Registered Number: 5310128

Telefonica Europe plc

Annual Report and Financial Statements for the year ended 31 December 2014

Contents

Company information

Directors

Patricia Cobian
Ronan Dunne
Enrique Medina Malo
Richard Poston

Secretary

Robert Harwood

Registered office

260 Bath Road
Slough
Berkshire
SL1 4DX

Auditor

Ernst & Young LLP
Apex Plaza
Forbury Road,
Reading
RG1 1YE

Strategic report

Strategy

Telefonica Europe plc ("the Company") is an intermediate holding company within the Telefonica Group. The Company's strategy is integral to that of its principal subsidiaries which aims to excel in traditional communications businesses through customer experience leadership and innovative value propositions and partnerships, whilst playing a wider role in the digital and online world. The subsidiaries trade under the Brand names "O2" and "giffgaff"

Performance and Development

Financial performance of the Company for the year ended 31 December 2014:

The operating loss for the Company in the year to 31 December 2014 is £686 million (year ended 31 December 2013: £39 million profit). This has arisen primarily as a result of charge for impairment of investments in subsidiary companies during the current year.

The Company has generated a profit before tax of £360 million in 2014 in comparison to a profit before tax of £1,143 million in the prior year. This has been driven by the net financial income, largely attributable to dividends received of £1,044 million (year ended 31 December 2013: £1,100 million), offset by the impairment charge referred to above.

Financial position of the Company as at 31 December 2014:

The net assets of the Company as at 31 December 2014 were £10,717 million compared to £11,362 million at 31 December 2013.

Given that the Company operates as a holding company, the performance of the Company is integral to the performance of its principal trading subsidiaries and the Directors are of the opinion that analysis using key performance indicators is not necessary for understanding the Company's business itself.

Detail about the operating performance of the Company's main subsidiary, Telefonica UK Limited, can be obtained from that company's statutory accounts and from the financial results releases of the Company's ultimate shareholder, Telefonica S.A.

Strategic report (continued)

Principal risks and uncertainties

The Directors have satisfied themselves that it is not essential for the Company to have a separate risk management system since the Company's risks and uncertainties are integral to the principal risks and uncertainties of its key subsidiaries as listed in note 7. These risks include:

Regulatory Intervention: New or more onerous regulatory obligations imposed by the National Regulatory Authorities and the European Commission on wholesale and retail pricing and the exercise of commercial freedom, which could negatively affect the Company's profitability.

Competition: Ongoing risks from new or existing competitors that could challenge The Company's strategy and business model.

Managed Services/Outsourcing: The key subsidiaries rely on outsourcing for the delivery of various services. Failure to manage outsourced services could result in reduced control over the quality and consistency of services.

Breach of Data Security: A failure to maintain sufficient information security processes could lead to a data protection breach, resulting in loss of customer confidence, fines and damage to brand reputation.

Network Infrastructure: Inadequate resilience in critical systems could negatively affect service delivery to customers in the event of a lengthy outage.

Pension Scheme: The Company pension arrangements are an important part of the reward package and a key element in the attraction and retention of employees. The defined benefit pension funding position is sensitive to the assumptions for discount rates, inflation and life expectancy, as well as the Plan's actual asset performance. Therefore any variation from the assumptions made has the potential to introduce volatility to the Company's results.

The key subsidiaries have a series of controls in place to mitigate these risks, both within their internal operations and in the wider external market.

The key subsidiaries employ regulatory professionals to engage with the associated regulatory authorities on all aspects of their businesses to ensure that the impact on the subsidiaries profitability is not negatively impacted.

The key subsidiaries monitor products, prices and customer preferences so that they can compete with new products and services introduced by competitors and offer fair, pre-emptive pricing strategies which successfully deliver the cost-versus-service balance that their customers demand.

Mandatory Service Level Agreements and security controls are written into outsourcing contracts and the 'Customer Plan' focuses on positively differentiating customer experience. Governance meetings are also held with the key outsourced providers to ensure SLA's and KPI's are regularly monitored, reviewed and reported upon.

Data security is consistently monitored through the deployment of Network Access Control (NAC) and Data Loss Prevention (DLP) software. The "Security-in-Life" process is engaged with every project delivery to ensure adequate security measures are taken to minimize the risk of data loss. The Security Incident Management process is in place and is initiated whenever a possible security incident is identified.

Strategic report (continued)

Principal risks and uncertainties (continued)

Through the continual roll-out of new network technologies the risk of inadequate resilient systems is continually reducing.

Through the implementation of a robust Quality Management System (QMS) a team of quality experts supported by external professional bodies monitors and attests to the effectiveness of the QMS to ensure that the risk of maintaining certifications and accreditations is mitigated.

The Company and the Trustee of the Plan regularly monitor the Plan's funding position and investment strategy to understand and manage the risks associated with the operation of the Plan. Agreed investment triggers are in place to reduce the Plan's investment risk when opportunities arise in the future. The defined benefit sections of the Plan closed to accrual with effect from 28 February 2013 to limit the further build-up of risk.

Group reorganisation

The Group has previously indicated its intention to undertake a corporate simplification project to rationalise the corporate structure including the elimination, where possible, of dormant and non-trading entities. The project will also involve a reorganisation of companies in preparation for the Telefonica Group's proposed disposal of the UK business as a whole, subject to clearance by the Regulatory and Competition Authorities as disclosed in the subsequent event paragraph..

Strategic Development

Subsequent event

On 24 March 2015 Telefonica SA announced that it had entered into a definitive agreement with Hutchison Whampoa, the parent company of Three in the UK for the sale of Telefonica's UK business for an initial cash consideration of £9.25 billion upon completion of the transaction and an additional deferred payment of £1billion to be paid once the cumulative cash flow of the combined entity in the UK has reached an agreed threshold.The agreement is subject to clearance by the Regulatory and Competition Authorities.

The Strategic Report was approved by the Board on 12 May 2015

By Order of the Board

Robert Harwood
Company Secretary
12 May 2015

Directors' report

Legal form

Telefonica Europe plc is a public limited company registered in England and Wales under the number 5310128. The registered address is 260 Bath Road, Slough, Berkshire SL1 4DX. The Company is a wholly owned subsidiary of Telefónica S.A., a company incorporated in Spain.

