Telefónica Europe B.V.
(Incorporated with limited liability under the laws of The Netherlands
with corporate seat in Rotterdam)

$1,250,000,000 7.35% Notes due 2005
$2,500,000,000 7.75% Notes due 2010
$1,250,000,000 8.25% Notes due 2030
€1,000,000,000 6.125% Notes due 2005

Guaranteed as to Payment of Principal and Interest by

Telefónica, S.A.

Telefónica Europe B.V. ("Telefónica Europe") will pay interest on the notes on March 15 and
September 15 of each year, beginning on March 15, 2001, in the case of the U.S. dollar notes, and
on September 21 of each year, beginning on September 21, 2001, in the case of the euro notes.
Telefónica Europe may redeem the notes at 100% of their principal amount plus accrued interest if
certain tax events occur as described in the accompanying prospectus relating to our debt securities.

Telefónica Europe has the option to redeem all or a portion of each series of U.S. dollar notes at
any time. The redemption price will be based on the present value of the scheduled payments of
principal and interest remaining at the time of redemption, plus accrued interest. The discount rate
used will be based on a U.S. Treasury security having a maturity comparable to the remaining life to
maturity of the relevant series of U.S. dollar notes, plus the applicable number of basis points
specified in this prospectus supplement. The redemption price will not be less than 100% of the
principal amount of the notes to be redeemed plus accrued interest to the date of redemption.

Application has been made to list the notes on the Luxembourg Stock Exchange.

See "Risk Factors", beginning on page S-14, for a discussion of certain
factors you should consider before buying the notes.

Neither the Securities and Exchange Commission nor any other regulatory body has
approved or disapproved of these securities or passed upon the accuracy or adequacy of this
prospectus supplement. Any representation to the contrary is a criminal offense.

<table>
<thead>
<tr>
<th></th>
<th>Price to Public</th>
<th>Underwriting Discounts and Commissions</th>
<th>Proceeds to Telefónica Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>Per U.S. dollar note due 2005</td>
<td>99.961%</td>
<td>0.35%</td>
<td>99.611%</td>
</tr>
<tr>
<td>Per U.S. dollar note due 2010</td>
<td>99.646%</td>
<td>0.45%</td>
<td>99.196%</td>
</tr>
<tr>
<td>Per U.S. dollar note due 2030</td>
<td>99.958%</td>
<td>0.875%</td>
<td>99.083%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$4,990,137,500</strong></td>
<td><strong>$26,562,500</strong></td>
<td><strong>$4,963,575,000</strong></td>
</tr>
<tr>
<td>Per euro note due 2005</td>
<td>99.675%</td>
<td>0.35%</td>
<td>99.325%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>€996,750,000</strong></td>
<td><strong>€3,500,000</strong></td>
<td><strong>€993,250,000</strong></td>
</tr>
</tbody>
</table>

The underwriters expect to deliver the notes in book-entry form only through the facilities of the
Depository Trust Company ("DTC"), Clearstream, Luxembourg, and Euroclear against payment in
immediately available funds on or about September 21, 2000. The clearing and settlement systems we
will use are the book-entry systems operated by DTC, Clearstream, Luxembourg, and Euroclear.

Joint Bookrunners of the Euro and US Dollar Notes

Banco Bilbao Vizcaya Argentaria, S.A.   InverCaixa Valores, SVB, S.A.
Joint Bookrunners of the Euro Notes

The date of this Prospectus Supplement is September 14, 2000.
**U.S. Dollar Notes**

- Goldman, Sachs & Co.
- BNP Paribas
- Deutsche Bank
- Banco Bilbao Vizcaya Argentaria, S.A.
- Chase Securities Inc.
- J.P. Morgan & Co.
- ING Barings/BBL
- SG Investment Banking
- Morgan Stanley Dean Witter
- BARCLAYS CAPITAL
- UBS Warburg
- ABN AMRO Incorporated
- Dresdner Keinwort Benson

---

**Euro Notes**

- Goldman, Sachs & Co.
- Banco Bilbao Vizcaya Argentaria, S.A.
- BNP Paribas
- Deutsche Bank
- ABN AMRO Bank N.V.
- J.P. Morgan & Co.
- ING Barings/BBL
- SG Investment Banking
- Morgan Stanley Dean Witter
- InverCaixa Valores, SVB, S.A.
- BARCLAYS CAPITAL
- UBS Warburg
- Chase Manhattan International Limited
- Dresdner Keinwort Benson
ABOUT THIS PROSPECTUS SUPPLEMENT

Telefónica Europe B.V. ("Telefónica Europe") and Telefónica, S.A. ("Telefónica") offer through this prospectus supplement and the accompanying prospectus dated September 1, 2000 the notes described on the cover page of this prospectus supplement.

