

**REPORT PREPARED BY THE APPOINTMENTS AND REMUNERATION COMMITTEE OF EUSKALTEL, S.A. ON THE PROPOSED RESOLUTION RELATING TO THE REMUNERATION POLICY FOR THE DIRECTORS OF THE COMPANY REFERRED TO IN THE ITEM SIX ON THE AGENDA FOR THE ORDINARY GENERAL SHAREHOLDERS' MEETING OF THE COMPANY CALLED FOR 27 JUNE 2016, ON FIRST CALL, AND FOR 28 JUNE 2016 ON SECOND CALL**

**I. Introduction**

Pursuant to the provisions of Section 529 *novodecies* of Royal Legislative Decree 1/2010 of 2 July approving the consolidated text of the Companies Act (the “**Companies Act**”), the Appointments and Remuneration Committee of Euskaltel, S.A., at its meeting of 24 May 2016, formulates and approves this report on the reasoned proposal for the director remuneration policy for this financial year 2016 and financial years 2017 and 2018 (the “**Remuneration Policy**”) which the Company’s Board of Directors will submit for approval of the shareholders at the General Shareholders’ Meeting of Euskaltel set for 27 and 28 June 2016, on first and second call, respectively (the “**Report**”).

**II. Director remuneration policy**

**1. Effective period**

The Remuneration Policy will apply in this financial year 2016 and next two financial years (2017 and 2018), unless the shareholders acting at a General Shareholders’ Meeting of Euskaltel resolve to amend or replace it during said period, all as provided in Section 529 *novodecies* of the Companies Act.

**2. Principles and foundations**

Pursuant to article 27 of the Regulations of the Board of Directors of the Company, and within the limits set out in the Company’s Bylaws, the Board of Directors shall endeavour to ensure that the remuneration of the directors is reasonably commensurate with the significance of the Company, the financial situation thereof and the market standards used at companies of a similar size or activity, and takes into account their dedication to the Company. The remuneration system established should be focused on promoting the long-term profitability and sustainability of the Company and include the measures necessary to avoid the excessive assumption of risk or rewarding unfavourable results.

The Board of Directors shall also ensure that the amount of the remuneration of external directors is such that it provides incentives to their dedication but does not compromise their independence.

In line with the foregoing, the Remuneration Policy is based on the following principles:

- **Moderation:** remuneration must be reasonably proportional to the Company, the economic situation at any particular time and the market practices of comparable companies.
- **Suitability:** the Remuneration Policy shall be focused on the attraction, motivation and retention of valuable human capital, as well as on remunerating professional merit, responsibility assumed, and dedication in the case of non-executive directors.

- Balance: the Remuneration Policy shall establish a proper balance between fixed and variable components, such that fixed remuneration is a high enough percentage of overall remuneration to allow flexible measures to be introduced for directors carrying out executive duties.
- Profitability and sustainability: the remuneration of directors performing executive functions is to provide incentives for performance and reward the creation of long-term value.
- Results-based: for directors performing executive duties, the remuneration thereof shall include the necessary linkage to the Company's results over an appropriate time period, in alignment with the interests, values and strategy of the Company.
- Fairness and external competitiveness: in setting director remuneration, account shall be taken of the external competitive environment and principles of internal fairness.
- Transparency of remuneration policy: the Remuneration Policy shall be established, set and applied in accordance with applicable laws, the Company's internal rules and best corporate practices, ensuring transparency and adherence to the Good Governance Code of Listed Companies approved by the National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) on 18 February 2015 (the "**Good Governance Code**"). In particular, upon the call to the Annual General Shareholders' Meeting, the Company shall make available to the shareholders the Annual Director Remuneration Report, which shall be submitted to a consultative vote thereat as a separate item on the agenda.

The Remuneration Policy essentially differentiates directors in their capacity as such (external non-executive directors) from those who perform executive duties at the Company (currently applicable only to the Chair of the Board of Directors), as describe below.

### **3. Remuneration of directors in their capacity as such**

The remuneration of directors in their capacity as such consists of a fixed annual allocation by reason of their membership on the Board of Directors and any of its various Committees, without distinction among the duty function performed or the post held, except as the Board of Directors may otherwise establish and without prejudice to what is indicated below regarding the lead independent director. This fixed allocation is paid entirely in cash.