In accordance with Section 400 of the Companies Act 2006 the Company is exempt from producing consolidated financial statements by virtue of being a wholly owned subsidiary of Telefónica S.A. and the Directors have accordingly decided to prepare individual financial statements. The consolidated annual report for Telefónica S.A. can be found on its website www.telefonica.com.

Directors

The Directors who served during the year, except where indicated otherwise, are shown below:

Eva Maria Castillo Sanz (resigned on 5 March 2014)
Sally Ashford (resigned on 31 December 2014)
Patricia Cobian
Ronan Dunne
María Pilar López Álvarez
Enrique Medina Malo
Richard Poston

The Secretary who held office during the year was Robert Harwood.

Post year end

On 28 February 2015 Maria Pilar Lopez Alvarez resigned as director of the Company.

Directors' liability insurance and indemnities

Telefónica S.A., the Company's parent company, maintains Directors' and Officers' Liability Insurance in respect of legal action that might be brought against Directors of companies within the Telefónica Group and the Directors of the Company are covered by this Insurance.
The Company has granted indemnities as permitted under UK Company Law to certain Directors on the Board.

Dividends

During the year ended 31 December 2014 the Directors declared and paid an interim dividend totalling £1,044million (year ended 31 December 2013: £1,100 million).

Political contributions

The Company made no political contributions during the year ended 31 December 2014 (2013: £nil).

Directors' report (continued)

Employees

The Company itself does not have employees.

Going concern

The Company's business activity is to act as an intermediate holding company within the Telefonica Group. The financial position of the Company is described above. In addition, notes 14 and 17 to the financial statements include the Company's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments; and its exposures to credit risk, liquidity risk and interest rate risk. The Directors believe that the Company is well placed to manage its business risk successfully despite the current uncertain economic outlook.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

Statement as to disclosure to auditor

So far as each Director is aware, there is no relevant audit information of which the Company's auditor is unaware. The Directors have taken all the steps that they ought to have taken as Directors in order to make themselves aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

The Directors' report was approved by the Board on 12 May 2015.

By Order of the Board

Robert Harwood
Company Secretary

Statement of Directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union.

Under Company Law the directors must not approve the financial statements unless they are satisfied that they present fairly the financial position, financial performance and cash flows of the Company for that period. In preparing the financial statements the directors are required to:

- select suitable accounting policies in accordance with IAS 8: Accounting Policies, Changes in Accounting Estimates and Errors and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance;
- state that the Company has complied with IFRSs, subject to any material departures disclosed and explained in the financial statements; and
- make judgments and estimates that are reasonable and prudent.

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF Telefonica Europe Plc

We have audited the financial statements of Telefonica Europe Plc for the year ended 2014 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statements of Changes in Equity and the related notes 1 to 19. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 7, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the Annual Report and Financial Statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 December 2014 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Ernst & Young LLP

Marcus Butler (Senior statutory auditor)
for and on behalf of Ernst & Young LLP, Statutory Auditor
Reading
12 May 2015

Statement of comprehensive income
Year ended 31 December 2014

	Note	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Other income		**65**	50
Administrative expenses		**(18)**	(11)
Other non-recurring expenses -impairment charge	7	**(733)**	-
Operating (loss) / profit		**(686)**	39
Financial income	4	**1,046**	1,104
Profit before taxation		**360**	1,143
Taxation credit/(charge)	5	**57**	(11)
Profit for the year attributable to the equity holders of the parent		**417**	1,132

Other comprehensive income:

	Note	2014 £m	2013 £m
Actuarial loss on defined benefit pension plan	12	**(23)**	(106)
Income tax relating to defined benefit pension plan	5	**5**	24
Other comprehensive loss for the year, net of tax		**(18)**	(82)
Total comprehensive income for the year attributable to the equity holders of the parent		**399**	1,050

The accompanying notes are an integral part of these financial statements.

Statement of financial position
As at 31 December 2014

	Note	31 December 2014 £m	31 December 2013 £m
Non-current assets			
Investments in subsidiary undertakings	7	**10,273**	11,006
Deferred tax asset	13	**-**	1
Retirement benefit asset	12	**37**	-
		10,310	11,007
Current assets			
Trade and other receivables	8	**435**	378
Cash and cash equivalents	9	**2**	2
		437	380
Current liabilities			
Trade and other payables	11	**(17)**	(13)
		(17)	(13)
Net current assets		**420**	367
Total assets less current liabilities		**10,730**	11,374
Non-current liabilities			
Borrowings	10	**(6)**	(6)
Retirement benefit obligation	12	**-**	(6)
Deferred tax liability	13	**(7)**	-
		(13)	(12)
Net assets		**10,717**	11,362
Equity			
Ordinary share capital	14	**9**	9
Share premium		**440**	440
Other reserves	14	**3,767**	3,767
Retained earnings		**6,501**	7,146
Total equity		**10,717**	11,362

The accompanying notes are an integral part of these financial statements.

These financial statements were approved and authorised for issue by the Board of Directors on 12 May 2015 and were signed on its behalf by:

Ronan Dunne
Director

Statement of changes in equity
Year ended 31 December 2014

	Ordinary share capital (note 14)	Share premium	Other reserves (note 14)	Retained earnings	Total equity
	£m	£m	£m	£m	£m
At 1 January 2013	**9**	**440**	**3,767**	**7,196**	**11,412**
Profit for the year	-	-	-	1,132	**1,132**
Other comprehensive loss	-	-	-	(82)	**(82)**
Dividends paid (note 6)	-	-	-	(1,100)	**(1,100)**
At 31 December 2013	**9**	**440**	**3,767**	**7,146**	**11,362**
Profit for the year	-	-	-	417	**417**
Other comprehensive loss	-	-	-	(18)	**(18)**
Dividends paid (note 6)	-	-	-	(1,044)	**(1,044)**
At 31 December 2014	**9**	**440**	**3,767**	**6,501**	**10,717**

The accompanying notes are an integral part of these financial statements.