This prospectus supplement contains detailed information about the specific terms of the notes that we are offering. This prospectus supplement contains, for example, specific information regarding the aggregate amount of the notes that we are offering, their maturity and interest rate. This prospectus supplement may also add to, update or change some of the information contained in the accompanying prospectus. If there is any inconsistency between the information in this prospectus supplement and the accompanying prospectus, you should rely on the information in this prospectus supplement. You should read both this prospectus supplement and the accompanying prospectus together with the additional information described under the heading "Where You Can Find More Information—Incorporation by Reference".

As indicated in the accompanying prospectus, under the heading "About this Prospectus", that prospectus is part of a registration statement that we have filed with the United States Securities and Exchange Commission. The registration statement containing the prospectus and the exhibits to the registration statement provide additional information about us and the debt securities offered through this prospectus supplement and the accompanying prospectus. The registration statement can be read at the SEC offices mentioned under the heading "Where You Can Find More Information—Incorporation by Reference".

When you decide whether to purchase any debt securities described in this prospectus supplement and the accompanying prospectus, you should rely only on the information contained or incorporated by reference in this prospectus supplement and the prospectus (see the discussion under the heading "Where You Can Find More Information—Incorporation by Reference"). Neither we, nor any underwriters, dealers or agents participating in the offering of the notes, have authorized anyone to provide you with different or additional information. The information in this prospectus supplement, in the accompanying prospectus, and in any document incorporated by reference in this prospectus supplement or the prospectus, is truthful and complete on the date of this prospectus supplement, the prospectus or the document that is so incorporated. You should not assume the continued truthfulness or completeness of that information at any later date. We accept responsibility for the information contained in this prospectus supplement and the accompanying prospectus.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus supplement to "we", "us", "our", or similar references mean Telefónica and its consolidated subsidiaries.

Unless otherwise specified, all references to "U.S. dollars," "dollars," "U.S.$" or "$" are to United States dollars. References to "EUR", "euro" or "€" are to the single currency of the European Union member states, including The Netherlands and Spain, participating in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time. The Federal Reserve Bank of New York noon buying rate for the euro on September 14, 2000 was U.S.$1.00 = €1.1605. The equivalent amount in pesetas, translated at the irrevocably fixed rate of €1.00 = Pesos 166.386, would be approximately Pesos 193.09.

This prospectus supplement and the accompanying prospectus do not constitute an offer to sell, or the solicitation of an offer to purchase, the notes by any person in any jurisdiction where such offer or solicitation would be unlawful. Offers and sales of the notes may be restricted by law in some jurisdictions. You should inform yourself about and observe such restrictions.
FORWARD-LOOKING STATEMENTS

This prospectus supplement, the prospectus and the documents incorporated by reference in the prospectus contain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this prospectus supplement, the prospectus and such documents, and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effects on our results of the introduction of competition in the several telecommunications markets in which Telefónica operates;
- trends affecting our financial condition or results of operations;
- acquisitions or investments which we may make in the future;
- our capital expenditures plan;
- supervision and regulation of the telecommunications sector;
- our strategic partnerships; and
- the potential for growth and competition in current and anticipated areas of our business.

Forward-looking statements involve risks and uncertainties and are not guarantees of future performance. Actual results may differ materially from those in the forward-looking statements as a result of circumstances such as:

- changes in the economic, political or regulatory framework in the different countries in which Telefónica operates;
- the occurrence of events described as risk factors in Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 1999; or
- other factors described in the prospectus, this prospectus supplement or a document incorporated by reference in the prospectus. Some of those factors appear in Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 1999, under the headings "Information on the Company", "Operating and Financial Review and Prospects" and "Quantitative and Qualitative Disclosures About Market Risk".

Accordingly, readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of their respective dates.