The Board of Directors may also assign the lead independent director an additional allocation for performance of the duties specific to said post. The amount of said additional allocation, if any, shall be determined by the Board of Directors annually and may not individually exceed 25% of the fixed annual remuneration to which the director is entitled for membership on the Board.

The maximum remuneration of the directors in their capacity as such may not exceed the maximum amount approved each year by the shareholders at the General Shareholders' Meeting, and the Board of Directors may establish a lower amount.

For financial year 2016, the maximum amount of total annual remuneration of the directors in their capacity as such is 1,500,000 euros. For the period during which this Remuneration Policy is in effect, said maximum amount of total annual remuneration shall be kept at the same amount, except as otherwise decided by the shareholders at a General Shareholders' Meeting.

Of this amount, the Board of Directors has approved the following amounts, to be paid as the fixed annual allocation:

- Fixed annual allocation for membership on the Board of Directors: 65,000 euros.
- Fixed annual allocation for membership on the Audit and Control Committee or the Appointments and Remuneration Committee: 15,000 euros.

Furthermore, and in accordance with article 62 of the Bylaws, directors in their capacity as such may receive in-kind remuneration consisting of the payment by Euskaltel of insurance premiums, with a maximum annual limit of 8,000 euros for each director, the implementation of which must be approved by the Board of Directors.

The Company also has civil liability insurance for its directors upon customary terms and proportional to the circumstances of the Company. The maximum amount of this coverage is 10,000,000 euros.

For purposes of clarification, it should be noted that the preceding categories of remuneration are received only by directors in their capacity as such, including as proprietary directors, but excluding executive directors, since the latter are to receive only the remuneration stipulated in their respective contracts, as described in section **¡Error! No se encuentra el origen de la referencia.** below.

#### **4. Remuneration of directors for the performance of executive duties**

The remuneration system for executive directors is made up of:

- Fixed remuneration, which includes a fixed salary and specific in-kind remuneration.
- Variable annual remuneration tied to short-term objectives.
- Variable remuneration, in the form of the delivery of shares, options on shares or instruments indexed to the value thereof linked to business objectives, the value of the shares and any other corporate social responsibility objectives, all subject to approval by the Board of Directors of the corresponding incentives plans, as applicable.

##### *4.1. Fixed remuneration*

The purpose of the fixed remuneration is to reward the performance of executive duties, and includes (i) a fixed salary, and (ii) specific in-kind remuneration.

Executive directors may receive specific in-kind remuneration, including the provision of an individual company vehicle, a life assurance policy covering death due to any cause, a health insurance policy, an accident insurance policy and a policy for other minor coverage.

Fixed remuneration (i) shall primarily be based on a market approach and takes account of the size, nature and scope of the Company's business; and (ii) shall be in proper alignment with the remuneration established at comparable companies in the industry at the domestic and international level.

##### *4.2. Variable annual remuneration*

As stated above, variable annual remuneration applies only to executive directors, as a percentage of their fixed remuneration. Said variable remuneration is based on objective criteria which seek to evaluate the contribution of performing their executive duties to the Company's business objectives.

In this regard, said variable annual remuneration of executive directors will generally fluctuate between 0% and 75% of fixed salary as a maximum, assuming 50% of fixed salary for the achievement of 100% of the objectives. By way of exception, the variable annual remuneration of the Chair of the Board of Directors will fluctuate between 0% and 60% of fixed salary, as indicated in section **¡Error! No se encuentra el origen de la referencia..**

The setting of objectives, as well as the scale of attainment and the evaluation of performance, is carried out by the Board of Directors, which must subsequently determine the degree to which the business objectives used as a reference have been met and the level of achievement of the variable annual remuneration (including situations of under- and over-achievement, as applicable).

Generally, the parameters to be taken into account for determining compliance with the variable annual remuneration objectives, as well as the respective weightings thereof, will be determined annually by the Board of Directors, upon a proposal of the Appointments and Remuneration Committee, based on indicators correlated to Company variables relating to (i) growth; (ii) profitability; (iii) innovation; and, when applicable, (iv) others of a qualitative or quantitative nature including, but not limited to, medium- and long-term sustainability, meeting strategic objectives or objectives relating to corporate social responsibility.