Statement of cash flows
Year ended 31 December 2014

	Note	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Profit before taxation		**360**	1,143
Adjustments for			
Financial income		**(1,046)**	(1,104)
Increase / (decrease) in trade and other payables		**4**	(7)
Decrease / (increase) in trade and other receivables		**13**	(1)
Other non-cash movements	7	**668**	(46)
Net cash flow used in operating activities		**(1)**	(15)
Dividends received	4	**1,044**	1,100
Interest received		**1**	-
Net cash flow from investing activities		**1,045**	1,100
Dividends paid	6	**(1,044)**	(1,100)
Net cash flow used in financing activities		**(1,044)**	(1,100)
Net decrease in cash and cash equivalents		**-**	(15)
Cash and cash equivalents at start of year	9	**2**	17
Cash and cash equivalents at end of year	9	**2**	2

The accompanying notes are an integral part of these financial statements.

Other non-cash movements include an amount of £733 million representing an impairment charge and £65 million is other pension income.

The prior period statement of cash-flows has been restated to show a reconciliation to net cash flow from operating activities beginning with profit before taxation, rather than beginning with operating profit as was previously presented. There was no effect on the net cash flow from operating activities, or the net decrease in cash and cash equivalents as a result of this change in presentation.

Notes to the financial statements

1. Accounting policies

Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and International Financial Reporting Interpretations Committee ("IFRIC") interpretations, as adopted for use in the EU. In addition the financial statements have been prepared in accordance with those parts of the Companies Act 2006 applicable to companies reporting under IFRS. The financial statements have been prepared using historical cost principles except that, as disclosed in the accounting policies below, certain items are measured at fair value.

The Directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future thus they continue to adopt the going concern basis of accounting in preparing the annual financial statements.

The financial statements provide comparative information in respect of the previous period. The Company presents restated the statement of cash flows at the earliest period presented following a change in the reclassification of certain items in the statement. An additional explanation is provided in the financial statements due to the restatement.

Consolidated financial statements

In accordance with s400 of the Companies Act 2006, consolidated financial statements have not been prepared as the Company and its subsidiaries are included in the group financial statements of Telefónica S.A.

The principal accounting policies of the Company applied in the preparation of these financial statements are set out below. The IFRS accounting policies have been applied consistently to all periods presented.

Investments

Investments are stated at cost less provision for impairment. An impairment loss is recognised for the amount by which the investment's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an investment's fair value less costs to sell and value in use.

Employee benefits - Pension obligations

The Company is the sponsoring employer of the Telefonica Pension Plan ("the Plan") and its defined benefit section. A defined benefit plan generally provides pensions based on the employee's length of service and their final pensionable salary. A defined contribution plan offers employees individual funds which are converted into pension benefits on retirement. The assets of all schemes are held independently of the Company's finances.

The asset or liability recognised in the statement of financial position in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

The Company has elected to adopt the option in IAS 19 of recognising the full assets and liabilities of its defined benefit pension schemes on the statement of financial position. Accordingly all actuarial gains and losses are recognised in full in the statement of comprehensive income and expense in the period in which they arise.

1. Accounting policies (continued)

Taxation

The charge for current tax is based on the results for the period as adjusted for items which are non-assessable or disallowed.

Deferred income tax is provided in full, using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax liabilities are recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable future taxable profits will be available against which deductible temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, except where the timing of the reversal of the temporary difference is controlled by the Company and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred income tax and current tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Income tax relating to items recognised directly in other comprehensive income is also recognised directly in other comprehensive income.

Cash and cash equivalents

Cash and cash equivalents are carried in the statement of financial position at cost. Cash and cash equivalents includes cash in hand, deposits held at call with banks, and other short-term highly liquid investments with original maturities of three months or less, and bank overdrafts.

Borrowings

Borrowings are recognised initially at fair value. Subsequent to initial recognition, borrowings are stated at amortised cost with any difference between the cost and the redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis. Accrued interest on borrowings is included within the carrying value.

Dividends

Dividend distributions to the Company's shareholders are recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

Income is recognised when the company's rights to receive the payment is established. Dividends received from subsidiary companies are recognised as finance income in the Company's financial statements in the period in which the dividends are received.

Functional currency

The financial statements are presented in sterling, which is also the company's functional currency.

1. Accounting policies (continued)

New IFRS and interpretations of the International Financial Reporting Interpretations Committee (IFRIC)

The accounting policies applied in the preparation of the company financial statements for the year ended December 31, 2014 are consistent with those used in the preparation of the Company's financial statements for the year ended December 31, 2013, except for the application of new standards, amendments to standards and interpretations published by the IASB and the IFRIC, and adopted by the European Union, effective as of January 1, 2014, noted below:

IAS 32 Offsetting Financial Assets and Financial Liabilities – Amendments to IAS32

These amendments clarify the meaning of "currently has a legally enforceable right to set-off" and the criteria for non-simultaneous settlement mechanism of clearing houses to qualify for offsetting.

IFRIC 21 Interpretation 21 Levies

IFRIC 21 clarifies that an entity recognizes a liability for a levy when the activity that triggers payment, as identified by the relevant legislation, occurs. For a levy that is triggered upon reaching a minimum threshold, the interpretation clarifies that no liability should be anticipated before the specified minimum threshold is reached The adoption of IFRIC 21 did not have a material financial impact in the Company's financial position or results.

IAS39 Novation of Derivatives and Continuation of Hedge Accounting – Amendments to IAS39
Amendments to IAS 36 Impairment of Assets.

The application of these amendments has had no impact on the Company's financial position or results.

Investments entities (Amendments to IFRS10, IFRS 12 and IAS 27)
These amendments provide an exception to the consolidation requirement for entities that meet the definition of an investment entity under IFRS 10. The exception to consolidation requires investment entities to account for subsidiaries –as well as investments in associates and joint ventures at fair value through profit or loss. This amendment is not relevant to the Group, since none of the entities in the Group qualifies to be an investment entity under IFRS 10.

