification and strategic commitment to growth in our operating markets.

Cash received from customers decreased by 2.5% to €67,358 million in 2009 from €69,060 million in 2008. This decrease was in line with the decline in revenues. In 2008, cash received from customers increased by 2.9% to €69,060 million from €67,129 million in 2007. This growth was the result of modestly higher revenue due to the growth in accesses, which in turn was due to the success of the commercial campaigns to win and retain customers.

Cash paid to suppliers and employees in 2009 decreased 4.8% to €46,198 million from €48,500 million in 2008. This reduction is the result of the drive to contain expenses and to maximize the efficiency of the cost structure. In addition, cash paid to employees in 2009 and 2008 was broadly in line with the evolution of the average headcount. In 2008 cash paid to suppliers and employees rose 3.1% to €48,500 million from €47,024 million in 2007. This increase was primarily attributable to greater commercial efforts in the various geographic areas while maximizing the efficiency of the cost structure and to higher interconnection charges.

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Payments for net interest and other finance expenses decreased by 25.0% to €2,170 million in 2009 from €2,894 million in 2008, due to the decline in average interest rates applicable to our debt during the year and the reduction in our financial debt outstanding during the year. These figures do not include payments to be made on the main issuances of our debt securities made in 2009, with interest payments that will begin to become due in 2010. In 2008 payments for net interest and other finance expenses decreased 10.2% to €2,894 million from €3,221 million in 2007 mostly due to the decrease in our debt outstanding over the period.

Taxes paid in 2009 increased by 108.2% to €2,942 million from €1,413 million in 2008 due to the €1,297 million payment made by Telefónica, S.A. in the year. The increase was mainly due to the absence in 2009 of tax credits in Group companies. Taxes paid in 2008 fell 3.0% to €1,413 million from €1,457 million in 2007.

## Net cash used in investing activities

Net cash used in investing activities in 2009 increased by 2.2% to €9,300 million from €9,101 million in 2008, mainly due to the investment of certain short-term cash surpluses in higher yielding financial investments.

Net cash used in investing activities increased by €4,509 million in 2008 to €9,101 million from €4,592 million in 2007. This net increase was primarily attributable to the following investments in 2008: the acquisitions of Telemig by Brasilcel for €347 million, of shares of CNC and China Unicom for €688 million and €424 million, respectively, and of a 51.8% interest in CTC from minority shareholders for €640 million. This net increase was partially offset by a 22.2% decrease in payments on investments in companies, net of cash and cash equivalents acquired, from €2,798 million in 2007 to €2,178 million in 2008. The main investment in 2007 was for a 42.3% stake in Telco for €2,314 million.

Payments on investment in property, plant and equipment and intangible assets in 2009 decreased by 3.8% to €7,593 million from €7,889 million in 2008. This decrease was in line with the evolution of the investment in capital expenditures in the period. Payments on investment in property, plant and equipment and intangible assets in 2008 totaled €7,889 million, an increase of €615 million from 2007, driven by further investment in fiber optics, 3G technology, pay TV technology and ADSL.

Proceeds on disposals of companies, net of cash and cash equivalents disposed amounted to €34 million in 2009. Proceeds on disposals of companies, net of cash and cash equivalents disposed, amounted to €686 million in 2008 mainly due to the €648 million obtained from the sale of Sogecable. In 2007, the figure was €5,346 million, as a result of our disposals of stakes in Airwave and Endemol for €2,841 million and €2,107 million, respectively.

Interest received on cash surpluses not included under cash equivalents in 2009 amounted €548 million. Net disposals of these investment in 2008 and 2007 amounted €76 million and €74 million, respectively.

## Net cash used in financing activities

Net cash used in financing activities in 2009 decreased by 71% to €2,281 million from €7,765 million in 2008, mainly due to the increase of proceeds from the issuance of debentures and bonds in 2009 for aggregate proceeds of €8,617 million compared to aggregate proceeds of €1,317 million raised in 2008.

Net cash used in financing activities in 2008 totaled €7,765 million, down from €9,425 million in 2007. The €1,660 million decline is primarily due to a decrease in the repayment of financing as a result of a decrease in our average outstanding net debt in 2008 to €45,785 million compared to €48,938 million in 2007.

## Anticipated Uses of Funds



Our principal liquidity and capital resource requirements consist of the following:

- capital expenditures for existing and new operations;
- acquisitions of new licenses or other operators or companies engaged in complementary or related businesses;

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- costs and expenses relating to the operation of our business;
- dividend, other shareholder remuneration, and pre-retirement payments; and
- debt service requirements relating to our existing and future debt.

We have announced a capital expenditure target in the range of €7,450 million to €7,650 million for 2010. This target range was proposed based on constant 2009 exchange rates and excludes the effects of Venezuela being considered a hyperinflationary economy in 2009 and any effects should it remain a hyperinflationary economy in 2010. This target range also excludes any spectrum licenses which we may acquire and investments in our Real Estate Efficiency Program in Spain, a multi-year program related to the optimization of our real estate assets and rented properties in Spain. In 2010, we expect to continue investing mainly in our 3G and broadband networks to meet existing growth opportunities related to broadband, increased network traffic and the offering of new products and services utilizing new or evolving technologies. By region, our capital expenditures will be mainly directed to Latin America, as we view this region to possess the most growth potential for the Group, but we will manage spending depending on the needs of each country and return on potential investments, as our main goal is to sustain cash flow generation. Nevertheless, we expect to continue to make investments in our mobile and fixed networks due to increased usage and the need to offer new services and greater functionality afforded by new or evolving technologies. Our principal capital expenditures are described in “Item 4. Information on the Company”. Our anticipated amounts of capital expenditures and investments in affiliates and the underlying assumptions are subject to risks and uncertainties, and actual capital expenditures and investments in affiliates may be less than or exceed these amounts. See “Cautionary Statement Regarding Forward-Looking Statements”.

We may also use funds to acquire new licenses or other operators or companies engaged in complementary or related businesses.

We also have liquidity requirements related to the costs and expenses relating to the operation of our business, our payment of dividends, shareholder remuneration and pre-retirement payment commitments and financial and real estate investments. In 2009, with respect to these items, we had the following principal cash expenditures: €4,557 million in connection with the payment of dividends on Telefónica S.A. shares, €1,178 million in connection with financial and real estate net investments, €959 million in connection with our share buyback program and €793 million in connection with commitments under pre-retirement plans.

We also have liquidity requirements related to debt service requirements in connection with our existing and future debt. At December 31, 2009, we had gross financial debt of €56,791 million compared with €53,188 million at December 31, 2008. For the amortization schedule of our consolidated gross financial debt at December 31, 2009, see “—Anticipated Sources of Liquidity” below. Our net financial debt increased to €43,551 million at December 31, 2009 compared to €42,733 million at December 31, 2008. For a reconciliation of net financial debt to gross financial debt (the sum of current and non-current interest-bearing liabilities), see “—Presentation of Financial Information—Non-GAAP financial information—Net financial debt and net debt”.

For a discussion of our liquidity risk management policy, see Note 16 to our Consolidated Financial Statements.

**Anticipated Sources of Liquidity**

Cash flows from operations are our primary source of cash funding for existing operations, capital expenditures, interest obligations and principal payments. We also rely on external borrowings, including a variety of short- and medium-term financial instruments, principally bonds and debentures, and borrowings from financial institutions. Cash and cash equivalents are mainly held in euro and euro-denominated instruments. We believe that,

in addition to internal generation of funds, our medium-term note program, our euro commercial paper program, our corporate domestic promissory note program and available lines of credit will provide us with substantial flexibility for our future capital requirements as existing debt is retired. As of the date of this Annual Report, our management believes that our working capital is sufficient to meet our present requirements.

The following table shows the amortization schedule of our consolidated gross financial debt at December 31, 2009, as stated in euro using the European Central Bank buying rate for euro on such date. We may have exchange

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rate financial derivatives instruments assigned to the underlying debt instruments. In 2009, the average cost of net debt, which we measure as net financial expense divided by our average net debt, was 7.31%. The effects derived from Venezuela as a hyperinflationary economy as described in “Item 5. Operating and Financial Review and Prospects—A. Operating Results—Significant Factors Affecting the Comparability of our Results of Operations in the Periods Under Review—Classification of Venezuela as a Hyper inflationary Economy”, resulted in an increase in net financial expense of €630 million in 2009. Excluding such effects in 2009 and negative exchange differences, our average cost of net debt in 2009 would have been 5.54%. The table below includes the fair value of those derivatives classified as financial liabilities (negative mark-to-market) under IFRS (€1,432 million). It does not include the fair value of derivatives classified as financial assets (positive mark-to-market) under IFRS (€537 million). For a further description of liquidity risk faced by us, see Note 16 to our Consolidated Financial Statements, and for a description of our financial liabilities, see Note 13 to our Consolidated Financial Statements.

	AMORTIZATION SCHEDULE FOR THE YEAR ENDED DECEMBER 31,						
	2010	2011	2012	2013	2014	Subsequent	Total
	(in millions of euros)						
Non-convertible euro and foreign currency debentures and bonds	5,090	3,275	1,749	4,174	4,763	13,911	32,962
Promissory notes and commercial paper	812	—	—	—	—	—	812
Other marketable debt securities	61	54	—	—	—	1,954	2,069
Loans and other payables (principal and interest accrued)	1,789	6,132	3,695	1,433	513	4,396	17,958
Derivatives financial liabilities	1,432	255	106	65	63	1,069	2,990
Total	9,184	9,716	5,550	5,672	5,339	21,330	56,791

(\*) Estimated future interest payments as of December 31, 2009 on our interest-bearing-debt are as follows: €2,382 million in 2010, €2,074 million in 2011, €1,818 million in 2012, €1,620 million in 2013, €1,355 million in 2014 and €8,190 million in subsequent years. With respect to floating rate debt, we estimate future interest payments as the forward rates derived from yield curves quoted for the different currencies on December 31, 2009.

During 2009, we obtained financing of over €14,000 million (excluding financing under short-term commercial paper programs), mainly in connection with refinancing 2009 maturities and pre-financing part of the 2010 debt maturities.

In 2009, as a part of our refinancing plan to enhance our flexibility, primarily, we issued: (i) five-year bonds in an aggregate principal amount of €2,000 million, with an annual interest rate of 5.431%, on February 3, 2009; (ii) seven-year bonds in an aggregate principal amount of €1,000 million, with an annual interest rate of 5.496%, on April 1, 2009 increased up to an aggregate principal amount of €1,500 million, on June 3, 2009; (iii) six-year bonds in an aggregate principal amount of €400 million, which bear interest at a floating rate based on three-month EURIBOR plus a margin of 1.825%, on June 2, 2009 (iv) ten-year bonds in an aggregate principal amount of \$1,000 million, with an annual interest rate of 5.877%, on July 6, 2009; (v) five and a half-year bonds in an aggregate principal amount of \$1,250 million, with an annual interest rate of 4.949%, on July 6, 2009; (vi) ten-year bonds in an aggregate principal amount of €1,750 million, with an annual interest rate of 4.693%, on November 11, 2009; (vii) 13-year bonds in an

aggregate principal amount of 650 million pounds sterling, with an annual interest rate of 5.289%, on December 10, 2009; (viii) five-year bonds in an aggregate principal amount of €100 million, which bear interest at a floating rate based on three-month EURIBOR plus a margin of 0.7%, on December 23, 2009. In 2009, some of our Latin American companies issued bonds with an aggregate principal amount equivalent to approximately €2,000 million.

In addition, on February 13, 2009, Telefónica, S.A. signed an agreement with the banks involved in its €6,000 million credit facility granted on June 28, 2005 and maturing on June 28, 2011, to extend the maturity of €4,000 million of the €6,000 million drawn-down in exchange for the payment of additional fees and an upward adjustment in interest rates, as follows: (i) the maturity date for €2,000 million outstanding was extended to June 28, 2012 and (ii) the maturity date for the remaining €2,000 million outstanding was extended to June 28, 2013.

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During 2009, we have continued to be active under certain commercial paper programs (domestic and European) (with an outstanding balance of €800 million at December 31, 2009).

At December 31, 2009, we had unused committed credit lines of approximately €7,200 million, all of which bear interest at a floating rate based on market indices, principally the Euro Interbank Offered Rate, or EURIBOR and the London Interbank Offered Rate, or LIBOR. An aggregate of €2,779 million in principal amount of such credit lines are scheduled to expire prior to December 31, 2010.

On March 24, 2010 we issued five-year bonds in an aggregate principal amount of €1,400 million, with an annual interest rate of 3.406%.

Our borrowing requirements are not significantly affected by seasonal trends.

The table below sets forth the ratings of our short- and long-term debt as of the date of this Annual Report. A credit rating is not a recommendation to buy, sell or hold securities, may be subject to revision at any time and should be evaluated independently of any other rating.

Rating Agency	Issuer	Long-Term Debt	Short-Term Debt	Outlook	Last Update
Moody's	Telefónica, S.A.	Baa1	P-2	Positive	February 17, 2009
JCR	Telefónica, S.A.	A	-	Stable	December 17, 2008
Standard & Poor's	Telefónica, S.A.	A-	A-2	Stable	December 2, 2008
Fitch	Telefónica, S.A.	A-	F-2	Stable	November 25, 2008

- Moody's, on February 17, 2009, raised Telefónica S.A.'s rating outlook to "Baa1/positive outlook" from "Baa1/stable outlook".
- JCR, the Japanese rating agency, on December 17, 2008, upgraded its credit rating for Telefónica, S.A. to "A/stable outlook" from "A-/stable outlook".
- Standard & Poor's, on December 2, 2008, upgraded its rating of Telefónica S.A. from "BBB+/positive outlook" to "A-/stable outlook".
  - Fitch, on November 25, 2008, upgraded its rating from "BBB+/positive outlook" to "A-/stable outlook".

Our ability to use external sources of financing will depend in large part on our credit ratings. We believe that we are well-positioned to raise capital in financial markets. However, negative conditions in the financial markets or a downgrade of any of the ratings of our debt by any of Fitch, Moody's, JCR and/or Standard & Poor's may increase the cost of our future borrowing or may make it more difficult to access the public debt markets. In connection with the credit rating agencies' review of our debt ratings, the rating agencies may give considerable weight to the general macroeconomic and political conditions, the performance of our businesses in countries where we operate, our financial and shareholder remuneration policy, our acquisition policy, our ability to integrate acquisitions and our ability to refinance debt.

For a discussion of our liquidity and country risk management policy, see Note 16 to our Consolidated Financial Statements.