The preceding objectives and parameters will also take account of the risk assumed to obtain a result and will pursue a balance among the Company's short-, medium- and long-term objectives, not revolving solely around one-off, occasional or extraordinary facts or data.

The objectives, parameters and weightings generally approved by the Board of Directors for the Company's management team will in any event be applicable to executive directors.

The Board of Directors, upon a proposal of the Appointments and Remuneration Committee, may adjust the above weightings or include other objectives that have priority for the short-term development of the business.

The variable annual remuneration system will be periodically reviewed by the Appointments and Remuneration Committee, which will determine whether it is appropriate for measuring contributions to Euskaltel's results.

The specific variable annual remuneration parameters applicable to this financial year 2016, and the respective weightings thereof, are described below:

- Growth (income and net customer increase): 30% weighting.
- Profitability (EBITDA and Free Cash Flow): 30% weighting.
- Innovation (new products launched and number of connected products launched): 15% weighting.
- Integration (synergies): 25% weighting.

For financial year 2016, these objectives and metrics represent an appropriate balance between financial and operating aspects of the Company.

Should the Company's auditors make qualifications in their audit report affecting one or more of the objectives and parameters that are to be taken into account in setting the variable annual remuneration of the executive directors, said qualifications shall be taken into account by the Board of Directors in setting the variable remuneration to be received by executive directors.

The Company may also demand reimbursement of all or part of the variable remuneration, as applicable, if (i) the payment of the variable remuneration did not match the conditions for

performance of the Company; or (ii) the variable remuneration was paid in light of data subsequently proven to be incorrect (e.g. if there was a correction to the annual accounts on which the variable remuneration was based).

#### *4.3. Variable remuneration in the form of the delivery of shares, options on shares or instruments indexed to the value thereof*

Variable remuneration of the executive directors in the form of the delivery of shares, options on shares or instruments indexed to the value thereof seeks multiple objectives:

- Reward contributions to value by allowing the participants therein, including executive directors, to benefit from the results of their management.
- Align the interests of executive directors with those of shareholders by linking them to an increase in the value of Euskaltel shares, the objectives set in the Business Plan approved by the Board of Directors and, where applicable, other corporate social responsibility objectives.
- Include in the remuneration package a variable remuneration element through the delivery of shares, options on shares or instruments indexed to the value thereof, in line with the best recommendations on remuneration as well as with the market practice of other listed companies comparable to Euskaltel.

To that end, when the Board of Directors approves the corresponding incentive plans or share purchase incentive plans or other similar instruments for the officers or employees of Euskaltel, executive directors may enrol and participate therein on the terms and conditions set by the Board of Directors, which will entail the delivery of shares of the Company in the quantity and for the price or value that applies pursuant to the terms of said plans or instruments.

#### *4.4. Main terms and conditions of the contract of the Chair of the Board of Directors*

The essential terms and conditions of the contract of the Chair of the Board of Directors (the only executive director as of the date the Remuneration Policy was formulated by the Board of Directors) are as indicated below:

- Fixed remuneration: the fixed salary of the Chair of the Board of Directors is 323,144 euros.

It should be noted that the fixed salary of the Chair of the Board of Directors did not undergo substantial changes upon the admission to trading of the Company's shares, as the principles and criteria applied in prior financial years have been continued.

- Variable annual remuneration: the variable annual remuneration of the Chair of the Board of Directors will fluctuate between 0% and 60% of fixed salary as a maximum, assuming 50% of fixed salary for the achievement of 100% of the objectives.

As is the case with fixed remuneration, the variable annual remuneration of the Chair of the Board of Directors did not undergo substantial changes upon the admission to trading of the Company's shares, as the principles and criteria applied in prior financial years have been continued.

- Variable remuneration in the form of the delivery of shares, options on shares or instruments indexed to the value thereof: the Chair, as a director performing executive duties, may enrol and participate in incentive plans or share purchase incentive plans or other similar instruments in effect from time to time for officers or employees of Euskaltel,

which will entail receipt by the Chair of an incentive in shares of the Company, options on shares or instruments indexed to the value thereof.

