

Supervisory Board Report for the 2014 financial year_



Eva Castillo Sanz,
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG

Dear Shareholders,

In the interests of good corporate governance, the Supervisory Board collaborated well with the Management Board on the basis of trustful cooperation, advised it and fulfilled its controlling responsibilities in the reporting period with regard to all significant concerns – not least in connection with the successful closing of the acquisition of E-Plus. The Supervisory Board of Telefónica Deutschland Holding AG consistently and responsibly performed its duties as set out by law, the Articles of Association and the by-laws.

Composition of the Supervisory Board

At the beginning of the 2014 financial year, the Supervisory Board consisted of twelve members, being the shareholder representatives Eva Castillo Sanz (Chairperson of the Supervisory Board), Angel Vilá Boix, María Pilar López Álvarez, Patricia Cobián González, Michael Hoffmann and Enrique Medina Malo, as well as the employee representatives Imke Blumenthal (Vice Chairperson of the Supervisory Board), Marcus Thurand, Thomas Pfeil, Dr Jan-Erik Walter, Christoph Heil and Claudia Weber.

The Annual General Meeting on 20 May 2014 resolved to increase the Supervisory Board from twelve to 16 members and elected Sally Anne Ashford and Antonio Manuel Ledesma Santiago as additional members of the Supervisory Board of Telefónica Deutschland Holding AG representing the shareholders. Their term of office began on 18 September 2014 when the amendment to the articles of association regarding the increase of the Supervisory Board from twelve to 16 members was registered. Joachim Rieger and Jürgen Thierfelder were appointed as additional employee representatives on the Supervisory Board by decision of the Munich Local Court on 31 October 2014. Since that date, the Supervisory Board has consisted at full strength with 16 members (eight shareholder representatives and eight employee representatives).

The German Stock Corporation Act determines for listed companies that at least one independent member of the

Supervisory Board must have expertise in the areas of accounting or auditing. In the Supervisory Board of Telefónica Deutschland Holding AG, Michael Hoffmann performs the function of the independent financial expert within the meaning of section 100 para. 5 German Stock Corporation Act (AktG).

Composition of the Management Board

At the beginning of the 2014 financial year, the Management Board comprised three members (René Schuster, Markus Haas and Rachel Empey).

With effect as of 1 February 2014, René Schuster left the Management Board by mutual agreement. Markus Haas and Rachel Empey then jointly took over the responsibilities of the CEO in addition to their other responsibilities. Since then, Markus Haas took on the function as labour director.

On 2 July 2014, the Supervisory Board of Telefónica Deutschland Holding AG resolved to appoint Thorsten Dirks as the future Chief Executive Officer (CEO). Following the closing of the E-Plus transaction, Thorsten Dirks was then formally appointed as a member of the Management Board and as CEO pursuant to the Supervisory Board resolution of 9 October 2014.

By way of a Supervisory Board resolution of the same date, the appointment of Rachel Empey and Markus Haas as members of the Management Board was extended. All members of the Management Board are appointed for the period up until 30 September 2017.

The Management Board currently comprises three members: Alongside Thorsten Dirks as CEO, Markus Haas is responsible for the operative business as Chief Operating Officer (COO) and Rachel Empey for finance and strategy as CFO.

Cooperation between the Management Board and Supervisory Board

The Management Board provides the Supervisory Board with a monthly written report, which covers in particular relevant financial key performance indicators (KPIs).

The Chairperson of the Supervisory Board and the entire Management Board are also in constant contact outside Supervisory Board meetings. Here they discuss in particular the current position and future development of the company as well as the progress of current projects, in the reporting period especially the E-Plus acquisition. The Chairperson of the Supervisory Board informs the other members of the

Supervisory Board of important issues discussed in that context.

In the reporting period, the Management Board involved the Supervisory Board in due time in all actions requiring its approval. For this purpose, it submitted reports and documents to the Supervisory Board in due time and provided additional information when required. When necessary, the Supervisory Board was also able to refer to the expertise of external consultants.

Meetings of the Supervisory Board

In 2014, five ordinary meetings of the Supervisory Board took place, namely on 18 March, 13 May, 25 July, 25 September and 3 November 2014. Meetings of the Audit Committee were also held on these days. In addition, there were eight extraordinary meetings of the Supervisory Board (some of which by telephone), further informational video and/or telephone conferences and resolutions of the Supervisory Board outside of meetings.

So far there have been three Supervisory Board meetings in 2015: on 12 January, 19 February and 23 March 2015 (meeting on the financial statements for the 2014 financial year; "Bilanzsitzung").