#### Intragroup Loans

We lend funds to our operating subsidiaries, directly or through holding companies that head our different lines of business. At December 31, 2009, we had loans outstanding totaling €5,975 million (€13,594 million at December 31, 2008) to companies in the Telefónica Group (including subsidiaries located in Latin American countries). These funds are derived from retained cash flows, loans, bonds and other sources (such as asset disposals).

#### C. Research and Development, Patents and Licenses, etc.

We continue to be firmly committed to technological innovation as a key tool for achieving sustainable competitive advantage, preempting market trends and differentiating our products. Through the introduction of new

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technologies and the development of new products and business processes, we seek to become more effective, efficient and customer-oriented.

We have developed an open model for the management of technological innovation in order to promote the application of technical research to the development of commercial products and services. We focus on certain applied research and development, or R&D, priorities which are aligned with our strategy. This model promotes open innovation initiatives such as the creation of a venture capital fund and participation in enterprise collaboration forums, among other things. It also makes use of the knowledge developed at technological centers, universities, and start-up companies, among other sources, and encourages innovation in collaboration with other agents, who will become “technological partners”, including clients, universities, public administrations, suppliers, content providers and other companies. We believe that differentiating our products from those of our competitors and improving our market position cannot be based solely on acquired technology. We also believe it is important to foster R&D activities in an effort to achieve this differentiation and to advance other innovation activities. Our R&D policy is aimed at:

- developing new products and services in order to gain market share;
  - fostering customer loyalty;
  - increasing revenues;
  - improving management;
  - improving business practices; and
- increasing the quality of our infrastructure and services to improve customer service and reducing costs.

In 2009, we undertook technological innovation projects focusing on profitable innovation, process efficiency, the creation of new sources of revenues, customer satisfaction, the consolidation of our presence in new markets and technological leadership.

Our technological innovation activities are an integral part of our strategy to create value through broadband, IP network, wireless and new generation (fiber optic) networks communications and services.

In 2009 we undertook projects to promote increased access to information technology, new services focused on new Internet business models, advanced user interfaces, mobile TV and other broadband services. These projects, among others, were undertaken based on our objective to quickly identify emerging technologies that might have a relevant impact on our businesses, and to test such technologies with trials relating to new services, applications and platform prototypes.

In 2009, new business and operational support systems were developed and existing systems were improved.

Most of our R&D activities are carried out by Telefónica Investigación y Desarrollo S.A.U., or Telefónica I+D, our wholly owned subsidiary, which works principally for our lines of business. In performing its functions, Telefónica I+D receives assistance from other companies and universities. Telefónica I+D’s mission focuses on improving our competitiveness through technological innovation and product development. Telefónica I+D leads experimental and applied research and product development to increase the range of our services and reduce operating costs. It also provides technical assistance to our Latin American and European operations. Telefónica I+D’s activities include the following:



- development of new products and fixed telephone services, particularly the development of such value added services as broadband, digital home, mobile communications and Internet services for the public, corporate, mobile TV and multimedia sectors;
- development of new modes of communications for communities, telemedicine, home and company telemonitoring and new infrastructure to provide such services, such as the Internet protocol environment and new generation networks, such as fiber optics;

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- development of innovative solutions for the real time provisioning, operating and billing of our networks and services, which includes the development of management systems designed to strengthen infrastructure and its quality providing security, privacy and trust;
- development of business support systems to better identify customer characteristics in order to provide personalized and innovative solutions; and
- applied research to undertake, understand and develop those aspects, opportunities and specialty new technologies for the evolution of our different businesses.

In 2009, approximately 41% of Telefónica I+D's funding assigned to R&D was for the benefit of the business in Spain, 33% for businesses in Latin America, 13% for Telefónica (primarily the Corporate Innovation Program, which includes projects with a medium- to long-term focus involving two or more business units), 6% for Telefónica Europe and 7% to third-party customers.

At December 31, 2009, Telefónica I+D had 1,221 employees, who also collaborated with qualified professionals from 84 companies and more than 50 universities.

Our total R&D expenses were €594 million, €668 million and €693 million in 2007, 2008 and 2009, respectively. These expenses represented 1.1%, 1.2% and 1.2% of our consolidated revenues, respectively. These figures have been calculated using the guidelines set out in the OECD Manual. These guidelines include expenses for research and development that, because of timing of projects or accounting classifications, we do not include in their entirety in our consolidated statement of financial position.

During 2009, Telefónica registered 57 patents, 48 of which were registered at Spanish Patent Office and nine of which were registered at European or U.S. patent offices.

### D. Trend Information

We are an integrated diversified telecommunications group that offers a wide range of services, mainly in Spain, Europe, and Latin America. Our activity is based upon providing fixed and mobile services, Internet and data, pay TV and value added services, among others. In addition, our holdings in China Unicom and Telecom Italia create opportunities for strategic alliances that reinforce our competitive position, scale and efficiency.

Our business is impacted by general economic conditions and other similar factors in each of the countries in which we operate. The continuing recession in Spain and uncertainty about an economic recovery elsewhere may negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers.

As a multinational telecommunications company that operates in regulated markets, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. We can expect the regulatory landscape 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, we 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.

We face intense competition in most of our markets, and we are therefore subject to the effects of actions taken by our competitors. The intensity of the competition may deepen, having an impact on tariff structures, consumption, market share and commercial activity, which could result in decreases in current and potential customers, revenues and

profitability.

However, we are in a strong competitive position in most of the markets where we operate. We intend to continue to seek and take advantage of growth opportunities, 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. We seek to lead the industry by anticipating trends in the new digital environment.

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We will continue transforming our operating model to increase our operational efficiency and capture the synergies arising from our integrated approach to businesses, processes and technologies and will maintain a regional approach to tackle this transformation more efficiently. At the same time, we will continue to be strongly committed to technological innovation as a key tool for achieving sustainable competitive advantages, anticipating market trends and differentiating our products. We continually seek to become a more efficient and customer-oriented Group, by introducing new technologies and developing new products and business processes.

In Spain, we will continue to intensify our commercial focus on offering higher quality services, by increasing the effectiveness of our sales channels and further improving our networks to increase customer satisfaction. We will seek to strengthen relations with our customers through targeted commercial offerings. We will focus on boosting mobile and fixed broadband growth and bundling services more effectively, taking into account the different geographical areas in which we operate. 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.

In Latin America, our 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 we continue to further improve the capacity and coverage of our networks, adapting our distribution network to enhance the quality of our offer both in voice and data in order to keep and attract high value customers. With regard to the fixed telephony business, we will encourage the increase of broadband speed and expand the supply of bundled services. We 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 our strategy and management priorities in the region. With the objective of offering our customers the best value, we will boost the mobile and fixed broadband services to strengthen our market position. Various initiatives will be implemented to improve our operating efficiency.

In summary, in the context of continued economic uncertainty, intense competition and regulatory pressure on pricing, we will continue strengthening our business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while focusing even more on the client.

E. Off-Balance Sheet Arrangements

We have commitments that could require us to make material payments in the future. These commitments are not included in our consolidated statement of financial position at December 31, 2009 although they are described in the notes to our Consolidated Financial Statements. These commitments primarily relate to put rights pursuant to which third parties can require us to purchase some or all of their interests in certain of our subsidiaries or joint ventures, as in the case of Brasilcel, and contingent obligations in the form of guarantees. For additional detail on our off-balance sheet commitments, see Note 21(b) to our Consolidated Financial Statements.

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## F. Tabular Disclosure of Contractual Obligations

The following table describes our contractual obligations and commitments with definitive payment terms which may require significant cash outlays in the future. The amounts payable (including accrued interest payments) are as of December 31, 2009. For additional information, see our Consolidated Financial Statements included elsewhere herein.

	Total	Payments Due by Period			More than 5 Years
		Less than 1 year	1-3 years	3-5 years	
		(in millions of euros)			
Financial liabilities (1)(2)	56,791	9,184	15,266	11,011	21,330
Operating lease obligations (3)	6,547	1,023	1,700	1,327	2,497
Purchase obligations (4)	3,151	1,305	769	395	682
Other liabilities (5)	1,695	296	1,399	—	—
<b>Total</b>	<b>68,184</b>	<b>11,808</b>	<b>19,134</b>	<b>12,733</b>	<b>24,509</b>

(1) Capital (finance) lease obligations are not calculated separately and are instead included as part of our long-term debt obligations.

(2) This item includes the fair value of those derivatives classified as financial liabilities (negative mark-to-market) under IFRS (€1,432 million). Future interest payments as of December 31, 2009 on our interest-bearing-debt are as follows: €2,382 million in 2010, €2,074 million in 2011, €1,818 million in 2012, €1,620 million in 2013, €1,355 million in 2014 and €8,190 million in subsequent years. With respect to floating rate debt, we estimate future interest payments as the forward rates derived from yield curves quoted for the different currencies on December 31, 2009. It does not include the fair value of derivatives classified as financial assets (positive mark-to-market) under IFRS (€537 million). For a more detailed description of our financial derivative transactions, see “Item 11. Quantitative and Qualitative Disclosures About Market Risk” and Note 16 to our Consolidated Financial Statements.

(3) Our operating lease obligations have in some cases extension options conditioned on the applicable law of each country. Accordingly, we have included only those amounts that represent the initial contract period.

(4) This item includes definitive payments due for agreements to purchase goods (such as network equipment) and services.

(5) “Other liabilities” include long-term obligations that require us to make cash payments, excluding financial debt obligations included in the table under “Financial Liabilities” above. Because of the nature of the risks covered by “Other liabilities” such as “Other provisions”, it is not possible to determine a reliable schedule of potential payments, if any. For details of the composition of “other provisions” see Note 15 to our Consolidated Financial Statements.

In addition, at December 31, 2009, we have short and long term employee benefits provisions amounting to €667 million and €3,594 million, respectively.

For details of the composition of, and changes in, our debt, see “—Liquidity and Capital Resources—Anticipated Sources of Liquidity” and Note 13 to our Consolidated Financial Statements.



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## Item 6. Directors, Senior Management and Employees

## A. Directors and Senior Management

During 2009, our Board of Directors met 13 times. At March 25, our Board of Directors had met three times during 2010. At March 25, 2010, our directors, their respective positions on our Board and the year they were appointed to such positions were as follows:

Name	Age	First Appointed	Current Term Ends
<b>Chairman</b>			
César Alierta Izuel(1)	64	1997	2012
<b>Vice-chairmen</b>			
Isidro Fainé Casas(1)(2)	67	1994	2011
Vitalino Manuel Nafría Aznar(3)(4)(5)(6)(7)	59	2005	2011
<b>Members (vocales)</b>			
Julio Linares López(1)(8)	64	2005	2011
José María Abril Pérez (1)(3)(5)	58	2007	2013
José Fernando de Almansa Moreno-Barreda(5)(6)(9)	61	2003	2013
Jose María Álvarez –Pallete López	46	2006	2012
David Arculus (5)(6)	63	2006	2011
Eva Castillo Sanz (6)(9)(11)	47	2008	2013
Carlos Colomer Casellas(1)(8)(10)(11)	65	2001	2011
Peter Erskine(1)(8)(9)(10)	58	2006	2011
Alfonso Ferrari Herrero (1)(4)(5)(6)(7)(10)(11)	68	2001	2011
Luiz Fernando Furlán(5)	63	2008	2013
Gonzalo Hinojosa Fernández de Angulo (1)(4)(5)(7)(9)(10)(11)	64	2002	2012
Pablo Isla Álvarez de Tejera(6)(7)(8)(10)(11)	46	2002	2012
Antonio Massanell Lavilla(2)(4)(7)(8)(11)	55	1995	2011
Francisco Javier de Paz Mancho (1)(5)(6)(7)	51	2007	2013

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- (1) Member of the Executive Commission of the Board of Directors.
- (2) Nominated by Caja de Ahorros y Pensiones de Barcelona (“La Caixa”).
- (3) Nominated by Banco Bilbao Vizcaya Argentaria, S.A. (“BBVA”).
- (4) Member of the Audit and Control Committee of the Board of Directors.
- (5) Member of the International Affairs Committee.

- (6) Member of the Regulation Committee.
- (7) Member of the Human Resources and Corporate Reputation and Responsibility Committee.
- (8) Member of the Innovation Committee.
- (9) Member of the Strategy Committee.
- (10) Member of the Nominating, Compensation and Corporate Governance Committee.
- (11) Member of the Service Quality and Customer Service Committee.

Board Committees

At March 25, 2010, the committees of our Board of Directors and members thereof are as follows:

Executive Commission

Our Board of Directors has expressly delegated all of its authority and power to the Executive Commission except as prohibited by Spanish corporate law, under our Articles of Association, or under our Board Regulations. This commission is made up of fewer directors and meets more frequently than our Board of Directors. The members of the Executive Commission are Mr. César Alierta Izuel, Mr. Isidro Fainé Casas, Mr. Julio Linares López, Mr. José María Abril Pérez, Mr. Carlos Colomer Casellas, Mr. Peter Erskine, Mr. Alfonso Ferrari Herrero,



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Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Francisco Javier de Paz Mancho and Mr. Ramiro Sánchez de Lerín García-Ovies, as secretary.

### Audit and Control Committee

The Audit and Control Committee functions are regulated by our bylaws and our Board Regulations. The Audit and Control Committee has the primary objective of providing support to our Board of Directors in its supervisory and oversight functions, specifically having the following responsibilities:

- to report, through its chairman, to our general meeting of shareholders on matters raised at the general meeting of shareholders relating to the functions and matters of competence of the committee;
- to propose to our Board of Directors to submit to our general meeting of shareholders the appointment of our auditors referred to in Article 204 of the Stock Company Act, as well as, when appropriate, the terms of their engagement, scope of professional assignment and revocation or non-renewal of their appointment;
- to supervise the internal audit services;
- to have an understanding of the process for gathering financial information and the internal control systems; and
- to maintain the necessary relations with the auditors to receive information on all matters that may put their independence at risk, and any other matters related to the process of auditing our accounts, as well as to receive information and maintain communication with our auditors as required by laws relating to the audit process and with respect to technical regulations on auditing.

The Audit and Control Committee meets at least once per quarter and as many times as considered necessary. During 2009, the Audit and Control Committee met ten times and, as of the date of this Annual Report, had met three times in 2010. The members of the Audit and Control Committee are Mr. Gonzalo Hinojosa Fernández de Angulo (chairman), Mr. Antonio Massanell Lavilla, Mr. Alfonso Ferrari Herrero and Mr. Vitalino Manuel Nafría Aznar.