Notes to the financial statements (continued)

1. Accounting policies (continued)

New standards and IFRIC interpretations issued but not effective as of December 31, 2014

At the date of preparation of the financial statements, the following IFRS and IFRIC interpretations have been published, but their application is not mandatory:

Effective for annual periods beginning after 31 December 2014
New Standards and amendments

		Effective date: annual periods beginning on or after
Amendments to IAS 19	*Defined Benefit Plans: Employee Contributions*	1 July 2014
Improvements to IFRS 2010-2012		1 July 2014
Improvements to IFRS 2011-2013		1 July 2014
Improvements to IFRS 2012-2014		1 January 2016
IFRS 14	*Regulatory Deferral Accounts*	1 January 2016
Amendments to IFRS 11	*Accounting for Acquisitions of Interests in Joint Operations*	1 January 2016
Amendments to IAS 16 and IAS 38	*Clarification of Acceptable Methods of Depreciation and Amortisation*	1 January 2016
Amendments to IAS 16 and IAS 41	*Agriculture: Bearer Plants*	1 January 2016
Amendments to IFRS 10 and IAS 28	*Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*	1 January 2016
Amendments to IAS 1	*Disclosure Initiative*	1 January 2016
Amendments to IFRS 10, IFRS 12 and IAS 28	*Investment Entities: Applying the Consolidation Exception*	1 January 2016
IFRS 15	*Revenues from Contracts with Customers*	1 January 2017
IFRS 9	*Financial instruments*	1 January 2018
Amendments to IFRS 7	*Disclosures - Transition to IFRS 9*	1 January 2018

The Company is currently analysing the potential impact of the application of the aforementioned standards, amendments and interpretations. As there are a significant number of changes, it is possible that such application may have some impact on its financial statements in the initial period of application. The standards will be adopted on the effective date mentioned in the table above.

1. Accounting policies (continued)

Critical accounting estimates and judgements

The preparation of financial statements in accordance with IFRS requires the use of certain critical accounting estimates and assumptions. It also requires management to exercise judgement in the process of applying the Company's accounting policies. A significant change in the facts and circumstances on which these estimates are based could have a material negative impact on the Company's earnings and financial position. The areas involving a higher degree of judgement or complexity and areas where assumptions and estimates are significant to the financial statements are discussed below.

Impairment of investments

An impairment exists when the carrying value of a an investment exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. The value in use calculation is based on a discounted cash flow model. The cash flows are derived from forecasts. The recoverable amount is most sensitive to the discount rate used in the discounted cash flow model as well as the expected cash inflows and the growth rate used for extrapolation purposes.

Pension benefits

The cost of the defined benefit pension plan and the present value of the pension obligation are determined using actuarial valuations. An actuarial valuation involves making various assumptions. These include the discount rate, future salary increases, mortality rates and future pension increases. Due to the complexity of the valuation, the underlying assumptions and its long term nature, a defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each reporting date.

In determining the appropriate discount rate, management considers the interest rates of corporate bonds with at least an AA rating, with extrapolated maturities corresponding to the expected duration of the defined benefit obligation. The mortality rate is based on publicly available mortality tables. Future salary increases and pension increases are based on expected future inflation rates.

Further details about the assumptions are given in note 12.

2. Operating profit

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Operating profit is stated after charging/(crediting):		
Other income – pension contributions received from subsidiaries	**(65)**	(50)
Staff costs – pension costs	**2**	1
Subsidiary company recharges – O2 Holdings Limited	**3**	9
Other expenses	**13**	-

Other income relates to contributions from subsidiary companies in respect of the Telefonica Pension Plan (The Plan). Further information on the Plan is provided in note 12.

3. Key management and directors

None of the Directors received any remuneration in respect of their services to the Company specifically. It is not possible to apportion directors' costs between the entities they have served during the year.

The Directors of the Company are part of the key management of the Telefonica Europe Group. A complete list of the Company's subsidiaries is given in note 7.

The compensation of key management of the Company for the year ended 31 December 2014 was as follows:

	Year ended 31 December 2014 £000	Year ended 31 December 2013 £000
Salaries and short-term employee benefits	**6,864**	7,914
Long-term incentives	**318**	-
Post-employment benefits	**114**	199
Termination benefits	**741**	-
Total key management compensation	**8,038**	8,113

The remuneration of the Directors of the Company for the year ended 31 December 2014 was, in summary, as follows:

	Year ended 31 December 2014 £000	Year ended 31 December 2013 £000
Aggregate remuneration in respect of qualifying services	**6,864**	6,496
Aggregate amounts paid under long term incentive plans	**318**	-
Aggregate amount of company contributions paid to a pension scheme	**114**	199
Aggregate amount paid or receivable for loss of office	**741**	-
Total director remuneration	**8,038**	6,695

During the year, five directors (year ended 31 December 2013: six) accrued retirement benefits under a defined contribution pension plan. None of the directors were entitled to receive shares under the Performance Share Plan in the year (year ended 31 December 2013: nil).

In respect of the highest paid director included in key management:

	Year ended 31 December 2014	Year ended 31 December 2013
	£000	£000
Remuneration in respect of qualifying services	**2,236**	2,365
Amounts paid under long term incentive plan	**-**	-
Company contributions paid to a pension scheme	**7**	7
	2,243	2,372

The Company had no employees in the current or prior year.

Notes to the financial statements (continued)

4. Net financial income

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Dividends received	**1,044**	1,100
Net interest income recognised on pension plan (note 12)	**2**	4
Financial income	**1,046**	1,104
Financial expense	**-**	-
Net financial income	**1,046**	1,104

5. Taxation

The analysis of the charge / (credit) for the year is as follows:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Current tax – UK	**-**	(1)
Current tax – adjustments in respect of prior period	**(70)**	-
Deferred tax – origination and reversal of temporary differences	**13**	12
Total tax charge	**(57)**	11

The tax assessed for the year varied from the amount computed by applying the UK statutory tax rate to profit or loss on ordinary activities before taxation. The differences were attributable to the following factors:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Profit before taxation	**360**	1,143
Profit before taxation multiplied by the rate of UK corporation tax of 23.25% (2013: 23.25%)	**77**	266
Effect of:		
Income not taxable	**(255)**	(255)
Expenses not deductible	**161**	-
Adjustments in respect of prior periods	**(70)**	-
Taxation – charge / (credit) for the year	**(57)**	11

Finance Act 2013 reduced the main rate of corporation tax to 21% with effect from 1 April 2014, with a further reduction to 20% with effect from 1 April 2015. As a result the disclosure of deferred tax has been adjusted to reflect the enactment with no significant impact on these financial statements.

Notes to the financial statements (continued)

5. Taxation (continued)

The analysis of income tax credited to other comprehensive income during the year is as follows:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Current tax	-	-
Deferred tax	**(5)**	(24)
Total tax in other comprehensive income	**(5)**	(24)

Amounts credited to other comprehensive income relate to the defined benefit pension scheme.

