

***REPORT FOR THE
AUDIT AND CONTROL COMMITTEE OF
THE BOARD OF DIRECTORS OF
TELEFÓNICA, S.A.
RELATED-PARTY TRANSACTIONS FOR THE
FINANCIAL YEAR 2016***

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This document contains the Report of the Audit and Control Committee of the Board of Directors of Telefónica, S.A. (hereinafter, the “Company”) regarding related-party transactions, referred to in Recommendation number 6 of the Good Governance Code of Listed Companies approved by the Board of the National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) on February 18, 2015.

In connection therewith, and pursuant to the provisions of Section 529 *ter* of the Companies Act (*Ley de Sociedades de Capital*), Article 5 of the Regulations of the Board of Directors of the Company provides that the powers that may not be delegated by the Board of Directors include the following power:

Approval, after a report from the Audit and Control Committee, of the transactions that the Company or companies of its Group enter into with Directors or with shareholders that individually or collectively with others hold a significant interest.

Under urgent and duly justified circumstances, decisions regarding the above matters may be made by the delegated bodies or persons within the Company, but must be ratified at the first meeting of the Board of Directors held after the decision is made.

Additionally, in relation to the foregoing, Article 38 of the Regulations of the Board of Directors of the Company provides as follows:

The Board of Directors, after a report from the Audit and Control Committee, shall approve transactions of the Company or its Group with shareholders that individually or collectively with others have a significant shareholding, including shareholders represented on the Board of Directors of the Company or of other companies of the Group, or with persons related thereto, unless the law assigns this power to the shareholders acting at a General Shareholders’ Meeting.

The Directors that are affected, or that represent or are associated with the affected shareholders, must abstain from taking part in the deliberation and voting on the resolution in question.

Those transactions that do not require such approval or waiver under current legislation are excepted from this approval.

In this regard, Section 529 *ter* of the Companies Act provides that only those transactions that simultaneously meet the following three requirements shall be excepted from the aforementioned approval:

1. they are carried out under standard-form agreements applied on an across-the-board basis to a large number of clients,

2. they are carried out at prices or rates established generally by the party acting as supplier of the goods or service in question; and
3. the amount thereof does not exceed one percent of the company's annual income.

All of the aforementioned transactions shall be assessed from the point of view of equal treatment of shareholders and the arm's length basis of the transaction, and shall be included in the Annual Corporate Governance Report and in the Company's Periodic Public Information upon the terms provided by law.

The approval of such transactions shall require an assurance as to the harmlessness of the transaction to corporate assets, or if applicable, the performance thereof on market terms and the transparency of the process.

In addition, the rules governing the approval of transactions made by the Company with Directors are set forth in Article 30.f) of the Regulations of the Board of Directors, upon the following terms:

No Director may directly or indirectly enter into professional or commercial transactions with the Company or with any of the companies of its Group, if such transactions are unrelated to the ordinary course of business or are not performed on an arm's length basis, unless the Board of Directors is informed thereof in advance and, with the prior report of the Audit and Control Committee, it approves the transaction upon the affirmative vote of at least 90% of the Directors present at the meeting in person or by proxy.

In connection with all of the foregoing, it is stated for the record that, during the fiscal year 2016, the Company and companies of the Group have not carried out any transaction with their directors or directors' closely associated persons (according to article 231 of the Companies Act) that, pursuant to the applicable laws or the Regulations of the Board of Directors, require the prior authorization of the Board of Directors.

Likewise, all the significant transactions due to the amount or the matter involved carried out during the financial year 2016 between the Company and the companies of the Group, and the shareholders that hold a significant participation, legally regarded as significant in the Company or closely associated persons (pursuant to article 231 of the Companies Act) or with other related parties can be found in the Company's Annual Financial Statements as well as in the Annual Corporate Governance Report for such fiscal year 2016.

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