### Nominating, Compensation and Corporate Governance Committee

The Nominating, Compensation and Corporate Governance Committee is responsible for, among other things, reporting to our Board of Directors with respect to proposals for the appointment, re-election and removal of directors, members of the Executive Committee and the other committees of our Board of Directors and top members of our management and management of our subsidiaries. In addition, the Nominating, Compensation and Corporate Governance Committee is responsible for proposing to the Board of Directors, within the framework established in the bylaws, the compensation for the directors and reviewing it periodically to ensure that it is in keeping with the tasks performed by them, as provided in Article 35 of the Board Regulations, 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 Telefónica, including the basic terms of their contracts, for purposes of contractual implementation thereof and to supervise compliance with Telefónica's internal rules of conduct and the corporate governance rules thereof in effect from time to time.

The members of the Nominating, Compensation and Corporate Governance Committee are Mr. Alfonso Ferrari Herrero (chairman), Mr. Carlos Colomer Casellas, Mr. Peter Erskine, Mr. Gonzalo Hinojosa Fernández de Angulo and Mr. Pablo Isla Álvarez de Tejera. During 2009, the Nominating, Compensation and Corporate Governance Committee met nine times, and as of the date of this Annual Report, had met four times in 2010.

Human Resources and Corporate Reputation and Responsibility Committee

The Human Resources and Corporate Reputation and Responsibility Committee is responsible for reviewing our personnel policy and making proposals to our Board of Directors regarding our personnel policy, corporate reputation, responsibility and the promotion of our values within the Telefónica Group. The Human Resources and

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Corporate Reputation and Responsibility Committee met five times during 2009, and as of the date of this Annual Report had met once in 2010. The members of the Human Resources and Corporate Reputation and Responsibility Committee are Mr. Francisco Javier de Paz Mancho (chairman), Mr. Alfonso Ferrari Herrero, Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Pablo Isla Álvarez de Tejera, Mr. Antonio Massanell Lavilla and Mr. Vitalino Manuel Nafría Aznar.

## Regulation Committee

The Regulation Committee's main objective is to monitor the main regulatory matters which affect us. Another responsibility of the Regulation Committee is to act as a communication and information channel between our management team and our Board of Directors concerning regulatory matters. The members of the Regulation Committee are Mr. Pablo Isla Álvarez de Tejera (chairman), Mr. José Fernando de Almansa Moreno-Barreda, Mr. David Arculus, Ms. Eva Castillo Sanz, Mr. Alfonso Ferrari Herrero, Mr. Vitalino Manuel Nafría Aznar and Mr. Francisco Javier de Paz Mancho. During 2009, the Regulation Committee met six times, and as of the date of this Annual Report, had met once in 2010.

## Service Quality and Customer Service Committee

The Service Quality and Customer Service Committee is responsible for monitoring and reviewing the standards of quality of the main services we provide. The Service Quality and Customer Service Committee acts as an information channel between our senior management team and our Board of Directors. The members of the Service Quality and Customer Service Committee are Mr. Antonio Massanell Lavilla (chairman), Ms. Eva Castillo Sanz, Mr. Carlos Colomer Casellas, Mr. Alfonso Ferrari Herrero, Mr. Gonzalo Hinojosa Fernández de Angulo, and Mr. Pablo Isla Álvarez de Tejera. During 2009 the Service Quality and Customer Service Committee met four times, and as of the date of this Annual Report, had met once in 2010.

## International Affairs Committee

The International Affairs Committee is responsible for analyzing international events and matters that affect the Telefónica Group and reporting these events and possible consequences to our Board of Directors. The International Affairs Committee pays close attention to events taking place in countries where we have operations and which may affect our competitive position, corporate image and financial results. The International Affairs Committee also oversees our non-profit foundations in such countries. The members of the International Affairs Committee are Mr. José Fernando de Almansa Moreno-Barreda (chairman), Mr. José María Abril Pérez, Mr. David Arculus, Mr. Alfonso Ferrari Herrero, Mr. Luiz Fernando Furlán, Mr. Gonzalo Hinojosa Fernández de Angulo, Mr. Vitalino Manuel Nafría Aznar and Mr. Francisco Javier de Paz Mancho. During 2009, the International Affairs Committee met four times, and as of the date of this Annual Report had met once in 2010.

## Innovation Committee

The Innovation Committee is responsible for advising and assisting in all matters regarding innovation. Its main object is to examine, analyze and periodically monitor the Group's innovation projects, provide guidance and help ensure the implementation and development of innovation initiatives across the Group. The members of the Innovation Committee are Mr. Carlos Colomer Casellas (chairman), Mr. Pablo Isla Álvarez de Tejera, Mr. Antonio Massanell Lavilla, Mr. Peter Erskine and Mr. Julio Linares López. During 2009, the Innovation Committee met eight times, and as of the date of this Annual Report, had met three times in 2010.

## Strategy Committee

Without prejudice to any other tasks that the Board of Directors may assign thereto, the primary duty of the Strategy Committee is to support the Board of Directors in the analysis and implementation of the global strategy policy of the Telefónica Group. The members of the Strategy Committee are Mr. Peter Erskine (chairman), Mr. José Fernando de Almansa Moreno-Barreda, Ms. Eva Castillo Sanz and Mr. Gonzalo Hinojosa Fernández de Angulo. The Strategy Committee met ten times during 2009, and as of the date of this Annual Report, had met three times in 2010.

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## Biographies of Directors

Mr. César Alierta Izuel serves as our Executive Chairman and Chairman of our Board of Directors. Mr. Alierta began his career in 1970 as general manager of the capital markets division at Banco Urquijo, S.A. in Madrid, where he worked until 1985. Subsequently, he founded and served as chairman of Beta Capital Sociedad de Valores, S.A. which he combined as from 1991 with his post as chairman of the Spanish Financial Analysts' Association (Asociación Española de Analistas Financieros). Between 1996 and 2000, he was director and chairman of Tabacalera, S.A. At that time Tabacalera, S.A. changed its name into Altadis, S.A. (following its merger with the French Group, Seita-Société Nationale D'Éxploration Industrielle des Tabacs et Allumettes) and he became director and chairman of Altadis, S.A. He has also been a member of the board of directors of the Madrid Stock Exchange (Bolsa de Madrid), Plus Ultra Compañía de Seguros y Reaseguros, S.A. and of Iberia, S.A. On January 1997, Mr. Alierta was appointed as a director of Telefónica and on July 26, 2000, he was appointed as our Executive Chairman. Mr. Alierta is director of Telecom Italia since November 8, 2007 and of China Unicom (Hong Kong) Limited since October 15, 2008. Mr. Alierta holds a law degree from the University of Zaragoza and an MBA from Columbia University (New York) and is currently a member of the Columbia Business School Board of Overseers.

Mr. Isidro Fainé Casas serves as Vice-Chairman of our Board of Directors. For over 40 years, Mr. Fainé has worked in several financial institutions, including amongst others: Banco Atlántico, S.A., (1964), Banco de Asunción (Paraguay) (1969), Banco Riva y García, S.A. (1973), Banca Jover, S.A. (1974), and Banco Unión, S.A. (1978). Mr. Fainé is currently chairman of Caja de Ahorros y Pensiones de Barcelona ("la Caixa") and of Criteria CaixaCorp, S.A., vice-chairman of Abertis Infraestructuras, S.A. and of Confederación Española de Cajas de Ahorros, and second vice-chairman of Repsol YPF, S.A. He is also a member of the board of directors of Banco Português de Investimento, S.A. (BPI), Hisusa, Holding de Infraestructuras y Servicios Urbanos, S.A., Grupo Financiero Inbursa and a non-executive director of Bank of East Asia. Mr. Fainé holds a doctorate degree in economics, a diploma in Alta Dirección (Senior Management) from IESE Business School (Instituto de Estudios Superiores de la Empresa) and an ISMP in business administration from Harvard University. He is a member of the Real Academia de Ciencias Económicas y Financieras.

Mr. Vitalino Manuel Nafría Aznar serves as Vice-Chairman of our Board of Directors. In 1966 he joined Banco de Vizcaya, S.A. In 1983, Mr. Nafría Aznar was appointed general manager of Induban, S.A. (Banco de Financiación Industrial) in Bilbao. In 1988 he worked as regional manager for Aragón, Navarra y Rioja at Banco Bilbao Vizcaya (BBV). In 1990, he was appointed business manager of BBV. In April 1998, he was appointed director of the board of directors and general manager of BBV in Mexico. In July 2000, he was appointed chief executive officer and director of the board of directors of Grupo Financiero BBA Bancomer (GFBB). In December 2001, he was appointed member of the executive committee of BBVA and in January 2003 he became general manager of BBVA America. Since January 2005 he has been the Retail Banking Manager in Spain and Portugal for BBVA. He is now in early retirement. Since February 2009, he is chairman of the board of directors of Metrovacesa, S.A.

Mr. Julio Linares López serves as a director of our Board of Directors and as our Chief Operating Officer since December 19, 2007. In May 1970, he joined our Research and Development Center, where he held several positions until he was appointed head of our Technology Department. In April 1990, he was appointed General Manager of Telefónica Investigación y Desarrollo, S.A. In December 1994, he became deputy general manager of the Marketing and Services Development department in the commercial area and subsequently, deputy general manager for Corporate Marketing. In July 1997, he was appointed chief executive officer of Telefónica Multimedia S.A. and chairman of Telefónica Cable and Producciones Multitemáticas, S.A. In January 2000, he was appointed executive chairman of Telefónica de España, S.A., a position which he held until December 2005, when he was appointed our managing director for Coordination, Business Development and Synergies. He is currently member of the board of directors of Telecom Italia. Mr. Linares holds a degree in telecommunications engineering from the Polytechnic University of Madrid (Universidad Politécnica de Madrid).

Mr. José María Abril Pérez serves as a director of our Board of Directors. From 1975 to 1982 he served as financial manager of Sociedad Anónima de Alimentación (SAAL). Since then, and until he joined the Banco Bilbao Vizcaya Argentaria Group (BBVA), he was financial manager of Sancel-Scott Ibérica, S.A. In 1985 he joined Banco Bilbao, S.A. as managing director of Investment Corporate Banking. From January to April 1993, he was appointed

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executive coordinator of Banco Español de Crédito, S.A. In 1998, he became general manager of the Industrial Group of BBVA. In 1999, he was appointed member of the executive committee of the BBVA Group. He has also been a member of the board of directors of Repsol, S.A., Iberia, S.A. and Corporación IBV. In 2002 he became managing director of the Wholesale and Investment Banking Division and a member of the executive committee of BBVA, and he is now in early retirement. Until July 2007, he was vice president of Bolsas y Mercados Españoles, S.A. He is currently a member of the board of directors of Advancell, S.A. He holds a degree in economics from the University of Deusto (Bilbao, Spain) and he has been professor at such university for nine years.

Mr. José Fernando de Almansa Moreno-Barreda serves as a director of our Board of Directors. In December 1974 he joined the Spanish Diplomatic Corps (Cuerpo Diplomático) and served from 1976 to 1992 as Secretary of the Spanish Embassy in Brussels, Cultural Counselor of the Spanish Delegation to Mexico, Chief Director for Eastern European Affairs, Director of Atlantic Affairs in the Spanish Foreign Affairs Ministry, Counselor to the Spanish Permanent Representation to NATO in Brussels, Minister-Counselor of the Spanish Embassy in the Soviet Union, General Director of the National Commission for the 5th Centennial of the Discovery of the Americas and Deputy General Director for Eastern Europe Affairs in the Spanish Foreign Affairs Ministry. From 1993 to 2002, Mr. Fernando de Almansa was appointed Chief of the Royal Household by His Majesty King Juan Carlos I, and is currently personal advisor to His Majesty the King. He is also a substitute director of BBVA Bancomer México, S.A. de C.V.. He holds a law degree from the University of Deusto (Bilbao, Spain).

Mr. José María Álvarez-Pallete López serves as a director of our Board of Directors and, since July 2006, as Chairman of Telefónica Latin America. He began his career at Arthur Young Auditors in 1987. In 1988, he joined Benito & Monjardín/Kidder, Peabody & Co., where he held various positions in the research and corporate finance departments. In 1995, he joined Valenciana de Cementos Portland, S.A. (Cemex) as head of the Investor Relations and Studies department. In 1996 he was promoted to chief financial officer of Cemex Group in Spain, and in 1998, to chief administration and financial officer of Cemex in Indonesia, headquartered in Jakarta, and he was appointed member of the Board of Cemex Asia, Ltd. In February 1999 he joined the Telefónica Group as general manager of Finance for Telefónica International, S.A. In September of the same year he was promoted to chief financial officer of Telefónica. In July 2002, he was appointed chairman and chief executive officer of Telefónica Internacional, S.A. Mr. Álvarez-Pallete holds a degree in economics from the Complutense University of Madrid. He also studied economics at the Université Libre de Belgique and holds an International Management Program from the Pan-American Institute of Executive Business Administration (IPADE) and an advance research degree from the Universidad Complutense of Madrid.

Sir David Arculus serves as a director of our Board of Directors. From 1998 to 2001, he was chairman of Severn Trent Plc. and IPC Group Ltd. From 2002 to 2004, he was chairman of Earls Court and Olympia Ltd. From 2004 to January 2006, he served as chairman of O2 (now Telefónica Europe). Sir David Arculus was deputy president of the Confederation of British Industry (CBI) until 2006 and is currently a member of the board of directors of Pearson, Plc. He is also chairman of Numis, Plc. In 1972 he received an MBA from the London Business School. In 1996, he received his master's degree in engineering and economics from Oriel College, Oxford, and in 2003 he received a degree Honoris Causa from the University of Central England.

Ms. Eva Castillo Sanz serves as a director of our Board of Directors. Ms. Castillo began her career at the Spanish broker Beta Capital Sociedad de Valores, S.A., where she worked for five years. After that, she worked for another five years for Goldman Sachs International in London in the International Equities department. In 1997 Ms. Castillo joined Merrill Lynch as head of Equity Markets for Spain and Portugal. In 1999, she was promoted to Country Manager for Spain and Portugal and in 2000 she became chief executive officer of Merrill Lynch Capital Markets Spain. After that, Ms. Castillo was appointed chief operating officer for EMEA Equity Markets. In October 2003 she was appointed head of Global Markets & Investment Banking in Spain and Portugal, as well as president of Merrill

Lynch Spain. Until December 2009, she headed Global Wealth Management business operations in Europe, the Middle East and Africa, including Merrill Lynch Bank (Suisse) and the International Trust and Wealth Structuring business. She was a member of the Merrill Lynch EMEA Executive Committee, the Global Wealth Management Executive and Operating Committees. Ms. Castillo holds degrees in business, economics and law (ICADE – 3) from the Universidad Pontificia de Comillas of Madrid.