6. Dividends declared and paid

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Dividends on ordinary shares declared and paid during the year:		
Interim dividend for year ended 31 December 2014 – 11.8p per share	**1,044**	-
Interim dividend for year ended 31 December 2013 – 12.4p per share	**-**	1,100
	1,044	1,100

7. Investments in subsidiary undertaking

Cost	**Shares in subsidiary undertaking £m**
At 1 January 2013	11,006
Additions	-
At 31 December 2013	**11,006**
Additions	-
At 31 December 2014	**11,006**

Provision for impairment	**£m**
At 1 January 2013	-
Impairment charged during the year	-
At 31 December 2013	**-**
Impairment charged during the year	733
At 31 December 2014	**733**

Net book value	
At 31 December 2014	**10,273**
At 31 December 2013	11,006

For the year ended 31 December 2014, the Company recognized an impairment loss in relation to its investments in subsidiaries of £733 million. The impairment loss was derived from an updated value in use calculation, and was triggered principally by the payment of dividends during the year by certain subsidiaries and other revisions to estimated future cash flows from the UK business.

7. Investments in subsidiary undertaking

Main assumptions used in calculating value in use

Value in use is calculated based on the approved business plan and taking into account certain variables such as OIBDA margin, CAPEX ratio for non-current assets, expressed as a percentage of revenue, and discount and perpetuity growth rates.

OIBDA margin and long-term CAPEX

The OIBDA margin and long-term CAPEX ratio used to calculate terminal value, expressed as a percentage of revenue, are based on the business plans approved for each CGU, as well as external estimates of trends in operating indicators, and the outlook for the various businesses and markets.

Discount rate

The discount rate, applied to measure free cash flow, is the weighted average cost of capital (WACC), determined by the weighted average cost of equity and debt according to the finance structure established for each CGU.

The discounts rates applied to the cash flow projections in 2014 and 2013 are as follows:

	2014	2013
United Kingdom	**6.2%**	6.1%

Perpetuity growth rate

Cash flow projections to the end of the asset's useful life are estimated using a rate of growth for the future years.

Terminal value is calculated from the projected cash flows in the period, taking as the perpetuity growth rate consensus estimates among analysts for the business and the country based on the maturity of the industry depending on technology and the degree of development. Each indicator is compared to the forecasted long-term GDP growth adjusted for any specific characteristics of the business.

The perpetuity growth rates applied to the cash flow projections in 2014 and 2013 are as follows:

	2014	2013
United Kingdom	**1%**	1%

Sensitivity to changes in assumptions

The Group carries out its sensitivity analysis of the impairment test by considering reasonable changes in the main assumptions used in calculating value in use assuming the following increases or decreases in the assumptions, expressed in percentage points:

- Discount rate (-0.5p.p. / +0.5p.p.)
- Perpetuity growth rates (+0.25p.p / -0.25p.p)
- OIBDA Margin (+2p.p. / -2p.p.)
- Ratio of CAPEX / Revenues (+1p.p. / -1p.p.)

As a consequence of the sensitivity analysis performed as of December 2014, there is no significant risk associated to changes in financial and operating variables considered individually. Management considers that within the above ranges, reasonably wide, no impairment losses would be recognized over the carrying amounts of the goodwill allocated to the CGU.

Notes to the financial statements (continued)

7. Investments in subsidiary undertaking (continued)

Details of the subsidiary undertakings are given below.

Name	Country of incorporation and operation	Activity	Portion of ordinary shares held %
mmO2 plc	England and Wales	Intermediate holding company	100
Telefonica Digital Inc	United States of America	Intermediate holding company	100
Telefonica Digital Ltd	Israel	IP communications platform operator	100
Jajah Technologies S.A.	Luxembourg	IP communications platform operator	100
O2 Holdings Ltd	England and Wales	Intermediate holding company	100
Telefonica UK Ltd	England and Wales	Mobile cellular telephone system provider and operator	100
Tesco Mobile Ltd	England and Wales	Mobile cellular telephone distributor JV with Tesco	50
Weve Ltd	England and Wales	Development mobile services JV with Vodafone and EE	33
Cornerstone Telecommunications Infrastructure	England and Wales	Mobile infrastructure network JV with Vodafone	50
Giffgaff Ltd	England and Wales	Mobile communications network	100
Telefonica Financial Services UK Ltd	England and Wales	Financial services for O2 portfolio products	100
O2 Mobiles Ltd	England and Wales	Intermediate holding company	100
O2 Networks Ltd	England and Wales	Intermediate holding company	100
O2 Investments Ireland	Ireland	Intermediate holding company	100
O2 Pine Ltd	England and Wales	Active Non – trading company	100
O2 Willow Ltd	England and Wales	Active Non – Trading company	100
Kilmaine Ltd	Isle of Man	Intermediate holding company	100
O2 International Holdings Ltd	England and Wales	Intermediate holding company	100
O2 Credit Vouchers Ltd	England and Wales	Selling of Mobile phone credit vouchers	100
Telefonica UK Pension Trustee Ltd	England and Wales	Corporate trustee of the O2 Pension Plan	100
Telefonica O2 UK Ltd	England and Wales	Dormant entity	100
Cellular Radio Ltd	England and Wales	Dormant entity	100
Movistar Ltd	England and Wales	Dormant entity	100
O2 Secretaries Ltd	England and Wales	Dormant entity	100
O2 Communications Ltd	England and Wales	Intermediate holding company	100
O2 Transactions Ltd	England and Wales	Dormant entity	100
O2 Solutions Ltd	England and Wales	Dormant entity	100
Call Connections Ltd	England and Wales	Dormant entity	100
O2 (Online) Ltd	England and Wales	Marketing and customer relations services	100
O2 (Online) Netherlands BV	Netherlands	Intermediate holding company	100
O2 (Online) Hong Kong Ltd	England and Wales	Marketing and customer relations services	100
O2 (Online) Ltd Malaysia	England and Wales	Marketing and customer relations services	100
O2 (Online) Ltd SingaporeBranch	England and Wales	Dormant entity	100