We undertake no obligation to update any of these forward-looking statements to reflect subsequent events or circumstances, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.
SUMMARY

The following is not a complete summary of all the information contained in this prospectus supplement. For a comprehensive description of the information summarized below, please refer to the relevant sections of this prospectus supplement.

Telefónica

Telefónica is a diversified telecommunications and multimedia group that provides a comprehensive range of services primarily in Spain and Latin America through one of the world's largest and most modern telecommunications networks.

Telefónica is the leading provider of fixed-line telephone services, mobile services and data transmission services in Spain, the largest telecommunications operator in Latin America with operations in Argentina, Brazil, Chile, El Salvador, Guatemala, Peru and Puerto Rico, and a significant telecommunications operator in Austria and Morocco. Telefónica considers its principal lines of business to be:

- fixed-line telephone services;
- wireless or cellular telephone services;
- data transmissions;
- Internet services;
- media communications; and
- yellow pages or directory services.

On January 12, 2000, Telefónica announced a reorganization of its business along global business lines to enhance its strategic and competitive position globally and in each of these business lines. As part of the reorganization, Telefónica's Board of Directors created two new global business divisions, Telefónica Móviles and Telefónica DataCorp, for its wireless telephone services and its data transmission business, respectively. Some of Telefónica's current subsidiaries, such as Telefónica Internacional and Telefónica Intercontinental, may be combined with other subsidiaries as a result of the reorganization. In addition, Telefónica may create new business lines in the future, or transfer from a current subsidiary to an existing or newly created subsidiary, specific lines of business. As a result of this reorganization of its business, during 2000 Telefónica has introduced, and expects to continue introducing, changes to its organizational structure.

Telefónica's principal executive offices are located at Gran Vía 28, 28013 Madrid, Spain. Telefónica's telephone number is +34 91 584-0306. Telefónica's website address is http://www.Telefónica.es. Information contained in Telefónica's website is not part of this prospectus supplement.

Telefónica Europe

Telefónica created Telefónica Europe in The Netherlands in 1996 as its direct, wholly owned subsidiary whose principal purpose is raising funds for its parent company and other companies of the Telefónica group.

Telefónica Europe's corporate seat is at Rotterdam, The Netherlands; its office address is Aert van Nesstraat 45, 3012 CA Rotterdam, The Netherlands, and its postal address is P.O. Box 548, 3000 AM Rotterdam, The Netherlands. Telefónica Europe's telephone number is +31 10 414-7230. Telefónica Europe is registered with the Commercial Register of the Chamber of Commerce of Rotterdam under the number 24269798.
THE OFFERING

This section discusses the specific financial and legal terms of the notes that are more generally described in the accompanying prospectus under "DESCRIPTION OF THE DEBT SECURITIES AND THE GUARANTEE". If anything described in this section is inconsistent with the terms described under "DESCRIPTION OF THE DEBT SECURITIES AND THE GUARANTEE" in the accompanying prospectus, you should consider the terms here to be the ones that prevail.

Notes being offered

$1,250,000,000 7.35% Notes due 2005
$2,500,000,000 7.75% Notes due 2010
$1,250,000,000 8.25% Notes due 2030
€1,000,000,000 6.125% Notes due 2005

The notes will be issued under an indenture dated September 14, 2000 among Telefónica Europe, Telefónica as guarantor, and The Bank of New York, as trustee. The indenture is more fully described in the accompanying prospectus.

Issuer

Telefónica Europe B.V.

Aggregate principal amount being offered

$1,250,000,000 of U.S. dollar notes due 2005
$2,500,000,000 of U.S. dollar notes due 2010
$1,250,000,000 of U.S. dollar notes due 2030
€1,000,000,000 of euro notes due 2005

Due dates for principal

September 15, 2005 for U.S. dollar notes due 2005
September 15, 2010 for U.S. dollar notes due 2010
September 15, 2030 for U.S. dollar notes due 2030
September 21, 2005 for euro notes due 2005

Interest rates

7.35% for U.S. dollar notes due 2005
7.75% for U.S. dollar notes due 2010
8.25% for U.S. dollar notes due 2030
6.125% for euro notes due 2005

Denominations

$1,000 for the U.S. dollar notes
€1,000 for the euro notes

Date interest starts accruing

September 21, 2000

Interest payment dates

Every March 15 and September 15, beginning on March 15, 2001 for the U.S. dollar notes. Every September 21, beginning on September 21, 2001 for the euro notes.