Mr. Carlos Colomer Casellas serves as a director of our Board of Directors. Mr. Colomer began his career in 1970 as marketing vice-chairman of Henry Colomer, S.A. In 1980, he was appointed chairman and general manager



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of Henry Colomer, S.A. and Haugron Cientifical, S.A. In 1986, he was also appointed president of Revlon for Europe. In 1989, he became chairman of Revlon International and in 1990, he was appointed executive vice-president and chief operating officer of Revlon Inc. In 2000, he was appointed chairman and chief executive officer of the Colomer Group. Mr. Colomer is chairman of the Colomer Group. He is also chairman of Ahorro Bursátil, S.A. SICAV and Inversiones Mobiliarias Urquiola, S.A. SICAV. Mr. Colomer has a degree in economics from the University of Barcelona and an MBA from IESE Business School (Instituto de Estudios Superiores de la Empresa).

Mr. Peter Erskine serves as a director of our Board of Directors. He began his career in the field of marketing and brand management in Polycell and in Colgate Palmolive. He worked for several years at the Mars Group, serving as vice-chairman for Europe of Mars Electronics. In 1990 he was appointed vice-president of Marketing and Sales of Unitel. From 1993 to 1998, he held a number of senior positions, including director of British Telecom (BT) Mobile and president and chief executive officer of Concert. In 1998 he became managing director of BT Cellnet. Subsequently, in 2001 he became chief executive officer and a director of the board of directors of Telefónica O2 Europe, Plc (now Telefónica Europe). In 2006 he became executive chairman of Telefónica O2 Europe, Plc and from July 2006 until December 2007 he served as general manager of the business unit Telefónica Europe. In 2008, he joined the Telecom Advisory Boards of Apax Partners and MacQuarie European Infrastructure Fund, and become a member of the Strategy Advisory Committee of Henley Management Centre. In January 2009 he joined the Board of Ladbrokes P.L.C. as a non executive director. Currently, he is also member of the advisory board of Henley Management Centre. In 1973, he received a degree in psychology from Liverpool University.

Mr. Alfonso Ferrari Herrero serves as a director of our Board of Directors. From 1968 to 1969 he was assistant to the financial manager of Hidroeléctrica del Cantábrico, S.A. From 1969 to 1985, he worked in Banco Urquijo, S.A. holding several positions as analyst, manager of Industrial Investments and as a representative in several subsidiaries in his capacity as member of the board of directors of Banco Urquijo, S.A. From 1985 to 1996 he was a member of the board of directors and manager of Corporate Finance of Beta Capital Sociedad de Valores, S.A., of which Mr. Ferrari was a co-founder. From 1996 until 2000 served as chairman and chief operating officer of Beta Capital, S.A. He has a doctorate in industrial engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid (Escuela Técnica Superior de Ingenieros Industriales de la Universidad Politécnica de Madrid) and holds an MBA from Harvard University.

Mr. Luiz Fernando Furlán serves as a director of our Board of Directors. Throughout his career he has been a member of the board of directors of several companies in Brazil and abroad such as Sadia, S.A., Embraco, S.A. (Brasmotor Group-Brazil) and Panamco (Pan American Beverages, Inc. – USA). He was also member of the consulting board of IBM in Latin America and of ABN Amro Bank in Brazil, as well as chairman of Brazilian Chicken Exporters Association (ABEF), Brazilian Association of Public Owned Companies (ABRASCA) and of Mercosur European Union Business Forum (MEBF). He also was vice-president of Sao Paulo Entrepreneurs Association (FIESP). From 2003 to 2007 he was Minister of Development, Industry and Foreign Trade of Brazil. Currently he is also chairman of the board of directors of Brasil Foods, S.A. and of Amazonas Sustainability Foundation and member of the board of directors of Redecard S.A. and Amil Participações S.A., and member of the Advisory/Consultive Board of Panasonic (Japan) and McLarty & Associates (USA). He holds a degree in chemical engineering from the Industrial Engineering Faculty of São Paulo and in business administration from University of Santana (São Paulo), with specialization in financial administration from Fundação Getúlio Vargas (São Paulo).

Mr. Gonzalo Hinojosa Fernández de Angulo serves as a director of our Board of Directors. He began his career in 1966 in Cortefiel, S.A. and served in several management positions since then. From 1976 to 1985 Mr. Hinojosa was general manager of Cortefiel, S.A. and from 1985 until 2006 he served as chief executive officer of the company, a post which he combined with his appointment as chairman since 1998. From 1991 through 2002, he served as a director of Banco Central Hispano Americano, S.A. and as a director of Portland Valderribas, S.A. He has also served as a director of Altadis, S.A. and of Dinamia Capital Privado, S.A., SCR. Mr. Hinojosa has a degree in industrial

engineering from the Industrial Engineers Technical School of the Polytechnic University of Madrid (Escuela Técnica Superior de Ingenieros Industriales de la Universidad Politécnica de Madrid).

Mr. Pablo Isla Álvarez de Tejera serves as a director of our Board of Directors. Mr. Isla began his career in 1988 as Government Attorney (Abogado del Estado), and he joined the Body of Government Attorneys that year, in the first position of the candidates, for the Spanish Ministry of Transportation, Tourism and Communications. In 1991 he moved to the General Management of the Legal Services of the Spanish Government (Dirección General

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del Servicio Jurídico del Estado). From 1992 to 1996, Mr. Isla served as general manager of the Legal Services Department of Banco Popular, S.A. In 1996, he was appointed general manager of the National Heritage Department of the Treasury Department of Spain (Ministerio de Economía y Hacienda). He also served as General Secretary of Banco Popular Español, S.A. from 1998 to 2000. In July 2000, Mr. Isla was appointed chairman of the board of Grupo Altadis and co-chairman of the company. Since June 2005, Mr. Isla is the deputy chairman and chief executive officer of Inditex, S.A. Mr. Isla has a degree in law from the Universidad Complutense of Madrid.

Mr. Antonio Massanell Lavilla serves as a director of our Board of Directors. In 1971 he joined the Caja de Ahorros y Pensiones de Barcelona (“la Caixa”), where he held several posts and in 1990, he was appointed assistant manager and secretary of the Steering Committee. In the same year, he was appointed member of the board of directors of VidaCaixa, S.A., Seguros de la Caixa, S.A., Socredit (Monaco), and Sociedad Española de Medios de Pago, S.A. From 1992 to 1994, Mr. Massanell served as Chairman of the Steering Committee of Sistema 6000 de la Confederación Española de Cajas de Ahorros. Mr. Massanell is currently executive deputy general manager of la Caixa and a member of the boards of directors of e-la Caixa 1, S.A., Boursorama, S.A., Caixa Capital Risc, S.G.E.C.R., S.A., and Serveis Informàtics “La Caixa”, S.A. He is also chairman of Port Aventura Entertainment, S.A. and Barcelona Digital Centre Tecnològic (former Fundació Barcelona Digital). Mr. Antonio Massanell Lavilla holds a degree in economics from the University of Barcelona.

Mr. Francisco Javier De Paz Mancho serves as a director of our Board of Directors. From 1990 to 1993, he was Secretary to the Board of the Spanish Consumers Association (Unión de Consumidores de España, UCE). From 1993 to 1996, he served as general manager of Internal Trade of the Spanish Ministry of Tourism and Commerce. From 1994 to 1996, he was chairman of the Observatory of Trading of the Spanish Ministry of Tourism and Commerce (Observatorio de la Distribución Comercial del Ministerio de Comercio y Turismo); from 1996 to 2004, he was corporate strategy manager of the Panrico Donuts Group. From 1998 to 2004, he served as director of Mutua de Accidentes de Zaragoza (MAZ) and of the Panrico Group. From 2004 to 2006, he was director of Tunel de Cadí, S.A.C. and from 2003 to 2004, he served as chairman of the Patronal Pan y Bollería Marca (COE). From 2004 to 2007, he was chairman of the National Company MERCASA. He has also been a member of the board of directors of Altadis, S.A., and of the Economic and Social Board and its permanent commission. From July 2006, he has been a member of the Executive Committee of the Chambers Board (Consejo Superior de Cámaras). Mr. de Paz has a diploma in publicity and information and followed studies in law. He followed a Programa de Alta Dirección de Empresas from the IESE Business School (Instituto de Estudios Superiores de la Empresa, University of Navarra).

## Executive Officers/Management Team

At March 25, 2010, our executive management team was composed of six general managers, in addition to our three executive officers who are also directors on our Board of Directors.

Name	Position	Appointed	Age
Mr. César Alierta Izuel	Chairman of the Board of Directors and Chief Executive Officer	2000	64
Mr. Julio Linares López	Chief Operating Officer	2007	64
Mr. José María Álvarez-Pallete López	Chairman of Telefónica Latin America	2002	46
Mr. Guillermo Ansaldo Lutz	Chairman of Telefónica Spain	2007	48
Mr. Matthew Key	Chairman of Telefónica Europe	2007	47
Mr. Santiago Fernández Valbuena	General Manager of Finance and Corporate Development	2002	52
Mr. Luis Abril Pérez		2002	62

	Technical General Secretary to the Chairman		
Mr. Calixto Ríos Pérez	General Manager of Internal Audit	2002	65
Mr. Ramiro Sánchez de Lerín García-Ovies	General Legal Secretary and Secretary to the Board	2003	55

Biographies of the Executive Officers and Senior Management

We present below the biographies of our executive officers and senior management who do not also serve on our Board of Directors.

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Mr. Guillermo Ansaldo Lutz serves as Chairman of Telefónica Spain since December 2007, and he is also member of the Executive Committee of Telefónica. From 1989 to 2000 he worked for McKinsey & Company holding different positions in Spain and Argentina. In 1995, he was appointed partner of McKinsey & Company in Argentina. From 2000 to 2004 he was the chief executive officer of Telefónica de Argentina, S.A. and since April 2005, he held the position of chief executive officer of Telefónica de España, S.A. He holds a degree in industrial engineering from the Universidad de Buenos Aires and an MBA from The Amos Tuck School of Business Administration, Dartmouth College.

Mr. Matthew Key serves as Chairman of Telefónica Europe and is a member of the Executive Committee of Telefónica. From 1984 until 1998 he held various positions of responsibility in Arthur Young, the Grand Metropolitan Plc (1988), Coca Cola & Schweppes Beverages Ltd (1993-1995), Kingfisher Plc and finally, from 1998 to 2002, Vodafone Plc. From 2000 to 2002 he worked as non-executive director of Vodafone Egypt. He has served as chairman and non-executive director of Telco Mobile since 2003. From 2003 to 2005 he was non-executive director of Link Stores. In February 2002, he was appointed chief financial officer of Telefónica O2 UK until December 2004. In January 2005, he was appointed chief executive officer of Telefónica O2 UK. He holds a degree in economics from Birmingham University.

Mr. Santiago Fernández Valbuena serves as General Manager of Finance and Corporate Development since December 2002 and is a member of the Executive Committee of Telefónica. He has served as our chief financial officer since July 2002. He joined Telefónica Group in 1997 as chief executive officer of Fonditel, Telefónica's pension assets manager. Previously, he was the managing director of Société Générale Equities, and also head of Equities & Research at Beta Capital in Madrid. Mr. Fernández Valbuena served as president of the Research Commission at the Spanish Institute of Financial Analysts. He has held senior teaching positions with the MBA programs of the Manchester Business School and Instituto de Empresa. He holds a degree in economics from the Universidad Complutense of Madrid and he also holds an M.S. and a PhD degree in economics and finance from Northeastern University in the United States.

Mr. Luis Abril Pérez serves as our Technical General Secretary to the Chairman. Mr. Abril started his professional career as a microeconomics professor in the Universidad Comercial de Deusto, where he went on to head its Finance Department. In 1978, he moved to Banco de Vizcaya, S.A., as treasury director and then worked as head of the president's technical department. During his work with the Banco Bilbao Vizcaya Group (1988 to 1991), he acted as general director for the Asset Management division. From 1994 to 1999, Mr. Abril acted as general director for Banco Español de Crédito, S.A. (Banesto), and he later acted as general director for communications for Banco Santander Central Hispano, S.A. (1999 to 2001). Mr. Abril holds a degree in economics and a law degree from the Universidad Comercial de Deusto and he also holds an MBA from the North European Management Institute, Oslo, Norway.

Mr. Calixto Ríos Pérez serves as our General Manager of Internal Audit. In 1973, Mr. Ríos joined Banco Exterior de España, S.A. as the General Manager of Extetbank in New York City. Subsequently he was appointed chief executive officer and chief operating officer of Extetbandes in Venezuela. Later, Mr. Ríos returned to Madrid as the general manager of International Banking Subsidiaries of Banco Exterior de España, S.A. In 1990, he was appointed chief executive officer responsible for overseeing the construction, management and marketing of the Olympic Village for the Olympic games of Barcelona and a year later was appointed chief financial officer of Tabacalera, S.A. After the merger of Tabacalera with the French company, Seita, he was appointed advisor to the chairman and head of Strategy and Planning. In November 2000, he joined the Telefónica Group as general manager for Institutional Relations, and in July 2002 he was appointed general manager for Internal Auditing and Communications. He holds a degree in economics from the Universidad Complutense of Madrid.

Mr. Ramiro Sánchez de Lerín García-Ovies serves as our General Secretary and Secretary to our Board of Directors. He began his career in Arthur Andersen, first working for its audit department and later for its tax department. In 1982, he became a Government Attorney (Abogado del Estado) and started working for the local tax authorities in Madrid (Delegación de Hacienda de Madrid). Afterwards he was assigned to the State Secretariat for the European Communities and later to the Foreign Affairs Ministry. He has been general secretary and secretary of the Board of Elosúa, S.A., Tabacalera, S.A., Altadis, S.A. and Xfera Móviles, S.A. He has also held teaching positions in Instituto Católico de Administración y Dirección de Empresas (ICADE), Instituto de Empresa and Escuela de Hacienda Pública.

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## B. Compensation

## Directors

The compensation of our directors is governed by Article 28 of our bylaws, which states that the aggregate compensation amount that we may pay to all of our directors as remuneration and attendance fees shall be fixed by the shareholders at the general meeting of shareholders, and such amount shall remain unchanged until the shareholders decide to modify it. The Board of Directors shall determine the exact amounts to be paid within such limit and the distribution thereof among the directors. In this respect, on April 11, 2003, our shareholders set the maximum gross annual amount to be paid to the Board of Directors at €6 million. This includes fixed payments and fees for attending meetings of the Board of Directors' advisory or control committees described above. In addition, the compensation provided for above is in addition to other professional or employment compensation accruing to the directors by reason of any executive or advisory duties that they perform for the Group, other than the supervision and collective decision-making duties inherent in their capacity as directors.