Fundamental issues dealt with by the Supervisory Board

The first ordinary meeting of the Supervisory Board in the 2014 financial year on 18 March 2014 was the meeting regarding the financial statements for the 2013 financial year ("Bilanzsitzung"). In addition to the items associated therewith, such as the approval of the financial statements and management reports (Group and of the corporation) for the 2013 financial year and other reporting by Management to Supervisory Board inter alia pursuant to section 90 German Stock Corporation Act (AktG), the agenda and resolutions motions for the Annual General Meeting on 20 May 2014, issues of Management Board compensation and – like in nearly all other meetings with changing focus – the E-Plus transaction were dealt with in particular.

The agenda of the ordinary meeting of 13 May 2014 included the first quarterly results for 2014, compliance, corporate governance and the efficiency of the Supervisory Board. The discussion on the latter and other issues was continued in a Supervisory Board workshop following the Annual General Meeting on 20 May 2014.

The ordinary meeting of 25 July 2014 dealt with, inter alia, the half-year financial figures, the approval of relevant

contracts (option for shop transfer to Drillisch and data center transformation) and governance issues.

The ordinary meeting of 25 September 2014 – which was the first meeting after the formal commencement of the terms of office of the two new additional shareholder representatives Sally Anne Ashford and Antonio Manuel Ledesma – dealt with matters such as financial issues (especially budget, network investments) and updates to contracts as well as corporate governance. Also at this meeting, the Supervisory Board resolved to support the request for the court appointment of Jürgen Thierfelder and Joachim Rieger as two further employee representatives, and there was an opportunity to talk with the new future management team (so-called ExComm below management board).

The ordinary meeting of 3 November 2014 was the first ordinary meeting following the successful closing of the E-Plus transaction, the formal appointment of Thorsten Dirks as CEO and the court appointment of Jürgen Thierfelder and Joachim Rieger as additional members of the Supervisory Board. In addition to financial issues (including Q3 results, budget update), in particular resolutions were passed on Management Board compensation issues, first steps to simplify the new organisational and corporate structure and the date for the Annual General Meeting on 12 May 2015.

At extraordinary meetings (sometimes by telephone, sometimes in presence meetings), the Supervisory Board discussed in particular the negotiations with the European Commission and corresponding remedies in connection with the merger clearance of the E-Plus transaction as well as Management Board issues. When necessary, the Supervisory Board gave its approval to relevant operating contracts and transactions such as the sale of yourfone GmbH on 27 November 2014, discussed the new organisational and corporate law structure and approved the budget for the 2015 financial year at such meetings.

Furthermore, the Supervisory Board made decisions at extraordinary presence meetings on the composition of the Management Board: At the meeting on 29 January 2014, the Supervisory Board decided on René Schuster leaving by mutual agreement and at the meeting on 2 July 2014 on the nomination of Thorsten Dirks as future CEO.

At every ordinary meeting, the financial situation of the company including the relevant financial reports, budget, business planning, the market positioning and the telecommunications business were examined and discussed.

All Supervisory Board members in office for the entire 2014 financial year participated in more than half of the meetings in the reporting period.

Outside of the meetings the Supervisory Board passed resolutions, to the extent required, for example by e-mail.

For instance, resolutions were passed in this way – following appropriate preparation at meetings – on the new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG), the formal Management Board appointment of Thorsten Dirks and the implementation of the so-called Capital Increase Committee.

Committees of the Supervisory Board

As determined in its by-laws, the Supervisory Board has a Nomination Committee, a Mediation Committee and an Audit Committee. Another committee was implemented in the reporting period: The Capital Increase Committee.

The Audit Committee is responsible in particular for advice on and the passing of resolutions in accounting matters. It deals with issues relating to accounting, internal control systems and auditing, risk management, compliance and the financial, asset and earnings situation. It also examines the required independence of the external auditor and is responsible for coordination with the external auditor. The Committee consists of four members:

- Michael Hoffmann (Chairperson)
- María Pilar López Álvarez
- Thomas Pfeil and
- Christoph Heil.

In 2014, the Audit Committee met five times. In addition to financial results, auditing, risk management and compliance, it dealt in particular with valuation and accounting issues in connection with the closing of the E-Plus transaction.

The following members belong to the Mediation Committee with the responsibilities in accordance with section 31 German Co-Determination Act:

- Eva Castillo Sanz (Chairperson)
- Imke Blumenthal
- Angel Vilá Boix and
- Marcus Thurand.

Furthermore, there is a Nomination Committee. The Nomination Committee has the task of suggesting suitable candidates to the Supervisory Board for election proposals to the Annual General Meeting. Patricia Cobián González is the Chairperson of the Nomination Committee. In the 2014 financial year, the other members were María Pilar López Álvarez and Enrique Medina Malo. In 2014, the Nomination Committee dealt with the election proposal to the Annual General Meeting on 20 May 2014, at which the candidates Sally Anne Ashford and Antonio Manuel Ledesma Santiago were elected.

Another committee, the so-called Capital Increase Committee was formed in connection with the E-Plus transaction. Its members are:

- Patricia Cobián González (Chairperson)
- María Pilar López Álvarez
- Marcus Thurand
- Thomas Pfeil.