Regular record dates for interest

March 1 and September 1 for the U.S. dollar notes. September 7 for the euro notes.

Calculation of interest

With respect to the notes, if interest is required to be calculated for any period less than a year, other than with respect to regular semi-annual interest payments, it will be calculated based on a 360-day year consisting of twelve 30-day months.

With respect to the euro notes, if interest is required to be calculated for any period of less than a year, it will be calculated on the basis of the actual number of days elapsed since the closing date of the offering, or, if more recent, the last interest payment date divided by 365 (or if a portion of this period falls in a leap year, the sum of (A) the actual number of days in that portion of the period falling in a leap year divided by 366 and (B) the actual
number of days in that portion of the period falling in the non-
leap year divided by 365).

Guarantee 
Telefónica will fully, unconditionally and irrevocably guarantee to
each holder of the notes the due and punctual payment of the
principal and interest relating to the notes including any additional
amounts described below. Each guarantee will be a direct,
unconditional and unsecured obligation of Telefónica. The
guarantee is described in the accompanying prospectus under
"DESCRIPTION OF THE DEBT SECURITIES AND THE
GUARANTEE—Guarantee".

Payment of additional amounts 
The Netherlands or Spain may require us to withhold amounts
from payments on the principal or interest on the notes or any
amounts to be paid under the guarantees, as the case may be, for
taxes or any other governmental charges. If the relevant
jurisdiction requires a withholding of this type, we will, subject
to some exceptions, pay additional amounts in respect of those
payments of principal and interest so that the amount you receive
after such taxes and governmental charges will equal the amount
that you would have received if no such taxes and governmental
charges had been applicable. See "DESCRIPTION OF THE
DEBT SECURITIES AND THE GUARANTEE—Payment of
Additional Amounts" in the accompanying prospectus.

Optional tax redemption 
In the event of various tax law changes after the date of this
prospectus supplement and other limited circumstances that
require us to pay additional amounts as described in the
accompanying prospectus under "DESCRIPTION OF THE
DEBT SECURITIES AND THE GUARANTEE—Payment of
Additional Amounts", we may call all, but not less than all, of
the notes for redemption at 100% of their aggregate principal
amount plus accrued interest. This means we may repay them
early. You have no right to require us to call the notes. We discuss
our ability to redeem the notes in greater detail in the
accompanying prospectus under "DESCRIPTION OF THE
DEBT SECURITIES AND THE GUARANTEE—Optional Tax
Redemption".

Optional make-whole redemption 
The U.S. dollar notes will be redeemable at the option of
Telefónica Europe, in whole or in part at any time. See
"DESCRIPTION OF THE DEBT SECURITIES AND THE
GUARANTEE—Redemption at Our Option". Upon redemption,
we will pay a redemption price equal to the greater of (1) 100%
of the principal amount of the notes of that series plus accrued
interest to the date of redemption or (2) as determined by the
trustee, the sum of the present values of the remaining scheduled
payments of principal and interest on the notes of that series
(excluding any interest accrued as of the date of redemption).
The present value will be determined by discounting the remaining
principal and interest payments to the redemption date on a
semiannual basis (assuming a 360-day year consisting of twelve
30-day months) using the adjusted comparable yield (as defined
in the prospectus) plus 15 basis points in the case of the U.S.
dollar notes due 2005, 20 basis points in the case of the U.S.
dollar notes due 2010 and 25 basis points in the case of the U.S.
dollar notes due 2030. The “comparable issue” for purposes of
the definition contained in “DESCRIPTION OF THE DEBT
SECURITIES AND THE GUARANTEE—Redemption at Our
Option” will be the U.S. Treasury security selected by the
quotation agents as having a maturity comparable to the
remaining term of the relevant series of notes to be redeemed that
would be utilized, at the time of selection and in accordance with
customary financial practice, in pricing new issues of corporate
debt securities of comparable maturity to the remaining term of
the relevant series of notes.

Further issues ........................................

We may from time to time without the consent of the holders of
notes of any series create and issue further notes having the same
terms and conditions as such notes so that the further issue is
consolidated and forms a single series with that series of notes.