Therefore, the compensation paid to our directors in their capacity as members of the Board of Directors, the Executive Commission and/or any of 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. In this respect, executive board members, other than the Chairman, only receive compensation for discharging their executive duties as stipulated in their respective contracts and not in their capacity as directors.

The following table presents the fixed annual amounts paid to directors for membership in the Board of Directors, Executive Commission and any advisory or control committees.

Position	Board of Directors	Executive Commission (in euros)	Advisory or Control Committees
Chairman	300,000	100,000	28,000
Vice Chairman	250,000	100,000	—
Board member (vocal):			
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, each director is paid a fee of €1,250 for attendance at each meeting of an advisory or control committee.

Total compensation paid to our directors for discharging their duties in 2009 amounted to €4,081,333 in fixed compensation and €252,500 in fees for attending advisory or control committee meetings. It should also be noted that the compensation paid to our directors for serving as members on the boards of directors of other Telefónica Group companies amounted to €1,791,104. In addition, the directors who are members of the regional advisory committees, including the Telefónica Corporate University Advisory Council, received additional aggregate compensation of €553,750 in 2009.

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The following table presents the breakdown by item of the compensation and benefits paid to Telefónica directors for discharging their duties in 2009:

Board Members	Board of Directors	Executive Commission	Other Board Committees		Total
			Fixed payment (in euros)	Attendance fees	
<b>Chairman</b>					
César Alierta Izuel	300,000	100,000	—	—	400,000
<b>Vice chairmen</b>					
Isidro Fainé Casas	250,000	100,000	—	—	350,000
Vitalino Manuel Nafría Aznar	250,000	—	56,000	22,500	328,500
<b>Members</b>					
Julio Linares López	—	—	—	—	—
José María Abril Pérez	150,000	100,000	14,000	1,250	265,250
José Fernando de Almansa Moreno-Barreda	150,000	—	56,000	21,250	227,250
José María Álvarez-Pallete López	—	—	—	—	—
David Arculus	150,000	—	28,000	11,250	189,250
Eva Castillo Sanz	150,000	—	14,000	10,000	174,000
Carlos Colomer Casellas	150,000	100,000	56,000	16,250	322,250
Peter Erskine	150,000	100,000	56,000	25,000	331,000
Alfonso Ferrari Herrero	150,000	100,000	84,000	38,750	372,750
Luiz Fernando Furlán	150,000	—	14,000	3,750	167,750
Gonzalo Hinojosa Fernández de Angulo	150,000	100,000	98,000	42,500	390,500
Pablo Isla Álvarez de Tejera	150,000	—	84,000	16,250	250,250
Antonio Massanell Lavilla	150,000	—	65,333	28,750	244,083
Francisco Javier de Paz Mancho	150,000	100,000	56,000	15,000	321,000
<b>Total</b>	<b>2,600,000</b>	<b>800,000</b>	<b>681,333</b>	<b>252,500</b>	<b>4,333,833</b>

In addition, the breakdown of the total paid to executive directors Mr. César Alierta Izuel, Mr. Julio Linares López and Mr. José María Álvarez-Pallete López for discharging their executive duties by item is as follows:

Item	2009 (in euros)
Salaries	5,947,604
Variable compensation	8,058,179
Compensation in kind(1)	100,051
Contributions to pension plans	25,444

(1) “Compensation in kind” includes life and other insurance premiums (general medical and dental insurance).

In addition, under the Pension Plan for Senior Executives, we made total contributions in 2009 on behalf of executive directors of €1,925,387. The Pension Plan for Senior Executives is wholly funded by us. This plan envisages annual defined contributions equivalent to specific percentages of the relevant executives’ fixed remuneration, in accordance with their professional category, and extraordinary contributions in accordance with the circumstances of each such executive as detailed in the plan. See Note 21 to the Consolidated Financial Statements.



Our executive directors also receive compensation under the Performance Share Plan approved at the general shareholders' meeting of June 21, 2006 and described in more detail below. The maximum number of shares corresponding to the second, third and fourth phases of the Performance Share Plan will be granted on July 1, 2010, July 1, 2011, and July 1, 2012 respectively, to each of our executive directors if all the terms established for such delivery are met as follows: for Mr. César Alierta Izuel, 116,239, 148,818 and 173,716 shares, respectively; for Mr. Julio Linares López, 57,437, 101,466 and 130,287 shares, respectively; and for Mr. José María Álvarez-Pallete López, 53,204, 67,644 and 78,962 shares, respectively. With respect to the payout under the first phase of the Performance Share Plan in July 2009, the beneficiaries received, in accordance with the general terms and conditions of the Performance Share Plan, all the shares assigned to them as follows: to Mr. César Alierta Izuel, 129,183 shares; to Mr. Julio Linares López, 65,472 shares; and to Mr. José María Álvarez-Pallete López, 62,354 shares. This maximum payout was made because our total shareholder return, or TSR (as defined in the

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Performance Share Plan) exceeded that of the relevant comparison group. See Note 21 to the Consolidated Financial Statements.

It should be noted that the non-executive directors do not receive and did not receive in 2009 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to our share price.

In addition, we do not grant and did not grant in 2009 any advances, loans or credits to the directors, or to our top executives, in accordance with the requirements of the Sarbanes-Oxley Act.

### Executive Officers and Senior Management

In 2009, our six executive officers (excluding those that are also Directors) were paid a total compensation package of €10,533,852 in the aggregate.

Contributions made on behalf of these six executives under the Pension Plan for Senior Executives mentioned above amounted to an aggregate amount of €922,728 in 2009.

In addition, the maximum number of shares corresponding to the second, third and fourth phases of the Performance Share Plan, described below, to be delivered to these senior executives as a group, if all the established terms are met, is 130,911 shares, 306,115 shares and 394,779 shares, respectively. Similarly, as explained above, these senior executives received a total of 284,248 shares in 2009 as a result of satisfaction of the TSR requirement for the first phase under the Performance Share Plan.

Finally, executive officer contracts, including those of executive directors, generally include a severance clause entitling such executives to three years of salary plus another year based on the length of service with us. The annual salary on which the indemnity is based is the director's last fixed salary and the average amount of the last two variable payments received by contract.

### Incentive Plans

In each of 2007, 2008 and 2009, the Telefónica Group had the following incentive payment plans linked to the share price of Telefónica, S.A. in effect.

#### Telefónica, S.A. share plan: "Performance Share Plan"

At our general meeting of shareholders on June 21, 2006, our shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies (the "Performance Share Plan"). Under the Performance Share Plan, selected participants who meet the qualifying requirements are given a certain number of our shares as a form of variable compensation.

The Performance Share 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 Performance Share 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 all shares delivered on July 1, 2009, as described above) and the fifth phase begins on July 1, 2010 (with any shares earned delivered from July 1, 2013).

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

- The beneficiary must continue to work for us throughout the three years of the 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 TSR, which includes both the share price of and dividends on our shares, with the TSRs of a basket of listed

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telecommunications 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 degree of 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 on a linear basis for all points between these two benchmarks. If the TSR is below average no shares are awarded.

The end of the first phase of the Performance Share Plan was on June 30, 2009, which included the following maximum number of shares allocated:

Phase	Number of shares	Unit value (euros)	End date
1st phase July 1, 2006	6,530,615	6.43	June 30, 2009

With the expiration of the first phase of the Performance Share Plan in July 2009 a total of 3,309,968 shares (corresponding to a total of 4,533,393 gross shares less a withholding of 1,224,610 shares prior to delivery) were delivered to our directors included in the first phase. The shares delivered were deducted from our treasury shares in 2009.

All the shares delivered under the first phase of the Performance Share Plan were hedged with a derivative instrument acquired in 2006. The cost of this instrument was €46 million, which in unit terms is €6.43 per share. At June 30, 2009, the bank with whom the financial instrument was contracted delivered to us the shares contracted. These were initially accounted for as treasury shares.

The maximum number of the shares issuable in each of the three outstanding phases at December 31, 2009 is as follows:

Phase	Number of shares	Unit value (euros)	End date
2nd phase July 1, 2007	5,556,234	7.70	June 30, 2010
3rd phase July 1, 2008	5,286,980	8.39	June 30, 2011
4th phase July 1, 2009	6,356,597	8.41	June 30, 2012

The Performance Share Plan is equity-settled via the delivery of shares to the participants. Accordingly, an expense of €23 million, €38 million and €43 million of employee benefits was recorded in 2007, 2008 and 2009, respectively.

To ensure that we had enough shares to meet our obligations at the end of the first phase begun in 2006, we bought an instrument from a financial institution that delivered to us, at the end of the phase, a number of shares determined using the same measure of success as the plan, i.e. an instrument that mirrored the features of the first phase of the plan. The cost of this instrument was €46 million, which in unit terms is €6.43 per share, assuming the maximum number of shares under this instrument. See Note 20 to our Consolidated Financial Statements.

We have not arranged for any similar derivative for the second phase.

For the third phase, we have arranged a financial instrument under the same conditions as for the first phase, with possible delivery to us of up to 2,500,000 shares under such instrument. The cost of the financial instrument is €25 million, equivalent to €9.96 per share assuming the maximum number of shares under this instrument. See Note 20 to our Consolidated Financial Statements.

For the fourth phase of the Performance Share Plan, we have acquired an instrument from a financial institution with the same features of the fourth phase of the Performance Share Plan, whereby at the end of the phase, we may obtain part of the shares necessary to settle the phase (4,000,000 shares). The cost of the financial instrument was €34 million, equivalent to €8.41 per share. See Note 20 to our Consolidated Financial Statements.

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Telefónica, S.A. share option plan targeted at Telefónica Europe employees: “Performance Cash Plan”

In addition to the Performance Share Plan, another plan called the “Performance Cash Plan”, operating under the same conditions as the Performance Share Plan is targeted at employees of Telefónica Europe. This plan entails delivery to Telefónica Europe executives of a specific number of theoretical options in Telefónica, S.A., which are cash-settled at the end of each phase via a payment equivalent to the market value of the shares on settlement date up to a maximum of three times the value of the theoretical options, established for each phase, of the shares at the delivery date.

The value of the theoretical options is established as the average share price in the 30 days immediately prior to the start of each phase, except for the first phase, where the average share price during the 30 days immediately prior to May 11, 2006 (€12.83) was taken as the reference.

The estimated duration of this plan is also seven years, with five phases, each of three years, commencing on July 1 of each year, starting in 2006.

Like the Performance Share Plan, the performance rate for setting payments is measured based on the TSR of Telefónica shares with respect to the comparison group’s TSRs. Payments will be made in line with the following criteria:

- Below average 0%
- Average 30%
- Equal to or higher than the third quartile 100%

The aggregate number of options assigned to the three phases outstanding at December 31, 2009 was 412,869.

The fair value at December 31, 2009 of the options delivered in each phase in force at that time was €19.55 per option. This value is calculated by taking our share price and including the estimated TSR and is updated at each year end.

#### C. Board Practices

Please see “—Directors and Senior Management” above.

#### D. Employees

##### Employees and Labor Relations

The table below sets forth the average number of employees at the dates indicated for the Telefónica Group during 2007, 2008 and 2009 and each of the consolidated companies of the Group which comprise our different lines of business and other consolidated subsidiaries.

	2007		2008		2009	
	Average	Year-end	Average	Year-end	Average	Year-end
Telefónica Spain	37,688	35,792	35,708	35,562	35,318	35,338
Telefónica Latin America	48,844	49,946	49,990	49,849	50,709	51,606
Telefónica Europe	29,249	29,305	28,828	28,888	28,249	27,023

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Subsidiaries and other companies	128,271	133,444	137,249	142,736	140,875	143,459
Total	244,052	248,487	251,775	257,035	255,151	257,426

The number of employees shown in the table above corresponds to the consolidated companies. It is also worth highlighting the large number of employees at the various companies of the Atento Group performing call center activities included in the total numbers above, with an average of 129,885 in 2009 and 132,256 at December 31, 2009.

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Of our total employees at December 31, 2009, approximately 51.8 % were women (50.8% at December 31, 2008).

Employee Benefits

We have a pension plan for our Spanish employees. Our contribution corresponds to 4.51% of an employee's fixed salary (for those employees who joined Telefónica de España S.A.U. before June 30, 1992 the amount is 6.87%). The obligatory minimum employee contribution is 2.2%. This plan is fully funded.

As of December 31, 2009, 52,912 of our employees were members of the pension plan managed by our subsidiary Fonditel Entidad Gestora de Fondos y Pensiones, S.A. (54,819 employees as of December 31, 2008 and 57,675 at December 31, 2007). The total amount contributed in 2009 by the different Telefónica Group companies was €97 million (€98 million and €95 million in 2008 and 2007 respectively).

In addition, in 2006, we approved a Management Benefits Plan (Retirement Plan) for senior executives, wholly funded by us, which complements the current pension plan. This Management Benefits Plan envisages annual defined contributions by Telefónica equivalent to specific percentages of the executives' fixed remuneration, in accordance with such executive's professional category, and extraordinary contributions in accordance with the circumstances of each executive, payable in line with the conditions of this plan.

No provision was made for this Management Benefits Plan by us, as its operation has been fully outsourced to an investment fund that is responsible for its operation.



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## E. Share Ownership

At March 25, 2010, the following members of our Board of Directors beneficially owned directly or indirectly an aggregate of 6,429,677 shares, representing approximately 0.141% of our capital stock.

Name	Percentage of Shares Beneficially Owned
Mr. César Alierta Izuel(1)	0.089%
Mr. Isidro Fainé Casas	0.010%
Mr. Vitalino Manuel Nafría Aznar	—
Mr. Julio Linares López	0.006%
Mr. José María Abril Pérez	—
Mr. José Fernando de Almansa Moreno-Barreda	—
Mr. Jose María Álvarez-Pallete López	0.004%
Mr. David Arculus	—
Ms. Eva Castillo Sanz	0.002%
Mr. Carlos Colomer Casellas(2)	0.001%
Mr. Peter Erskine	0.002%
Mr. Alfonso Ferrari Herrero(3)	0.013%
Mr. Luiz Fernando Furlán	—
Mr. Gonzalo Hinojosa Fernández de Angulo	0.011%
Mr. Pablo Isla Alvarez de Tejera	—
Mr. Antonio Massanell Lavilla	—
Mr. Francisco Javier de Paz Mancho	0.001%

(1) Since March 2, 2007, Mr. Alierta Izuel holds 8,200,000 European call options over our shares with an exercise price of €22, which, if exercised, must be exercised on March 2, 2011 and settled in cash. In addition to this, since April 11, 2008, he holds 2,000,000 European call options over our shares with an exercise price of €30, which, if exercised, must be exercised on March 2, 2011 and settled in cash.