In accordance with its role, this committee dealt in particular with the specific implementation of the cash capital increase and the capital increase against contribution in kind in connection with the closing of the E-Plus transaction.

Corporate Governance

Good corporate governance is essential for corporate success and is therefore in the interest of the company's shareholders. Further details on the corporate governance of Telefónica Deutschland Holding AG can be found in the Management Declaration in accordance with section 289a German Commercial Code in the Annual Report and on the company's website at WWW.TELEFONICA.DE/MANAGEMENT-DECLARATION and in the Management Boards' Corporate Governance Report in the Annual Report and on the company's website at WWW.TELEFONICA.DE/CORPORATE-GOVERNANCE-REPORT

On 3/4 October 2014, the Management Board and the Supervisory Board approved a new Declaration of Compliance in accordance with section 161 German Stock Corporation Act (AktG) and approved an update thereto on 19 December 2014. The Declaration of Compliance and its update were both published immediately. They can be viewed in the Annual Report or at the company's website at WWW.TELEFONICA.DE/DECLARATION-OF-COMPLIANCE. Earlier versions thereof can be also found at this website.

Seven of the now 16 members of the Supervisory Board held positions in the administrative, management and supervisory bodies of the majority shareholder or its affiliated companies in 2014. Both the Supervisory Board members and the Management Board members disclose potential conflicts of interest promptly to the Supervisory Board. In the reporting period, no conflicts of interest arose within the meaning of the German Corporate Governance Code.

Review of the Financial Statements 2014

The 2014 annual financial statements for Telefónica Deutschland Holding AG and the consolidated financial statements with the management reports for Telefónica Deutschland Holding AG and the group as presented by the Management Board were audited by the auditing

company Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft with its seat in Stuttgart, branch Munich.

Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft had been appointed auditor and group auditor for the financial year 2014 by resolution of the Annual General Meeting on 20 May 2014.

Telefónica Deutschland Holding AG's financial statements and the management report were prepared in accordance with the legal requirements of the German Commercial Code (HGB). The consolidated financial statements and the corresponding group management report were prepared in accordance with section 315a of the German Commercial Code (HGB) and Regulation (EC) no. 1606/2002 on the basis of the International Financial Reporting Standards (IFRS) as applicable in the European Union.

The auditor performed its audit on the basis of German generally accepted auditing principles as promulgated by the Institut der Wirtschaftsprüfer (IDW). The auditor issued an unqualified opinion (uneingeschränkter Bestätigungsvermerk) for the 2014 annual financial statements of Telefónica Deutschland Holding AG with management report and the consolidated financial statements and the group management report.

The financial statements of the corporation and the group and all related documents thereto as well as the Management Board's proposal for the distribution of profit and the respective auditor's reports were submitted to the Supervisory Board in due time prior to the meeting on 23 March 2015 ("Bilanzsitzung"). The Audit Committee and the Supervisory Board in its entirety thoroughly examined the reports and discussed them in detail together with the auditor on 23 March 2015. The Supervisory Board acknowledged and approved the auditor's findings in the audit reports and had no objections. At its meeting on 23 March 2015, the Supervisory Board approved the annual financial statements of Telefónica Deutschland Holding AG and the consolidated financial statements together with their respective management reports for the 2014 financial year; the financial statement of Telefónica Deutschland Holding AG is thereby adopted.

Relations to affiliated companies

The report on relations to affiliated companies (dependency report) as prepared by the Management Board pursuant to section 312 of the German Stock Corporation Act was also audited by the auditor. With respect thereto, the auditor issued the following unqualified opinion (uneingeschränkter Bestätigungsvermerk):

"Based on our audit and assessment, which were carried out in accordance with professional standards, we confirm that

1. the factual statements made in the report are correct,
2. the payments made by the company in connection with legal transactions detailed in the report were not unreasonably high,
3. there are no circumstances that would require a materially different assessment of the measures listed in the report than that of the Management Board."

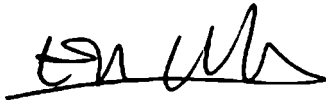
The dependency report as prepared by the management board and audited by the auditor as well as the audit report on the dependency report were submitted to the Supervisory Board in due time. Having examined the dependency report

and the corresponding audit report in accordance with section 314 of the German Stock Corporation Act, the Supervisory Board had no objections against the dependency report and the Management Board's declaration on the relations to affiliated companies contained therein and agrees with the auditor's findings.

The Supervisory Board thanks the members of the Management Board and all employees for their dedication and excellent work in the past year. With their commitment, which in the reporting period was demanded in particular by the successful closing of the E-Plus transaction, they have contributed considerably to the success of the company.

Munich, 23 March 2015

On behalf of the Supervisory Board



Eva Castillo Sanz
Chairperson of the Supervisory Board of
Telefónica Deutschland Holding AG