7. Investments in subsidiary undertaking (continued)

O2 (Netherlands) Holdings BV	Netherlands	Intermediate holding company	100
O2 Ltd	England and Wales	Intermediate holding company	100
TU Products Ltd	England and Wales	Dormant entity	100
O2 Redwood Ltd	England and Wales	Dormant entity	100
O2 Communications (Ireland) Ltd	Ireland	Dormant entity	100
Genie Internet Ltd	England and Wales	Dormant entity	100
O2 Cedar Ltd	England and Wales	Investment Company	100
Pacific Shelf 873 Ltd	Scotland	Dormant entity	100
DX Communications Ltd	Scotland	Dormant entity	100
DX Communications (Edinburgh) Ltd	Scotland	Dormant entity	100
The Link Stores Ltd	England and Wales	Dormant entity	100
Link FS Ltd	England and Wales	Dormant entity	100
Jajah Ltd	England and Wales	Dormant entity	100
Lumina Holdings Ltd	England and Wales	Dormant entity	100
O2 Unify Ltd	England and Wales	IT and Communications Solutions	100
Cellphones Direct (Holdings) Ltd	England and Wales	Dormant entity	100
Cellphones Direct (Investments) Ltd	England and Wales	Dormant entity	100
Cellphones Direct Ltd	England and Wales	Dormant entity	100
Telefonica Global Resources Ltd	England and Wales	Dormant entity	100
Telefonica Digital Ltd	Ireland	Dormant entity	100
Cellphones Direct International Holdings BV	Netherlands	Provision of financing to group	100
O2 (UK) Ltd	England and Wales	Dormant entity	100
Digital Mobile Spectrum Ltd	England and Wales	Provision of services in relation to spectrum auction obligations	25
O2 Third Generation Holdings Ltd	Isle of Man	Intermediate holding company	100
Computershare Trustees Ltd	Jersey	Management of Telefonica pension fund	100
The Mobile Phone Store Ltd	England and Wales	Dormant entity	100
O2 Third Generation	England and Wales	Dormant entity	100
Telefonica Europe People Services Ltd	Ireland	European HR services, support functions and administration provider	100

The shares held in mmO2 plc and Telefonica Digital Inc are held directly by the Company. The shares in all other operating and dormant companies are held by wholly owned subsidiaries. No subsidiary undertakings are listed on any public exchange.

With effective date of 12 February 2013, Lumina Ltd changed its name to O2 Unify Ltd.

On 24 June 2013, The Group entered into an agreement with H3G, the Irish subsidiary of Hutchison Whampoa to dispose of its 100% stake in Telefonica Ireland Ltd and its subsidiaries.

On 1st May 2015 Telefonica UK Limited acquired all remaining shares of Weve Limited for a negligible consideration. Weve will operate as a wholly owned subsidiary, providing digital advertising services to Telefonica UK.

Notes to the financial statements (continued)

8. Trade and other receivables

	31 December 2014 £m	31 December 2013 £m
Amounts owed by subsidiaries	**435**	378
	435	378

Principal amounts owed by subsidiaries represent receivables due from mmO2 plc of £107 million (31 December 2013: £107 million) and £328 million relating to amounts owed by subsidiaries for tax losses surrendered within the Telefonica Europe Group (31 December 2013: £258 million).

All inter-company trade receivable balances are payable on demand.

9. Cash and cash equivalents

	31 December 2014 £m	31 December 2013 £m
Short term deposits	**2**	2
Cash and cash equivalents	**2**	2

The Company's short term deposits are funds deposited with Telfisa Global BV, a related party.

10. Borrowings

	31 December 2014 £m	31 December 2013 £m
Non-current unsecured borrowings		
Amounts owed to subsidiaries	**6**	6
	6	6

The amounts owed to subsidiaries consist of a sterling denominated loan from O2 3G Holdings Limited with an effective interest rate of 1.1% (31 December 2013: 1.21%). Interest changes annually on the anniversary of the inception date of the loan and is based on the 12 month Sterling LIBOR.

The maturity of non-current borrowings is as follows:

	31 December 2014 £m	31 December 2013 £m
Between one and five years	**6**	6
	6	6

11. Trade and other payables

	31 December 2014 £m	31 December 2013 £m
Amounts owed to group undertakings	17	13
	17	13

Amounts owed to group undertakings represent amounts owed to O2 Holdings Limited.

12. Pension costs

The Telefonica Pension Plan

The Telefonica Pension Plan ("the Plan") provides the pension benefits for the majority of UK employees and is divided into defined contribution and defined benefit sections. The principal employer of the Plan is the Company. The retirement benefit obligation of the Plan is therefore recognised on the Company statement of financial position.

With effect from 28 February 2013 the defined benefit sections of the Plan closed to new entrants and further benefit accrual. Members' defined benefit pensions will continue to be increased in deferment by reference to the Consumer Prices Index but will not retain the link to any future increases in salary. Upon closure, members of the defined benefit sections of the Plan were given the option to become members of the defined contribution section of the Plan. The defined contribution sections of the Plan remain open to new entrants and further contributions. The assets of the Plan are held independently of the Company's finances.

The closure of defined benefit sections of the Plan resulted in a curtailment event and consequently, a gain of £76 million was recognised in the past service cost in 2012 in accordance with IAS19. No further impact has been or will be recognised.

The total operating charge included in the statement of comprehensive income for the Company's defined benefit pension schemes are as follows:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Telefonica Pension Plan cost	2	1

12.Pension costs (continued)

Actuarial valuation

A full valuation of the defined benefit sections of the Plan was undertaken as at 30 September 2011 by a suitably qualified independent actuary. The valuation used the projected unit method and set a future funding plan to ensure that contributions to the Plan meeting future liabilities (until closure at 28 February 2013) and past service liabilities are adequately funded. A full valuation of the Plan with an effective date of 30 September 2014 is currently underway but has not yet been finalised.

The 2011 valuation was completed in line with the current investment strategy of the Plan which is predominantly a corporate bond basis initiated following the 2008 valuation. Following the 2011 valuation, the ongoing contribution rate was increased to 33.8% of defined benefit members' payroll (note only payable until Plan closure on 28 February 2013). Based on the difference between the September 2011 pension asset value and the technical provisions a past service deficit of £164 million resulted. It was agreed that this deficit will be recovered by additional contributions over the period to 2016 totalling £163 million (2012: £40.5m (paid), 2013: £42.1m (paid), 2014: £40m (paid), 2015: £25m (paid), 2016: £16m). These contributions are in line with the schedule of contributions contract dated 13 September 2013.