(2) On April 6, 2009, Mr. Colomer Casellas reported to the Spanish Securities Markets Commission (CNMV) the sale of 14,815 puts over Telefónica, S.A. shares, with an exercise price of €13.50, as well as the sale of 24,000 puts over Telefónica, S.A. shares with an exercise price of €12.50. On August 6, 2009 Mr. Colomer Casellas reported to the CNMV the purchase of the above-mentioned 14,815 puts over our shares which were sold on April 6, 2009. On August 6, 2009 he reported the sale of 33,334 puts over our shares, with an exercise price of €15 that, if exercised, must be exercised on 31 May, 2010. On September 21, 2009 Mr. Colomer Casellas reported the purchase of the above-mentioned 24,000 puts over our shares, which were sold on April 6, 2009.

(3) In connection with his acquisition of 485,000 shares of Telefónica S.A. made on October 11, 2007, Mr. Ferrari Herrero holds 485,000 put warrants over our shares with an exercise price of €18.48 that, if exercised, must be exercised on October 11, 2010.

At March 25, 2010, members of our executive management team (excluding members of our Board of Directors listed above) beneficially owned an aggregate 878,888 of our shares, representing approximately 0.0193% of our capital stock.

None of our directors or executive officers beneficially owned shares representing one percent or more of our share capital at March 25, 2010.

None of our directors and executive officers held options in respect of shares representing one percent or more of our share capital at March 25, 2010.

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## Item 7. Major Shareholders and Related Party Transactions

## A. Major Shareholders

## General

At March 25, 2010, we had 4,563,996,485 shares outstanding, each having a nominal value of €1.00 per share. All outstanding shares have the same rights.

At March 25, 2010, according to information provided to us or to the Spanish National Securities Commission, the CNMV, beneficial owners of 3% or more of our voting stock were as follows:

Name of Beneficial Owner	Number of Shares	Percent
Banco Bilbao Vizcaya Argentaria, S.A.(1)	252,999,646	5.54%
Caja de Ahorros y Pensiones de Barcelona (“la Caixa”)(2)	235,973,505	5.17%
Blackrock, Inc.(3)	177,257,649	3.88%
Capital Research and Management Company(4)	144,578,826	3.16%

Based on the information provided by Banco Bilbao Vizcaya Argentaria, S.A. as at December 31, 2009 for the (1) 2009 Annual Report on Corporate Governance.

(2) Based on information provided by Caja de Ahorros y Pensiones de Barcelona, “la Caixa” as at December 31, 2009 for the 2009 Annual Report on Corporate Governance. The 5.16% indirect shareholding in Telefónica is owned by Criteria CaixaCorp, S.A.

(3) According to notification sent to the Spanish National Securities Commission, the CNMV, dated February 4, 2010.

(4) According to notification sent to the Spanish National Securities Commission, the CNMV, dated May 20, 2009.

To the extent that our shares are represented by account in the book-entry form, we do not keep a shareholder registry and our ownership structure cannot be known precisely. Based on the information available to us there is no individual or corporation that directly or indirectly through one or more intermediaries may exercise any type of control over us. Nevertheless, we have certain shareholders whose holdings are considered material.

At December 31, 2009, approximately 171,523,317 of our shares were held in the form of ADSs by 917 holders of record, including Cede & Co., the nominee of the Depository Trust Company. The number of ADSs outstanding was 57,174,439 at December 31, 2009.

## Ownership Limitations

There are no limitations with respect to the ownership of our assets or share capital except those derived from the application of the reciprocity principle. Article 6 of the General Telecommunications Law, or the GTL, provides for the application of the reciprocity principle under existing international treaties or agreements signed and ratified by Spain. The Spanish government, upon request, may authorize exceptions to the reciprocity principle contained in the GTL.

## B. Related Party Transactions

During 2009 and through the date of this Annual Report, none of our directors and no member of our management team has been involved in any related party transactions with us.

Our Board of Directors' Regulations grant the Board of Directors the exclusive power to authorize any transactions with major shareholders or with our directors. Prior to authorizing any such transaction, our Board will receive an opinion from the Nominating, Compensation and Corporate Governance Committee addressing the fairness of the transaction to our shareholders and us. Any of our directors that may have an interest in the proposed transaction must abstain from voting on the proposed transaction.

Two of our major shareholders are financial institutions. We have entered into related party transactions with both companies within our ordinary course of business, and always on arm's length terms. During 2009, the

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executed transactions were generally loans or capital markets transactions provided to us by these financial institutions and agreements for us to provide telecommunications and broadband services to such institutions.

### Related Party Transactions with Significant Shareholders

The main transactions between Telefónica Group companies and our significant shareholders were the following:

Banco Bilbao Vizcaya Argentaria, S.A. and subsidiaries comprising its consolidated group “BBVA”:

- Financing transactions arranged under market conditions, with approximately €531 million drawn down at December 31, 2009 (€436 million at December 31, 2008).
- Time deposits under market conditions amounting to €878 million at December 31, 2009 (€355 million at December 31, 2008).
- Derivative transactions arranged at market conditions, for a total nominal amount of approximately €7,824 million at December 31, 2009 (€6,930 million at December 31, 2008).
- Guarantees granted by BBVA under market conditions for approximately €237 million at December 31, 2009 (€13 million at December 31, 2008).
  - Dividends and other benefits paid to BBVA in 2009 for €287 million (€279 million in 2008).
- Services, mainly telecommunications and telemarketing, rendered by Telefónica Group companies to the BBVA Group, under market conditions.

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

- Financing transactions arranged under market conditions, with approximately €643 million drawn down at December 31, 2009 (€682 million at December 31, 2008).
- Time deposits under market conditions amounting to €1,293 million at December 31, 2009 (€368 million at December 31, 2008).
- Derivative transactions entered into under market conditions, for a total nominal amount of approximately €800 million in 2009. There was no amount in 2008.
  - Dividends and other benefits paid to La Caixa in 2009 for €260 million (€237 million in 2008).
- Guarantees granted by La Caixa under market conditions for approximately €17 million at December 31, 2009 (€1 million at December 31, 2008).
- The telecommunications services rendered by Telefónica Group companies to La Caixa group companies, under market conditions.

### Intra-Group Loans

We are the parent company of the Telefónica Group and operate through our subsidiaries and affiliated companies. We coordinate group policies, including financial policy and, in some cases, actual financial management

is conducted by us. Most of the transactions we perform with other members of the Telefónica Group relate to financing transactions, including covering their needs for funds and providing interest rate and exchange rate hedges.

At December 31, 2009, as recorded in our parent company accounts, we loaned a total of €5,975 million (€13,594 million at December 31, 2008) to companies of the Telefónica Group while companies of the Telefónica Group and their associates loaned us a total of €45,280 million (€46,694 million at December 31, 2008), of which €10,767 million (€12,331 million at December 31, 2008) was loaned to us by Telefónica Europe, B.V. and €24,532 million

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(€17,771 million at December 31, 2008) was loaned to us by Telefónica Emisiones S.A.U., our financing subsidiaries devoted to raising funds in the capital markets, and €8,915 million (€12,671 million at December 31, 2008) was loaned to us by Telefónica Finanzas, S.A.U., our subsidiary in charge of financial support for Telefónica Group companies.

With respect to the balances with associated companies, the line item “Loans to Associates” on the consolidated statement of financial position at December 31, 2009, presents an amount of €18 million (€126 million at December 31, 2008).

C. Interests of Experts and Counsel

Not applicable.

Item 8. Financial Information

Consolidated Financial Statements

Please see Item 18.

Legal Proceedings

Telefónica and its group companies are party to several legal proceedings which are currently in progress in the courts of law and the arbitration bodies of the various countries in which we are present.

Based on the advice of our legal counsel it is reasonable to assume that these legal proceedings will not materially affect our financial position or solvency, regardless of the outcome. We highlight the following unresolved legal proceedings or those underway in 2009:

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

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 by a ruling issued on September 21, 2009, and the appellants ordered to pay court costs. This ruling was appealed on December 4, 2009.

Claim before the Center for Settlement of Investment Disputes (ICSID) against the Argentine government

As a result of the enactment by the Argentine government of Public Emergency and Exchange Rules Reform Law 25,561, of January 6, 2002, Telefónica considered that the terms and conditions of the share transfer agreement approved by Decree 2332/90 (the “Transfer Agreement”) and the pricing agreement ratified by Decree 2585/91, both of which were executed by Telefónica with the Argentine government, had been affected appreciably, since the law rendered ineffective any dollar or other foreign currency adjustment clauses, or indexation clauses based on price indexes of other countries, or any other indexation mechanism in contracts with the public authorities. The law also required that prices and rates derived from such clauses be denominated in pesos at an exchange rate of one peso to one U.S. dollar.

Accordingly, since negotiations with the Argentine Government were unsuccessful, on May 14, 2003, Telefónica filed a request for arbitration with the International Center for Settlement of Investment Disputes (ICSID) pursuant to the Agreement for the Promotion and Reciprocal Protection of Investments between the Argentine Republic and the

Kingdom of Spain. On December 6, 2004, Telefónica filed the “Memorial” or claim with the ICSID.

On February 15, 2006, Telefónica de Argentina signed a memorandum of understanding with the Argentine government as a prerequisite to reaching an agreement to renegotiate the Transfer Agreement pursuant to the provisions of Article 9 of Law 25,561. Among other issues, the memorandum of understanding envisaged the suspension by Telefónica de Argentina and Telefónica for a certain period of all claims, appeals and demands



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planned or underway, based on events or measures taken as a result of emergency situation established by Law No. 25,561 with regard to the Transfer Agreement and the license granted to Telefónica de Argentina.

On August 21, 2009, after successive extensions of the period of suspension included in the memorandum of understanding, Telefónica and the Argentine government agreed to consider this arbitration proceeding concluded. As a result, both parties requested the ICSID Court to suspend the proceeding, which the court agreed to on September 24, 2009.

Appeal for judicial review of the Spanish Competition Court (TDC) ruling of April 1, 2004

On April 1, 2004, the TDC ruled that Telefónica de España had engaged in unfair trade practices prohibited under Article 6 of Antitrust Law 16/1989, dated July 17, and Article 82 of the EC Treaty, consisting in the abuse of a dominant market position, by conditioning the provision of certain services to the non-existence of predialing arrangements with rival operators and running disloyal advertising campaigns. It imposed a fine of €57 million.

Telefónica de España filed an appeal for judicial review of this decision. On January 31, 2007, the National Appellate Court ruled in favor of the appeal, thereby overturning the TDC's ruling. The State attorney filed an appeal to overturn the Supreme Court ruling on January 15, 2008, which Telefónica contested in July of 2008. This court has set April 6, 2010 as the judgment date.

Cancellation of the UMTS license granted to Quam GMBH in Germany

In December 2004, the Germany Telecommunications Market Regulator revoked the UMTS license granted in 2000 to Quam GmbH, in which Telefónica has a stake. After obtaining a suspension of the revocation order, on January 16, 2006, Quam GmbH filed a suit against the order with the German courts. This claim sought to overturn the revocation order and, if this failed, to be reimbursed for the total or partial payment of the original amount paid for the license.

This claim was rejected by the Cologne Administrative Court. Quam GmbH has appealed the decision before the Supreme Administrative Court of North Rhine-Westphalia, which also rejected its appeal.

Finally, Quam GmbH filed a new claim in third instance before the Federal Supreme court for Administrative Cases, which was not admitted for processing. Quam GmbH appealed this decision on August 14, 2009, and is currently awaiting another decision by this court.

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

On February 22, 2006, we were sent a statement of objections, initiating disciplinary proceedings for conduct that goes against Article 82 of EC Treaty rules. Subsequently, on July 9, 2007, the European Commission issued a decision, imposing a fine of €152 million on us and Telefónica de España. The ruling charged us with applying a margin squeeze between the prices we charged competitors to provide regional and national wholesale broadband services and our retail broadband prices using ADSL technology from September 2001 to December 2006.

On September 10, 2007, we and Telefónica de España both filed appeals to overturn the decision before the Court of First Instance of the European Community. The Kingdom of Spain also lodged an appeal to overturn the decision. Meanwhile, France Telecom and the Spanish Association of Bank Users (AUSBANC) filed requests to intervene, to which we have submitted our comments.

Appeal against the decision by Agencia Nacional de Telecomunicações (ANATEL) regarding the inclusion of interconnection and network usage revenues in the Fundo de Universalização de Serviços de Telecomunicações (FUST).

Brasilcel, N.V. (Vivo) Group operators, together with other Brazilian wireless operators, appealed ANATEL's decision of December 16, 2005, to include interconnection and network usage revenues and expenses in the calculation of the amounts payable into the Fund for Universal Access to Telecommunications Services (Fundo de Universalização de Serviços de Telecomunicações, or FUST for its initials in Portuguese), a fund to pay for the

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obligations to provide universal service, with retroactive application from 2000. On March 13, 2006, the Brasilia Federal Regional Court granted the injunction requested by the appellants, preventing ANATEL's decision from being applied. On March 6, 2007, a ruling in favor of the mobile operators was issued, stating that it was not appropriate to include the revenues received from other operators in the taxable income for the FUST calculation and rejecting the retroactive application of ANATEL's decision. ANATEL filed an appeal to overturn this decision with the Brasilia Regional Federal Court no.1. This appeal is pending resolution.

At the same time, Telesp and Telefónica Empresas, S.A., together with other fixed line operators through ABRAFIX (Associação Brasileira de Concessionárias de Serviço Telefônico Fixo Comutado) appealed ANATEL's decision of December 16, 2005, also obtaining injunctions. On June 21, 2007, Federal Regional Court no. 1 ruled that it was not appropriate to include the interconnection and network usage revenues and expense in FUST taxable income and rejected the retroactive application of ANATEL's decision. ANATEL filed an appeal to overturn this ruling on April 29, 2008 before Brasilia Federal Regional Court no. 1. This appeal is pending resolution.

Proceeding before the Prague District Court against the ruling of the Czech Telecommunications Office dated December 22, 2003.

On December 22, 2003, the Czech Telecommunications Office issued a ruling that required Cesky Telecom (now Telefónica O2 Czech Republic) to pay T-Mobile Czech Republic, a.s. 898 million Czech crowns (equivalent to approximately €26 million) in interconnection fees (call termination) for the period from January to November 2001.