Name of trustee ......................................
The Bank of New York. See “DESCRIPTION OF DEBT
SECURITIES AND THE GUARANTEE—Remedies if an Event
of Default Occurs” in the accompanying prospectus for a
description of the trustee’s procedures and remedies available in
the event of a default.

Principal Paying Agent ............................
The Bank of New York, London Office.

Ranking ...............................................\n
The notes and guarantees are not secured by any property or
assets of Telefónica Europe or Telefónica and will rank equally
with all of our other unsecured and unsubordinated indebtedness
present or future, except for indebtedness that is preferred by law
and, in the case of Telefónica, indebtedness that has been
notarized or intervened by a Spanish Notary or Corredor
colegiado de comercio, in compliance with Spanish law.

Form of the notes .................................

We will issue the U.S. dollar notes as global notes registered in the
name of The Depository Trust Company or its nominee. We will
issue the euro notes as global notes registered in the name of a
common depository for Clearstream société anonyme, Luxembourg
and Morgan Guaranty Trust Company of New York, Brussels Office,
as operator of the Euroclear System. Investors may hold book-entry
interests in a global note through organizations that participate,
directly or indirectly, in the clearing systems operated by DTC,
Clearstream, Luxembourg and Euroclear. Book-entry interests in
the U.S. dollar global notes and all transfers relating to the U.S.
dollar global notes will be reflected in the book-entry records of DTC
or its nominee. Book-entry interests in the euro global notes and
all transfers relating to the euro global notes will be reflected in
the book-entry records of Clearstream, Luxembourg and Euroclear.
See “DESCRIPTION OF THE DEBT SECURITIES AND THE
GUARANTEE—Clearance and Settlement” in the accompanying
prospectus.

Clearance and settlement ..........................
The distribution of the U.S. dollar notes will be cleared through
DTC and the distribution of the euro notes will be cleared through

S-8
Clearstream, Luxembourg and Euroclear. Any secondary market trading of book-entry interests in the U.S. dollar notes will take place through DTC participants, including Clearstream, Luxembourg and Euroclear, and will settle in same-day funds through DTC's same-day funds settlement system. Any secondary market trading of book-entry interests in the euro notes will take place through Clearstream, Luxembourg and Euroclear participants and will settle in same-day funds. See "DESCRIPTION OF THE DEBT SECURITIES AND THE GUARANTEE—Clearance and Settlement" in the accompanying prospectus.

Owners of book-entry interests in the U.S. dollar notes will receive payments relating to their notes in U.S. dollars and owners of book-entry interests in the euro notes will receive payments relating to their notes in euro.

The U.S. dollar notes have been accepted for clearance by DTC, Clearstream, Luxembourg and Euroclear. The common code for the U.S. dollar notes due 2005 is 011807445 and the ISIN is US879385AB82. The common code for the U.S. dollar notes due 2010 is 011807488 and the ISIN is US879385AC65. The common code for the U.S. dollar notes due 2030 is 011807496 and the ISIN is US879385AD49. The euro notes have been accepted for clearance by Clearstream, Luxembourg and Euroclear. The common code for the euro notes is 011800637 and the ISIN is XS0118006377.

Prescription

All claims against Telefónica Europe or Telefónica for payment of principal of or premium or interest (including additional amounts) on, or in respect of, the notes shall become void unless made within ten years (in the case of principal) and five years (in the case of premium or interest (including additional amounts)) from the later of (i) the date on which such payment first became due and (ii) if the full amount payable has not been received by the trustee on or prior to such due date, the date on which the full amount is so received.

Governing Law

The notes and the guarantees will be governed by the laws of the State of New York.

Listing

Application has been made to list the notes on the Luxembourg Stock Exchange.