Based on the current schedule of contributions, it is anticipated that the Company will pay no contribution to the Plan in respect of the Plan's funded defined benefit sections over 2015 as payment of the £25m contribution due by 7 January 2015 was made during 2014. Note a new schedule of contributions is expected to be agreed following completion of the 30 September 2014 valuation which may result in different contributions being agreed in 2015 and subsequent years. The total payment made during the year ended 31 December 2014 was £65m.

The main financial actuarial assumptions used in the valuation were as follows:

Life expectancy (male currently age 40 / 60)	88.8 / 87.3 years
Nominal rate of increase of pensions in payment (RPI max 5%)	3.05%
Discount rate	3.70%
Inflation assumption (RPI/CPI)	3.20% / 2.20%

The initial results of the actuarial valuation of the Plan as at 30 September 2014 have been updated to 31 December 2014 by an independent qualified actuary in accordance with the requirements of IAS 19. The defined benefit liabilities have been measured using the projected unit credit method. Plan assets are stated at fair value.

In June 2011 a new IAS19 (hereafter called "IAS19R") was published which came into effect for accounting years beginning on or after 1 January 2013. The Company adopted IAS19R for the first time for the accounting period ending 31 December 2013. Under IAS19R, the profit and loss lines for "Return on Plan assets" and "Interest on Plan liabilities" have been combined as "Net interest on the defined benefit asset/liability". The actuarial charge/credit in Other Comprehensive Income is now split into "Actuarial (gains)/losses on demographic assumptions", "Actuarial (gains)/losses on financial assumptions", "Actuarial (gains)/losses on experience adjustments" and "Return on Plan assets in excess of interest income".

Notes to the financial statements (continued)

12.Pension costs (continued)

Movements in the present value of the Plan's defined benefit obligations in the current and preceding period were as follows:

	31 December 2014 Funded £m	31 December 2013 Funded £m
At start of year	**1,037**	923
Total current service cost	**-**	3
Interest expense	**46**	42
Vested past service costs	**-**	(3)
Actuarial losses / (gains) on demographic assumptions	**(25)**	27
Actuarial losses / (gains) on financial assumptions	**160**	64
Actuarial losses / (gains) on experience adjustments	**(17)**	-
Benefits paid	**(18)**	(19)
At end of year	**1,183**	1,037

Movements in fair value of the Plan's defined benefit scheme assets in the current and preceding period were as follows:

	31 December 2014 Funded £m	31 December 2013 Funded £m
At start of year	**1,031**	972
Interest income	**48**	46
Return on plan assets in excess of interest income	**96**	(16)
Employer contributions	**65**	50
Employee contributions	**-**	-
Scheme expenses paid	**(2)**	(1)
Benefits paid	**(18)**	(19)
At end of year	**1,220**	1,031

The amount included in the statement of financial position of the Company arising from its obligations in respect of the defined benefit sections of the Plan, as well as the analysis of the Plan's assets, is as follows:

	31 December 2014 Funded £m	31 December 2013 Funded £m
Fair value of assets comprises:		
– Equities	**256**	216
– Corporate bonds	**938**	815
– Cash and net current assets	**26**	-
Fair value of assets	**1,220**	1,031
Present value of defined benefit obligations	**(1,183)**	(1,037)
Net asset/(obligation) recognised in statement of financial position of Telefonica Europe plc	**37**	(6)

Plan assets are valued by reference to quoted market prices in active markets. No assets of the Company are held by the Plan.

Notes to the financial statements (continued)

12.Pension costs (continued)

The amounts recognised in the statement of comprehensive income in respect of the defined benefit *sections of the Plan are as follows:*

	Year ended 31 December 2014 Funded £m	Year ended 31 December 2013 Funded £m
Analysis of the amount charged to operating profit:		
Current service cost (employers)	-	3
Past service cost (employers)	-	(3)
Scheme administration expenses	2	1
Total operating charge	2	1
Analysis of the amount (credited) to net financial income:		
Net interest on the defined benefit (asset)	(2)	(4)
Net interest	(2)	(4)
Analysis of the amount recognised in other comprehensive income:		
(Return on plan assets in excess of interest income)	(95)	16
Actuarial loss / (gain) on demographic assumptions	(25)	27
Actuarial loss / (gain) on financial assumptions	160	64
Actuarial loss / (gain) on experience adjustment	(17)	-
Actuarial loss	23	106

The main assumptions adopted for the Plan (funded and un-funded) under IAS 19 are as follows:

	Year ended 31 December 2014 Funded and unfunded %	Year ended 31 December 2013 Funded and unfunded %
Nominal rate of increase in salaries	N/A	N/A
Nominal rate of increase of pensions in payment:		
– Pension increases with inflation	3.2	3.4
– Pension increases with inflation Ltd to 5 per cent p.a.	3.05	3.25
Discount rate	3.7	4.5
Inflation assumption		
-- RPI	3.2	3.4
-- CPI	2.2	2.4
Life Expectancy		
-- Male (current age 40)	88.8	89.7
-- Male (current age 60)	87.3	88.3
-- Female (current age 40)	91.1	91.1
-- Female (current age 60)	89.6	89.5

At 31 December 2014, the weighted average duration of the defined benefit obligation of the funded plan was 23 years (2013: 23 years).

The position and results reported are subject to the accuracy of the assumptions used.

A reduction in the discount rate will increase the assessed value of liabilities as a higher value is placed on benefits paid in the future. A rise in the discount rate will have an opposite effect of similar magnitude.

12.Pension costs (continued)

An increase in the inflation rate will increase the assessed value of liabilities as a higher value is placed on benefits. A reduction in the inflation rate will have an opposite effect of similar magnitude.

There is also uncertainty around the future life expectancy of the UK population. The value of current and future pension benefits will depend on how long they are assumed to be in payment.

The following table summarises the estimated sensitivity of the disclosed liability value to changes in the principal assumptions that have been used in the calculations:

Change in assumption	Liabilities increase by
Decrease discount rate by 0.25%	£70m
Increase inflation rate by 0.25%	£61m
Increase life expectancy by 1 year	£28m

Other Group pension plans

The Group operates an un-funded defined benefit scheme in the UK. The assumptions adopted for the unfunded arrangement are consistent with those used for the funded portion of the Plan. The liabilities of this scheme are in addition to those reported above for the Telefonica Pension Plan. The liability for the unfunded scheme is £7m (2013: £7m). The amount of £7m is disclosed in the O2 Holdings Ltd statutory financial statements for 2014.