Although the administrative procedure filed by Telefónica O2 Czech Republic against this resolution had yet to be resolved, in 2007 T-Mobile Czech Republic asked the Prague District Court no. 3 to enforce the decision, entailing an amount of approximately 1,859 million Czech crowns (approximately €57.3 million) of principal and interest. The Prague District Court accepted the petition and on May 23, 2007, issued a ruling initiate the execution of against any asset of Telefónica O2 Czech Republic. Telefónica O2 Czech Republic requested that the execution ordered by the Prague District Court 3 be limited to certain assets or be ruled inadmissible. No definitive ruling has yet been made. Telefónica O2 Czech Republic paid approximately 2,023 million Czech crowns (approximately €82 million) to prevent a potential order of execution and to remove the preventive embargo on its assets. Nonetheless, the procedure continued in the courts. In April 2009, an agreement was reached between T-Mobile Czech Republic and Telefónica O2 Czech Republic that ended the procedure, whereby T-Mobile Czech Republic returned approximately 1,053 million Czech crowns (approximately €40 million) to Telefónica O2 Czech Republic. All disputes and related proceedings between T-Mobile and Telefónica O2 Czech Republic regarding interconnection fees in 2001 were terminated according to this settlement agreement. The relevant courts issued decisions on termination of all related proceedings during May and June 2009.

Public civil procedure by the Sao Paulo government against Telesp for alleged repeated malfunctioning in the services provided by Telesp requesting compensation for damages to the customers affected.

In February 3, 2009, the Public Ministry of the State of Sao Paulo initiated proceedings against Telesp for alleged repeated malfunctioning in the telecommunication services provided by Telesp. The proceedings sought compensation for damages to the customers affected. A general claim was filed by the Public Ministry of the State of Sao Paulo suggesting an indemnification of 1,000 million Brazilian reais, calculated on the company's revenue base over the last five years. Telesp's potential responsibility will only be known in the calculation and enforcement of the award by affected consumers.

This proceeding was suspended via resolution dated November 5, 2009, for a period of 90 days, to assess the proposed agreement being negotiated between the parties. As no agreement was reached, the suspension was lifted and the procedure remains in the courts. It is not currently possible to evaluate the amount involved in this lawsuit.

Tax proceedings.

For information on legal proceedings related to tax matters, see Note 17 to our Consolidated Financial Statements.

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## Dividend information and shareholders' return

## Dividend background

The table below sets forth the annual cash dividends declared per share and the year to which such dividends correspond. Generally, the dividend for a given year is paid in two tranches, one in the second-half of the relevant year and the other during the first half of the following year.

Year ended December 31,	Cash dividends per share (euro)
2009(1)	1.15
2008	1.00
2007	0.75
2006	0.60
2005(2)	0.52

(1) On January 28, 2009, our Board of Directors approved a proposal to increase the dividend for 2009 to a total amount of €1.15 per share, to be payable in two tranches. In accordance with this, a cash dividend of €0.50 per share was paid on November 11, 2009, charged against unrestricted reserves. In addition, the appropriate corporate resolutions will be passed during 2010 to complete the committed dividend payment for 2009.

(2) This amount includes a cash dividend of €0.27 per share paid on November 11, 2005 and charged against share premium. Additionally, there was a distribution on June 2005 of our treasury stock among our shareholders in the proportion of one share for every 25 shares held, also charged against share premium.

At our Seventh Investor Conference held on October 10, 2009, in Madrid, we announced a proposal to distribute a dividend of €1.40 per share for 2010. This dividend will be payable in two tranches. Additionally, we announced that we had set as a target to increase, up to a minimum of €1.75 per share, the dividend for 2012.

Payments of any future dividends will be dependent on our results of operations, liquidity and capital resources and market conditions at the time, all of which may be influenced by a variety of factors. See "Cautionary Statement Regarding Forward-Looking Statements".

## Treasury shares and share buyback program

We held the following Telefónica, S.A. shares as treasury shares at the dates indicated:

	Number of shares	Acquisition price (euro per share)	Trading price (1) (euro per share)	Market value(2) (in millions of euros)	Percentage of our capital stock (3)
Treasury shares at December 31, 2009	6,329,530	16.81	19.52	124	0.13868%
Treasury shares at December 31, 2008	125,561,011	16.68	15.85	1,990	2.66867%
Treasury shares at December 31, 2007	64,471,368	16.67	22.22	1,433	1.35061%

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(1) Closing price of our shares on the Automated Quotation System of the Spanish stock exchange at the indicated dates.

(2) Market value is calculated as trading price times number of shares held on treasury at the indicated dates.

(3) Calculated using capital stock at each date.

Telefónica S.A. is the only Group company which owns any Telefónica, S.A. shares.

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The following transactions involving treasury shares were carried out in 2008 and 2009:

	Number of shares
Treasury shares at December 31, 2009	6,329,530
Acquisitions	65,809,222
Share exchange of Telefónica, S.A. shares for China Unicom shares	(40,730,735)
Performance Share Plan	(3,309,968)
Share cancellation	(141,000,000)
Treasury shares at December 31, 2008	125,561,011
Acquisitions	129,658,402
Disposals	(68,759)
Share cancellation	(68,500,000)
Treasury shares at December 31, 2007	64,471,368

The amount paid to acquire Telefónica, S.A. shares in 2009 was €1,005 million (€2,225 million in 2008).

At December 31, 2009, we held call options on 150 million Telefónica, S.A. shares. At December 31, 2008, we held put options on 6 million Telefónica, S.A. shares.

On February 27, 2008, and within our shareholder remuneration policy, our Board of Directors announced the launching of a new 2008 share buyback program for a total amount of 100 million Telefónica, S.A. shares. On October 13, 2008, we announced an increase in the program size by 50%, implying the acquisition of 50 million shares in addition to the 100 million shares already bought since the beginning of 2008. At March 31, 2009, we completed the second tranche of the program. Therefore the share buyback program for a total amount of 150 million shares was concluded.

In accordance with our commitment to cancel the shares purchased as part of share buyback programs, our annual general shareholders' meeting held on April 22, 2008, approved the reduction of our share capital by €68,500,000, by cancelling 68,500,000 shares of treasury stock. This capital reduction was completed in July 2008.

Further, our annual general shareholders' meeting held on June 23, 2009 approved the reduction of our share capital by the amount of €141,000,000 by means of the cancellation of 141,000,000 shares of our treasury stock. This capital reduction was completed in December 2009. This capital reduction required us to amend Article 5 of our bylaws, relating to share capital, which as of the date of this Annual Report stands at €4,563,996,485, made up of an equal number of ordinary shares, all of a single series and with a nominal value of €1.00 per share, totally paid in.

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## Item 9. The Offering and Listing

## A. Offer and Listing Details

## General

Our ordinary shares, nominal value €1.00 each, are currently listed on each of the Madrid, Barcelona, Bilbao and Valencia stock exchanges and are quoted through the Automated Quotation System under the symbol “TEF”. They are also listed on various foreign exchanges such as the London, Buenos Aires and Tokyo stock exchanges. Our BDRs are listed on the São Paulo Stock Exchange. Our ADSs are listed on the New York Stock Exchange and the Lima Stock Exchange.

The table below sets forth, for the periods indicated, the reported high and low quoted closing prices, as adjusted for all stock splits, for our shares on the Madrid Stock Exchange, which is the principal Spanish market for our shares, and our ADSs on the New York Stock Exchange:

	Per Share (in euros)		Per ADS (in dollars)	
	High	Low	High	Low
Year ended December 31, 2005	14.560	12.320	56.63	43.41
Year ended December 31, 2006	16.400	11.920	64.91	44.34
Year ended December 31, 2007	23.260	15.200	103.11	60.44
Year ended December 31, 2008	22.780	12.730	101.92	47.65
Year ended December 31, 2009	19.750	13.690	89.08	51.73
Quarter ended March 31, 2008	22.780	17.890	101.92	82.18
Quarter ended June 30, 2008	19.540	16.760	91.87	78.79
Quarter ended September 30, 2008	17.950	15.990	83.26	72.02
Quarter ended December 31, 2008	17.350	12.730	72.74	47.65
Quarter ended March 31, 2009	16.420	13.690	68.09	51.73
Quarter ended June 30, 2009	16.250	14.410	68.66	56.29
Quarter ended September 30, 2009	19.060	15.605	84.03	65.37
Quarter ended December 31, 2009	19.750	18.480	89.08	80.63
Month ended September 30, 2009	19.060	17.210	84.03	73.58
Month ended October 31, 2009	19.340	18.480	86.81	80.63
Month ended November 30, 2009	19.650	18.755	88.51	83.33
Month ended December 31, 2009	19.750	19.040	89.08	82.13
Month ended January 31, 2010	19.820	17.275	85.65	71.60
Month ended February 28, 2010	17.500	16.440	73.01	67.58
Month ended March 31, 2010 (through March 23, 2010)	18.065	17.470	73.99	70.87

Source: Madrid Stock Exchange Information and Bloomberg.

On March 23, 2010, the closing price of our shares on the Automated Quotation System of the Spanish stock exchanges was €17.750 per share, equal to \$24.02 at the Noon Buying Rate on March 19, 2010 for cable transfers in euro as certified for customs purposes by the Federal Reserve Bank of New York on that date.

Our ADSs are listed on the New York Stock Exchange under the symbol “TEF”. Citibank, N.A. is the Depository issuing ADSs in form of certificated ADSs (American Depositary Receipts, or ADRs) or uncertificated ADSs



pursuant to the deposit agreement dated as of November 13, 1996, as amended as of December 3, 1999 and as further amended as of June 23, 2000 and as of March 9, 2007 among Telefónica, the Depositary and the holders from time to time of ADSs (the “Deposit Agreement”). Each ADS represents the right to receive three shares.

At December 31, 2009, approximately 171,523,317 of our shares were held in the form of ADSs by 917 holders of record, including Cede & Co., the nominee of The Depository Trust Company. The number of ADSs outstanding was 57,174,439 at December 31, 2009.

#### Spanish Securities Market Legislation

The Spanish Securities Markets Act (Ley del Mercado de Valores, or the LMV), enacted in 1988 and further amended, regulates the primary and secondary securities markets in Spain by establishing principles for their

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organization and operation, rules governing the activities of persons and institutions operating in these markets and a system for their supervision. This legislation and the regulation implementing it (mainly, as far as private issuers are concerned, Royal Decree 1310/2005, of November 4, in relation to the issuance of securities and its admission to listing in official secondary markets, and Royal Decree 1362/2007, of October 19, concerning the transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market):

- establishes an independent regulatory authority, the CNMV, to supervise the securities markets;
- establishes the rules for surveillance, supervision and sanction provided for the representation of transferable securities by book entries or by certificate;
- establishes a framework for the issuance of securities;
- establishes a framework for trading activities;
- establishes the disclosure obligations of issuers, particularly the obligation to file annual audited financial statements and to make public quarterly financial information;
- establishes the framework for tender offers;
- establishes the code of conduct for all market participants; and
- regulates market abuse infringements.

On March 11, 2005 Royal Decree Law 5/2005 was approved, modifying the LMV in order to implement the Directive 2003/71/EC of the European Parliament and of the Council on the prospectus to be published when securities are offered to the public or admitted to trading. The Directive: (i) harmonizes the requirements for the process of approval of the prospectuses in order to grant to the issuer a single passport for such document, valid throughout the European Union; (ii) incorporates the application of the country of origin principle by which the prospectus will be approved by the Member States of the European Union where the issuer has its registered office but it also introduces as a new matter the possibility that in certain circumstances, such as issues with high minimum denominations (€1,000 or more), the issuer may designate the relevant European Union competent authority for prospectus approval.

Subsequently, Royal Decree 1310/2005 partially developed the LMV in relation to the admission to trading of securities in the official secondary markets, the sales or subscription public offers and the prospectus required to those effects.

Royal Decree 1333/2005 developed the LMV in relation to market abuse, implementing Directive 2003/6/EC of the European Parliament and of the Council, relating insider dealing and market manipulation practices (“market abuse”).

On April 12, 2007 Law 6/2007 was approved, modifying the LMV in order to implement the Directive 2004/25/EC of the European Parliament and of the Council relating to public tender offers and the Directive 2004/109/EC relating to the transparency of issuers. Law 6/2007 intends: (i) to encourage an efficient market for corporate control, while protecting the rights of minority shareholders of listed companies and (ii) to enforce transparency in financial markets.

In relation to public tender offers, Law 6/2007 (i) establishes the cases in which a company must launch a takeover bid over the whole share capital of the relevant company; (ii) establishes that takeover bids shall be launched once a specific stake on the share capital of the company has been reached; (iii) adds new obligations for the board of directors of the target companies of the takeover bid in terms of defensive measures against the takeover bid; (iii)

regulates the squeeze-out and sell-out procedure when a 90% of the share capital is held following a takeover bid. Royal Decree 1066/2007 completes the regulation currently in place for takeover bids in Spain.

Regarding transparency of issuers whose shares are accepted to trading on an official market, Law 6/2007 (i) modifies the reporting requirements of the periodic financial information of listed companies and issuers of listed

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securities; (ii) establishes a new disclosure regime for significant shareholders; (iii) adds new information and disclosure requirements for issuers of listed securities; (iv) establishes a civil liability procedure of the issuer and board of directors in connection with the financial information disclosed by issuers of securities; and (v) confers new supervisory powers upon the CNMV with respect to the review of accounting information.

On December 19, 2007 Law 47/2007 was approved, modifying the LMV in order to implement the Directive 2004/39/EC of the European Parliament and of the Council, on Markets in Financial Instruments (MiFID); the Directive 2006/73/EC of the European Parliament and of the Council on organizational requirements and operating conditions regarding the Market in Financial Instruments Directive, and the Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions. Its principal aim is to establish a general legal framework for financial markets in the European Union, in particular with regard to financial services, as well as to ensure appropriate transparency for investors through a regular flow of the relevant information concerning security issuers. Amongst other things, the new regime (i) establishes new multilateral trading facilities for listing shares apart from the stock markets; (ii) reinforces the measures for the protection of investors; (iii) establishes new organizational requirements for investment firms; (iv) implements new supervisory powers for CNMV, establishing cooperation mechanisms amongst national supervisory authorities.

On July 4, 2009, Law 3/2009, regarding structural modifications on Spanish Corporations (*Ley 3/2009, de 3 de abril, sobre modificaciones estructurales de las sociedades mercantiles*) came into force, modifying the maximum threshold established in the Spanish Corporation Act as to the number of treasury shares held by listed companies and their subsidiaries from 5% up to 10% of their total capital outstanding.