Notices

Notices to holders of the notes will be valid if published (i) in a newspaper having general circulation in Luxembourg (which is expected to be the Luxemburger Wort), so long as the notes are listed on the Luxembourg Stock Exchange, and the rule of that stock exchange so require; and (ii) in the event that the notes are listed on any other stock exchange, in accordance with the rules of such other stock exchange, or, if any such publication is not practicable, in a leading English language daily newspaper having general circulation in Europe. Any notice given as contemplated in (i) and (ii) will be deemed to have been given on the date of first publication or, if published more than once or on different dates, on the first date on which publication was made.
SELECTED FINANCIAL DATA

The information in this section should be read in conjunction with our consolidated financial statements, and the notes thereto, included in our Annual Report on Form 20-F for the fiscal year ended December 31, 1999. Our consolidated financial statements have been prepared in accordance with Spanish GAAP, which differ in certain respects from U.S. GAAP. Please refer to note 25 to our consolidated financial statements for a discussion of these differences.

In accordance with Spanish regulation, the companies directly or indirectly over 50%-owned by us or whose management is effectively controlled by us are consolidated. In 1998, we accounted for Telesp and Tele Sudeste, in which we hold majority stakes, by the equity method as a result of the unavailability of information necessary to consolidate these entities as required by Spanish law. Financial information for 1999 reflects the full effect of the consolidation of Telesp and Tele Sudeste.

In addition, prior to 1998 we accounted for Compañía de Inversiones en Telecomunicaciones, S.A., or COINTEL, and Telefonica de Argentina, in which COINTEL has a 52.88% stake, under the equity method. In 1998 we consolidated COINTEL and Telefónica de Argentina under Spanish GAAP and accounted for them under the equity method under US GAAP.

The basis of presentation and principles of consolidation are described in detail in note 2 to our consolidated financial statements.

<table>
<thead>
<tr>
<th></th>
<th>At and for the year ended December 31,</th>
<th>As and for the six-month period ended June 30,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(millions of pesetas, except per share and per ADS data)</td>
<td>(millions of dollars, except per share and per ADS data)</td>
</tr>
<tr>
<td><strong>INCOME STATEMENT DATA</strong></td>
<td><strong>Spanish GAAP:</strong></td>
<td><strong>Spanish GAAP:</strong></td>
</tr>
<tr>
<td>Revenue from operations</td>
<td>1,740,557</td>
<td>2,006,058</td>
</tr>
<tr>
<td>Other operating revenue</td>
<td>33,402</td>
<td>37,758</td>
</tr>
<tr>
<td>Internal expenditures</td>
<td>121,548</td>
<td>127,319</td>
</tr>
<tr>
<td>Increase in inventories (net)</td>
<td>3,430</td>
<td>2,965</td>
</tr>
<tr>
<td>External services and local taxes</td>
<td>(198,044)</td>
<td>(242,744)</td>
</tr>
<tr>
<td>Personnel costs</td>
<td>(543,547)</td>
<td>(554,682)</td>
</tr>
<tr>
<td>Provision for depreciation and amortization</td>
<td>(501,480)</td>
<td>(526,229)</td>
</tr>
<tr>
<td>Trade provisions</td>
<td>(25,159)</td>
<td>(26,569)</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>(9,728)</td>
<td>(19,307)</td>
</tr>
<tr>
<td>Total operating costs before financial expenses and goodwill amortization</td>
<td>(1,389,055)</td>
<td>(1,598,135)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>509,882</td>
<td>575,965</td>
</tr>
<tr>
<td>Financial income (expense)</td>
<td>(185,666)</td>
<td>(166,817)</td>
</tr>
<tr>
<td>Exchange (foreign) gains</td>
<td>(6,503)</td>
<td>(9,774)</td>
</tr>
<tr>
<td>Income (loss) from associated companies</td>
<td>8,754</td>
<td>7,811</td>
</tr>
<tr>
<td>Amortization of goodwill</td>
<td>(6,985)</td>
<td>(16,786)</td>
</tr>
<tr>
<td>Profit from ordinary activities</td>
<td>319,482</td>
<td>390,399</td>
</tr>
<tr>
<td>extraordinary income</td>
<td>29,874</td>
<td>31,941</td>
</tr>
<tr>
<td>----------------------</td>
<td>--------</td>
<td>--------</td>
</tr>
<tr>
<td></td>
<td>(millions of pesetas, except per share and per ADS data)</td>
<td>(millions of dollars, except per share and per ADS data)</td>
</tr>
<tr>
<td>Losses on sale of fixed assets</td>
<td>(47,871)</td>
<td>(45,034)</td>
</tr>
<tr>
<td>Extraordinary expenses</td>
<td>(77,774)</td>
<td>(101,425)</td>
</tr>
<tr>
<td>Income before tax and minority interest</td>
<td>223,711</td>
<td>275,881</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>(39,358)</td>
<td>(50,921)</td>
</tr>
<tr>
<td>Income before minority interest</td>
<td>184,353</td>
<td>224,960</td>
</tr>
<tr>
<td>Minority interest</td>
<td>(51,139)</td>
<td>(58,678)</td>
</tr>
<tr>
<td>Net Income</td>
<td>133,214</td>
<td>161,282</td>
</tr>
<tr>
<td>Net income per share(3)</td>
<td>142</td>
<td>171</td>
</tr>
<tr>
<td>Dividends per share</td>
<td>76</td>
<td>89</td>
</tr>
<tr>
<td>Weighed average number of shares (thousands)</td>
<td>939,157</td>
<td>939,471</td>
</tr>
<tr>
<td>Net income per ADS(3)(4)</td>
<td>425</td>
<td>512</td>
</tr>
<tr>
<td>Dividends per ADS(4)</td>
<td>228</td>
<td>267</td>
</tr>
<tr>
<td>Weighed average number of ADSs (thousands)</td>
<td>313,157</td>
<td>313,157</td>
</tr>
<tr>
<td>U.S. GAAP:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total revenues</td>
<td>1,628,194</td>
<td>1,875,213</td>
</tr>
<tr>
<td>Total costs and expenses</td>
<td>(1,728,245)</td>
<td>(1,501,440)</td>
</tr>
<tr>
<td>Profit from ordinary activities</td>
<td>349,939</td>
<td>375,773</td>
</tr>
<tr>
<td>Income (loss) before tax</td>
<td>199,906</td>
<td>311,286</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>(32,990)</td>
<td>(30,410)</td>
</tr>
<tr>
<td>Net income</td>
<td>(157,010)</td>
<td>280,876</td>
</tr>
<tr>
<td>Net income per share(3)(5)</td>
<td>167</td>
<td>299</td>
</tr>
<tr>
<td>Net income per ADS(3)(4)(5)</td>
<td>502</td>
<td>897</td>
</tr>
</tbody>
</table>