If such enrolment or participation occurs, the Chair will be entitled to receive a number of shares established by the Company's Board of Directors and for the price or value set by said body from time to time in accordance with the incentive plans or share purchase incentive plans or other instruments of a similar nature formulated and approved by the Board of Directors within the framework of this Remuneration Policy.

- Term: indefinite.
- Exclusivity: the Chair of the Board of Directors must be exclusively dedicated to the Company.
- Non-competition: the Chair of the Board of Directors may not have direct or indirect economic interests in businesses competing with those of the Company.
- Prior notice period: there are no specific provisions in the contract with respect to prior notice periods for the Chair of the Board of Directors or the Company in cases of resignation, voluntary leave or withdrawal.
- Severance payments: in the case of the removal or resignation of the Chair of the Board of Directors, the Chair will have the option to terminate or to renew the ordinary employment relationship that was suspended on 28 November 2000.

If renewal of the previous ordinary employment relationship is chosen, it would be subject to the termination regime governed by Royal Legislative Decree 1/1995 of 24 March approving the Consolidated Text of the Workers' Statute Act (*Ley del Estatuto de los Trabajadores*). For purposes of severance payments, the time for which services have been provided shall be calculated as the entire period for which the Chair has been linked to the Company, regardless of whether it was pursuant to an ordinary or senior management employment relationship or to a commercial relationship.

If termination is chosen, the Chair will have the right to receive a severance payment equal to 45 days' salary per year of services provided to the Company, with periods of less than a year apportioned by months, up to a maximum of 24 monthly instalments, calculated based on the gross annual cash salary received in the calendar year immediately prior to the termination.

- The contract of the Chair of the Board of Directors does not contemplate disqualification clauses, golden parachute clauses or clauses relating to hiring bonuses.

Nor does the Chair's contract contain specific provisions with respect to continuance in office or loyalty agreements or post-contractual non-competition. However, it should be noted that as a director, the Chair of the Board of Directors is subject to the rules on prohibitions, duties of confidentiality and of non-competition, which are established in articles 51 of the Bylaws and 31 and 32 of the Regulations of the Board of Directors, respectively.

#### 4.5. *New appointments*

If other directors with executive duties join the Board of Directors during the period the Remuneration Policy is in effect, the determination of their remuneration package (i.e. remuneration components and the corresponding upper and lower limits) will be governed by the principles which inform sections **;****Error! No se encuentra el origen de la referencia.**, **;****Error! No se encuentra el origen de la referencia.** and **;****Error! No se encuentra el origen**

**de la referencia.** of the Remuneration Policy, without prejudice to the specific features of their respective service agreements with the Company.

In this regard, when proposing the basic terms of such service agreements for approval by the Board of Directors, this Appointments and Remuneration Committee must bear in mind variables and aspects including, but not limited to: (i) the duties assigned to the new executive director; (ii) the degree to which said director devotes his or her time to the Company; (iii) the responsibilities being assumed; (iv) the director's experience in management, leadership and business strategy; (v) the director's career path and history of value creation; and (vi) the director's level of remuneration at the time of appointment.

## **5. Application of the Remuneration Policy**

Without prejudice to the provisions of the Companies Act dealing with director remuneration policy, this Appointments and Remuneration Committee will endeavour to ensure compliance with the Remuneration Policy, review it periodically and propose amendments and updates thereto to the Board of Directors, to be submitted to the shareholders at the General Meeting, pursuant to the terms of the Regulations of the Appointments and Remuneration Committee.

## **III. Conclusions**

Pursuant to the provisions of Section 529 *novodecies* of the Companies Act, the Appointments and Remuneration Committee of Euskaltel submits this Report on the Director Remuneration Policy to the Company's Board of Directors, so that the Board in turn may submit it to the approval of the shareholders at the General Shareholders' Meeting, the Appointments and Remuneration Committee having concluded in view of all of the foregoing that the Remuneration Policy:

- (i) Conforms to applicable law, and particularly to the Companies Act, as well as the Good Governance Code and best policies relating to remuneration.
- (ii) Also conforms to the criteria of (a) transparency of information made available to shareholders; (b) alignment with best practices and current corporate governance standards; and (c) profitability and long-term sustainability of the Company.

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In Derio, on 24 May 2016