The Group also operates defined contribution schemes in Ireland and in the UK. The assets of these defined contribution arrangements are held separately from those of the Company in independently administered funds. The expense in the statement of comprehensive income relating to the defined contribution sections of the Plan is equal to the Company contributions paid over the year, which totalled £41m (2013: £42m).

13. Deferred taxation

The movement in deferred tax assets / (liabilities) during the year is as follows:

	Defined benefit pension liability/surplus £m
At 1 January 2013	**(11)**
Charge to comprehensive income	(12)
Credit to other comprehensive income	24
At 31 December 2013	**1**
Charge to comprehensive income	(13)
Credit to other comprehensive income	5
At 31 December 2014	**(7)**

Notes to the financial statements (continued)

14. Equity

	Number of shares	31 December 2014 £m	Number of shares	31 December 2013 £m
Authorised				
Ordinary shares of 0.1 pence each	**20,000,000,000**	**20**	20,000,000,000	20
Called up, allotted and fully paid				
Ordinary shares of 0.1 pence each	**8,880,812,164**	**9**	8,880,812,164	9

The Company has one class of authorised and issued share capital, comprising ordinary shares of 0.1 pence each. Subject to the Company's articles of association, and applicable law, the Company's ordinary shares have attached to them full voting, dividend and capital distribution (including on winding up) rights; they do not confer any rights of redemption.

Capital management

The Company's capital comprises share capital, share premium, reserves and retained earnings.

The Company's objectives when managing capital are to safeguard the Company's ability to continue to operate as a going concern, to maintain optimal capital structure commensurate with risk and return and to reduce the cost of capital.

In order to maintain or adjust the capital structure, the Company may pay dividends to its shareholder, return capital to its shareholder, issue new shares or sell assets to reduce debt or draw down more debt.

Other reserves

Other reserves of £3,767 million (2013: £3,767 million) represent the difference between the nominal value of the investment held in mmO2 plc and market price on the date of purchase.

15. Related party disclosures

During the year ended 31 December 2014, the Company entered into transactions with related parties as follows:

	Year ended 31 December 2014 £m	Year ended 31 December 2013 £m
Financial income		
Subsidiary companies	**1,044**	1,100
Other related parties	**-**	-
	1,044	1,100
Financial expense		
Subsidiary companies	**-**	-
Other related parties	**-**	-
Total net transactions	**1,044**	1,100

Notes to the financial statements (continued)

15. Related party disclosures (continued)

At 31 December 2014 the Company had the following balances arising from transactions with related parties:

	31 December 2014 £m	31 December 2013 £m
Receivables from related parties		
Subsidiary companies	**435**	378
	435	378
Payables to related parties		
Subsidiary companies	**(23)**	(19)
	(412)	(359)

Principal amounts owed by subsidiaries represent receivables due from mmO2 plc of £107 million (31 December 2013: £107 million) and £328 million relating to amounts owed by subsidiaries for tax losses surrendered within the Telefonica Europe Group (31 December 2013: £258 million).

The amounts owed to subsidiaries consist of a sterling denominated loan from O2 3G Holdings Limited with an effective interest rate of 1.1% (31 December 2013: 1.21%). Interest changes annually on the anniversary of the inception date of the loan and is based on the 12 month Sterling LIBOR

Amounts owed to group undertakings represent amounts owed to O2 Holdings Limited.

16. Auditor's remuneration

Audit fees for the Company were borne by another company within the Telefónica S.A. group and have not been allocated across the Group.

	Year ended 31 December 2014 £	Year ended 31 December 2013 £
Audit fees	**35,015**	**140,144**

17. Financial instruments

Financial risk factors and management

The Company's principal financial liabilities comprise borrowings and trade and other payables. The purpose of these financial liabilities is to raise finance for the Company to support their continued operations. The Company has various financial assets such as trade receivables and short term deposits.

The principal financial risks of the Company and how the Company manages these risks are discussed below.

Credit risk

Credit risk is the risk that a counterparty will not meet its obligation under a financial instrument leading to a financial loss.

The Company's principal credit risks are attributable to its trade receivables. Trade receivables as presented in the statement of financial position are net of provision for doubtful debts, estimated by the Company's management based on prior experience and their assessment of the current economic environment. Management has a credit policy in place and the exposure to credit risk is monitored on an ongoing basis. At the statement of financial position date there were no significant concentrations of credit risk.

The Company does not require collateral in respect of financial assets.

The Company does not have a significant exposure to credit risk. All of the Company's credit balances are held with group companies within the Telefónica S.A. group.

Liquidity risk

Management of the Company's liquidity risk is achieved mostly through being a part of the larger Telefónica group, which operates group wide policies in this area. The Company also maintains its own committed borrowing facilities, and holds financial assets primarily in short-term deposits with a central Telefónica group company that are readily convertible to known amounts of cash. These measures help keep liquidity risk low.

Interest rate risk

The Company's interest rate risk arises primarily from the effects of movements in interest rates on the value of the Company's long-term borrowings and financial assets. During the year it was policy to fix or protect expected interest flows where Company profits or key financial ratios would be materially at risk from interest rate movements. The Company's cash and cash equivalents are deposited with a central Telefónica group company that pays interest at variable market rates.

Fair value of financial instruments

The carrying value and fair value of the Company's financial assets and financial liabilities are not deemed to be materially different at 31 December 2014 and 31 December 2013.

18. Parent company and controlling party

At 31 December 2014, the immediate and ultimate parent company and controlling party was Telefónica S.A., a company incorporated in Spain. Copies of the financial statements of Telefónica S.A. may be obtained from Gran Vía 28, Madrid, Spain.

19. Subsequent event

On 24 March 2015 Telefonica SA announced that it had entered into a definitive agreement with Hutchison Whampoa, the parent company of Three in the UK, for the sale of Telefonica's UK business for an initial cash consideration of £9.25 billion upon completion of the transaction and an additional deferred payment of £1 billion to be paid once the cumulative cash flow of the combined entity in the UK has reached an agreed threshold.The agreement is subject to clearance by the Regulatory and Competition Authorities.