**BALANCE SHEET DATA**

**Spanish GAAP:**

| Cash | 11,933 | 12,647 | 10,432 | 23,795 | 30,964 | 178 | 21,816 | 76,496 |
| Property plant and equipment (net) | 3,597,426 | 3,973,870 | 4,148,113 | 4,629,131 | 5,949,113 | 34,128 | 5,858,576 | 6,234,555 |
| Total assets | 4,918,258 | 5,437,737 | 6,224,761 | 8,085,299 | 10,661,675 | 61,197 | 10,013,023 | 11,587,779 |
| Total long-term liabilities | 1,665,508 | 1,672,907 | 1,916,627 | 2,278,729 | 2,958,729 | 16,979 | 2,766,816 | 2,971,170 |
| Total shareholders' equity (net) | 1,546,472 | 1,863,760 | 1,991,374 | 2,544,889 | 2,420,028 | 13,883 | 2,476,979 | 2,601,879 |
| U.S. GAAP: | | | | | | | | |
| Cash | 8,102 | 9,371 | 7,050 | 21,862 | 39,802 | 228 | - | - |
| Property, plant and equipment (net) | 3,111,891 | 3,305,409 | 3,278,847 | 3,905,762 | 5,004,739 | 28,710 | - | - |
| Total assets | 4,307,244 | 4,595,126 | 5,108,925 | 7,173,538 | 9,867,771 | 56,608 | - | - |
| Total long-term indebtedness | 1,474,431 | 1,406,953 | 1,522,565 | 2,278,729 | 2,559,854 | 14,685 | - | - |
| Total shareholders' equity (net) | 1,580,563 | 1,799,081 | 1,931,324 | 2,485,364 | 2,816,331 | 16,156 | - | - |