### Securities Trading in Spain

The Spanish securities market for equity securities consists of four stock exchanges located in Madrid, Bilbao, Barcelona and Valencia and the Automated Quotation System, or Mercado Continuo. During 2009, the Automated Quotation System accounted for the majority of the total trading volume of equity securities on the Spanish stock exchanges.

### Automated Quotation System

The Automated Quotation System links the four Spanish stock exchanges, providing those securities listed on it with a uniform continuous market that eliminates certain of the differences among the local exchanges. The principal features of the system are the computerized matching of buy and sell orders at the time of entry of the order. Each order is executed as soon as a matching order is entered, but can be modified or canceled until executed. The activity of the market can be continuously monitored by investors and brokers. The Automated Quotation System is operated and regulated by Sociedad de Bolsas, S.A., a corporation owned by the companies that manage the stock exchanges. All trades on the Automated Quotation System must be placed through a brokerage firm, an official stock broker or a dealer firm that is a member of a Spanish stock exchange. Beginning January 1, 2000, Spanish banks were allowed to become members of Spanish stock exchange and, therefore, can trade through the Automated Quotation System.

In a pre-opening session held from 8:30 a.m. to 9:00 a.m. each trading day, an opening price is established for each security traded on the Automated Quotation System based on a real-time auction. The regime concerning opening prices was changed by an internal rule issued by the Sociedad de Bolsas. The new regime sets forth that all references to maximum changes in share prices will be substituted by static and dynamic price ranges for each listed share, calculated on the basis of the most recent historical volatility of each share, and made publicly available and updated on a regular basis by the Sociedad de Bolsas. The computerized trading hours are from 9:00 a.m. to 5:30 p.m., during which time the trading price of a security is permitted to vary by up to the stated levels. If, during the open session, the quoted price of a share exceeds these static or dynamic price ranges, Volatility Auctions are triggered, resulting in new

static or dynamic price ranges being set for the share object of the same. Between 5:30 p.m. and 5:35 p.m. a closing price is established for each security through an auction system similar to the one held for the pre-opening early in the morning.

Trading hours for block trades are also from 9:00 a.m. to 5:30 p.m. Between 5:30 p.m. and 8:00 p.m., certain trades may occur outside the computerized matching system without prior authorization from Sociedad de Bolsas,

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S.A. at a price within the range of 5% above the higher of the average price and closing price for the day and 5% below the lower of the average price and closing price for the day if there are no outstanding bids or offers, respectively, on the system matching or bettering the terms of the proposed off-system transaction and, if, among other things, the trade involves more than €300,000 and more than 20% of the average daily trading volume of the stock during the preceding three months. These trades must also relate to individual orders from the same person or entity and be reported to the Sociedad de Bolsas, S.A. before 8:00 p.m. At any time trades may take place (with the prior authorization of the Sociedad de Bolsas, S.A.) at any price if:

- the trade involves more than €1.5 million and more than 40% of the average daily volume of the stock during the preceding three months;
- the transaction derives from a merger or spin-off process, or from the reorganization of a group of companies;
- the transaction is executed for the purposes of settling a litigation or completing a complex group of contracts; or
- Sociedad de Bolsas, S.A. finds other justifiable cause.

Information with respect to the computerized trades between 9:00 a.m. and 5:30 p.m. is made public immediately, and information with respect to trades outside the computerized matching system is reported to Sociedad de Bolsas, S.A. by the end of the trading day and published in the Boletín de Cotización and in the computer system by the beginning of the next trading day.

Please note that the regime set forth above may be subject to change, as article 36 of the LMV, which defines trades in Spanish Exchanges, has been recently revised, in virtue of Law 47/2007. Thus, the Spanish stock exchanges are currently reviewing their trading rules in light of this new regulation.

### Clearance and settlement system

The Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores S.A.U., formerly Iberclear, was created by the Ley 44/2002 de Medidas de Reforma del Sistema Financiero, enacted on November 22, 2002 to increase the efficiency of the Spanish financial markets. Such law introduced a new article, 44-bis to the LMV which established the framework for the constitution of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores S.A.U.

Iberclear is regulated by the Spanish Securities Act and where appropriate by Royal Decree 505/1987 of April 3, 1987, Royal Decree 166/1992 of February 14, 1992, and by any other related regulation. This company, which is a wholly owned subsidiary of Bolsas y Mercados Españoles, Sociedad Holding de Mercados y Sistemas Financieros, S.A. (Bolsas y Mercados Españoles), has the following functions:

- bookkeeping of securities represented by means of book entries admitted to trading in the stock markets or in the public debt book entry market;
- managing the clearance and settlement system for the brokerage transactions in the stock markets and at the public debt book entry market; and
- providing technical and operational services directly linked to the registry, clearance and settlement of securities, or any other service required by Iberclear to be integrated with any other registry, clearance, and settlement systems.

Iberclear will provide the CNMV, the Bank of Spain and the Ministry of Economy with the information that these entities may request regarding the registry clearance and settlement performed within the systems managed by Iberclear.

Transactions carried out on the Spanish stock exchanges are cleared and settled through Iberclear.

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Only members of the system are entitled to use Iberclear, and membership is restricted to authorized broker members of the Spanish stock exchanges, the Bank of Spain (when an agreement, approved by the Spanish Ministry of Economy and Finance, is reached with Iberclear) and, with the approval of the CNMV, other brokers not members of the Spanish stock exchanges, banks, savings banks and foreign settlement and clearing systems. The clearance and settlement system and its members are responsible for maintaining records of purchases and sales under the book-entry system. Shares of listed Spanish companies are held in book-entry form. Iberclear, which manages the clearance and settlement system, maintains a registry reflecting the number of shares held by each of its member entities (each, an entidad participante) as well as the amount of such shares held on behalf of beneficial owners. Each member entity, in turn, maintains a registry of the owners of such shares. Spanish law considers the legal owner of the shares to be the member entity appearing in the records of Iberclear as holding the relevant shares in its own name or the investor appearing in the records of the member entity as holding the shares.

The settlement of any transactions must be made three business days following the date on which the transaction was carried out.

Obtaining legal title to shares of a company listed on a Spanish stock exchange requires the participation of a Spanish official stockbroker, broker-dealer or other entity authorized under Spanish law to record the transfer of shares. To evidence title to shares, at the owner's request, the relevant member entity must issue a certificate of ownership. In the event the owner is a member entity, Iberclear is in charge of the issuance of the certificate with respect to the shares held in the member entity's name.

Brokerage commissions are not regulated. Brokers' fees, to the extent charged, will apply upon transfer of title of shares from the Depositary to a holder of ADRs in exchange for such ADSs, and upon any later sale of such shares by such holder. Transfers of ADSs do not require the participation of an official stockbroker. The Deposit Agreement provides that holders depositing shares with the Depositary in exchange for ADSs or withdrawing shares in exchange for ADSs will pay the fees of the official stockbroker or other person or entity authorized under Spanish law applicable both to such holder and to the Depositary.

B. Plan of Distribution

Not applicable.

C. Markets

Please see "—Offer and Listing Details" above.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

Item 10. Additional Information



A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Our bylaws (estatutos) have been amended as our share capital was reduced in December 2009. According to this amendment, article 5 was amended to reflect this change as follows:

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1. The share capital is €4,563,996,485, represented by 4,563,996,485 ordinary shares in a single series and with a nominal value of one euro each, which have been fully paid up.
2. The shareholders acting at the general shareholders' meeting may, subject to the requirements and within the limits established by law for such purpose, delegate to the Board of Directors the power to increase the share capital.

The following summary describes certain material considerations concerning our capital stock and briefly describes certain provisions of our bylaws and Spanish law.

### Corporate Objectives

Article 4 of Title I of our bylaws sets forth our corporate purposes:

- The provision and operation of all kinds of public or private telecommunications services and, for such purpose, the design, installation, maintenance, repair, improvement, acquisition, disposition, interconnection, management, administration of, and any other activity not included in the preceding enumeration with respect to, all kinds of telecommunications networks, lines, satellites, equipment, systems and technical infrastructure whether now existing or to be created in the future, including the premises in which any and all of the foregoing items are located;
- the provision and operation of all kinds of services that are ancillary or supplemental to or result from telecommunications services;
- the research and development, promotion and application of all kinds of component principles, equipment and systems directly or indirectly used for telecommunications;
- manufacturing and production activities and, in general, all other forms of industrial activity in connection with telecommunications; and
- acquisition, disposition and, in general, all other forms of commercial activity in connection with telecommunications.

### Director Qualification

In order to be elected as a director, a person must have held a number of our shares representing a nominal value of no less than €3,000 for at least three years prior to his or her election. These shares may not be transferred so long as such person remains a director. This requirement does not apply to any person who, at the time of his or her appointment, has either a labor or professional relationship with the company or is expressly exempted from such requirement by a vote of at least 85% of the Board of Directors.

### Interested Transactions

When a director or persons related to him or her has an interest in a transaction with us or with any of the companies of our Group, such transaction (if unrelated to the ordinary course of our business or if not performed on an arm's length basis) must be presented to the Nominating, Compensation and Corporate Governance Committee. Such committee shall assess the transaction from the point of view of equal treatment of shareholders and the arm's length basis of the transaction. The performance of such transactions require the authorization of our Board of Directors, after the favorable report of the committee. The interested director must refrain from participating in votes that affect such transaction.



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### Significant Differences in Corporate Governance Practices

#### Corporate governance guidelines

In Spain, companies with securities listed on a Spanish stock exchange are expected to follow the Conthe Code published in May 2006, which contains corporate governance and shareholder disclosure recommendations. It combines and substitutes the former Spanish Corporate Governance Codes: the Olivencia Code of Good Governance and the Aldama Report. Spanish listed companies are required by law to publish an Annual Report on Corporate Governance and also to publish corporate governance information on their websites. We base our corporate governance procedures on the recommendations of the Conthe Code. As part of our corporate governance procedures, we have adopted regulations for our Board of Directors that govern, among other things, director qualification standards, responsibilities, compensation, access to management information, the Board of Directors' purpose and each of our Board committee's purpose and responsibilities. Moreover, we have a Regulation of the General Shareholders' Meeting that aims to reinforce its transparency, providing shareholders with a framework guaranteeing and facilitating exercise of their rights. The Annual Report on Corporate Governance published by us provides a detailed explanation of our corporate governance procedures and explains the role and duties of our Board of Directors and Board Committees. For a more detailed description regarding our corporate governance practices see "Item 16G. Corporate Governance".

#### Description of Our Capital Stock

##### Description of share capital

At March 25, 2010, our issued share capital consisted of 4,563,996,485 ordinary registered shares with a nominal value of €1.00 each. Pursuant to the resolution adopted by our shareholders at their annual general meeting, in June 2009, the Board of Directors was authorized to execute a capital reduction by the amount of €141,000,000, by means of the cancellation of 141,000,000 Telefónica S.A. shares held as treasury shares. The Board of Directors on December 16, 2009 resolved to execute the capital reduction by the cancellation of Telefónica S.A. shares held as treasury shares thereby reducing our share capital by €141,000,000 to € 4,563,996,485, made up of an equal number of ordinary shares.

Our shareholders have delegated to the Board of Directors the authority to issue up to 2,460,565,198 new shares. The Board of Directors is authorized to exclude preemptive rights, in whole or in part, pursuant to the applicable provisions of the Spanish Corporation Law. The Board's authorization to issue new shares expires on June 21, 2011.

##### Meetings and voting rights

We hold our ordinary general shareholders' meeting during the first six months of each fiscal year on a date fixed by the Board of Directors. Extraordinary general shareholders' meetings may be called, from time to time, at the discretion of our Board of Directors or upon the request of shareholders representing 5% of our paid-in share capital. We publish notices of all ordinary and extraordinary general shareholders' meetings in the Official Gazette of the Commercial Registry and in at least one newspaper in Madrid at least one month before the relevant meeting.

Each share of Telefónica, S.A. entitles the holder to one vote. However, only registered holders of shares representing a nominal value of at least €300 (which currently equals at least 300 shares) are entitled to attend a general shareholders' meeting. Holders of shares representing a nominal value of less than €300 (less than 300 shares), may aggregate their shares by proxy and select a representative that is a shareholder to attend a general shareholders' meeting or delegate his or her voting rights by proxy to a shareholder who has the right to attend the shareholders' meeting. However, under our bylaws, no shareholder may vote a number of shares exceeding 10% of our total outstanding voting capital.

Any share may be voted by proxy. Proxies must be in writing and are valid only for a single meeting.

Only holders of record five days prior to the day on which a general meeting of shareholders is scheduled to be held may attend and vote at the meeting. Under the deposit agreement for our ADSs, our depository accepts voting instructions from holders of ADSs. The depository executes such instructions to the extent permitted by law and by

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the terms governing the shares. The depositary or its nominee, whichever is applicable, will be entitled to vote by proxy the shares represented by the ADSs.

Shareholders representing, in person or by proxy, at least 25% of our subscribed voting capital constitute a quorum for a general meeting of shareholders. If a quorum is not present at the first call, then the meeting can be held on second call. Regardless of the number of shareholders present at the meeting on second call, they are deemed to constitute a quorum.

Shareholders representing, in person or by proxy, at least 50% of our subscribed voting capital constitute a quorum on a first call for shareholders' meetings at which shareholders will be voting on any of the following actions:

- issuance of bonds;
- increase or reduction of share capital;
- amendment of corporate purpose;
- any other amendment of our bylaws; or
- merger, split or spin-off of Telefónica.

When a quorum is present on the first call, these special resolutions must be adopted by the affirmative vote of shareholders representing a majority of our present subscribed voting capital.

If a quorum for the meeting is not present after the first call, upon a second call for the meeting, 25% of our subscribed voting capital will constitute a quorum. When shareholders representing less than 50% of the subscribed voting capital are in attendance, these special resolutions must be adopted by a vote of two-thirds of those shareholders present.

## Dividends

Shareholders vote on final dividend distributions at the shareholders' meeting. Distributable profits are equal to:

- net profits for the year; plus
- profits carried forward from previous years; plus
- distributable reserves; minus
- losses carried forward from previous years; minus
- amounts allocated to reserves as required by law or by our bylaws.

The amount of distributable profits is based on our unconsolidated financial statements prepared in accordance with Spanish GAAP, which differ from the Consolidated Financial Statements prepared in accordance with IFRS included elsewhere in this Annual Report.

The Board of Directors can approve interim dividend payments without a prior shareholder vote on the issue. However, under those circumstances, the dividend is limited to distributable net profits of the current year and

is subject to certain legal requirements.

Unclaimed dividends revert to us five years from their date of payment.

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