**CASH FLOW DATA**

**Spanish GAAP:**

<p>| EBITDA(6) | 1,011,362 | 1,102,194 | 1,263,111 | 1,540,712 | 1,811,182 | 10,390 | 968,892 | - |</p>
<table>
<thead>
<tr>
<th>Net cash provided by operating activities</th>
<th>860,463</th>
<th>851,625</th>
<th>1,016,860</th>
<th>1,120,669</th>
<th>1,290,966</th>
<th>7,406</th>
<th>460,779</th>
<th>-</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>(millions of pesetas, except per share and per ADS data)</td>
<td>(millions of dollars, except per share and per ADS data(1))</td>
<td>(millions of pesetas, except per share and per ADS data)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cash flow from investment activities:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from investments</td>
<td>76,609</td>
<td>95,463</td>
<td>399,558</td>
<td>2,292</td>
<td></td>
<td></td>
<td>219,038</td>
<td></td>
</tr>
<tr>
<td>and equipment</td>
<td>13,108</td>
<td>27,463</td>
<td>15,232</td>
<td>87</td>
<td></td>
<td></td>
<td>4,980</td>
<td></td>
</tr>
<tr>
<td>Proceeds from capital grants</td>
<td>24,381</td>
<td>24,616</td>
<td>18,178</td>
<td>104</td>
<td></td>
<td></td>
<td>14,792</td>
<td></td>
</tr>
<tr>
<td>Capital expenditures</td>
<td>(635,018)</td>
<td>(636,495)</td>
<td>(1,057,334)</td>
<td>(6,066)</td>
<td></td>
<td></td>
<td>(473,175)</td>
<td></td>
</tr>
<tr>
<td>Purchase of new investments, net of cash acquired</td>
<td>(477,090)</td>
<td>(1,328,552)</td>
<td>(763,429)</td>
<td>(4,380)</td>
<td></td>
<td></td>
<td>(214,438)</td>
<td></td>
</tr>
<tr>
<td>Payments for intangible assets and deferred charges</td>
<td>(103,585)</td>
<td>(140,165)</td>
<td>(209,659)</td>
<td>(1,203)</td>
<td></td>
<td></td>
<td>(95,556)</td>
<td></td>
</tr>
<tr>
<td><strong>Net cash used in investing activities</strong></td>
<td>629,559</td>
<td>812,132</td>
<td>(1,101,595)</td>
<td>(1,957,670)</td>
<td>(1,178,136)</td>
<td>6,759</td>
<td>(544,359)</td>
<td></td>
</tr>
<tr>
<td><strong>Cash flow from financing activities:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proceeds from issuance of common stock</td>
<td>868</td>
<td>460,758</td>
<td>165,109</td>
<td>947</td>
<td></td>
<td></td>
<td>(9,518)</td>
<td></td>
</tr>
<tr>
<td>Proceeds from debentures and bonds</td>
<td>206,967</td>
<td>215,931</td>
<td>238,011</td>
<td>1,365</td>
<td></td>
<td></td>
<td>91,512</td>
<td></td>
</tr>
<tr>
<td>Proceeds from other loans, credit facilities and notes payable</td>
<td>311,758</td>
<td>436,510</td>
<td>495,227</td>
<td>2,841</td>
<td></td>
<td></td>
<td>132,684</td>
<td></td>
</tr>
<tr>
<td>Repayments of other loans, credit facilities and notes payable</td>
<td>(212,739)</td>
<td>(184,099)</td>
<td>(132,388)</td>
<td>(759)</td>
<td></td>
<td></td>
<td>(115,958)</td>
<td></td>
</tr>
<tr>
<td>Repayments of short term loans (net)</td>
<td>(211,738)</td>
<td>(341,244)</td>
<td>(247,736)</td>
<td>(1,421)</td>
<td></td>
<td></td>
<td>(200,588)</td>
<td></td>
</tr>
<tr>
<td>Dividends paid</td>
<td>210,905</td>
<td>326,489</td>
<td>91,742</td>
<td>526</td>
<td></td>
<td></td>
<td>318,302</td>
<td></td>
</tr>
<tr>
<td><strong>Net cash used in (received from) financing activities</strong></td>
<td>233,309</td>
<td>71,087</td>
<td>(170,957)</td>
<td>(770,400)</td>
<td>(388,016)</td>
<td>(2,226)</td>
<td>(204,984)</td>
<td></td>
</tr>
<tr>
<td><strong>U.S. GAAP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EBITDA(6)</td>
<td>792,300</td>
<td>832,883</td>
<td>905,719</td>
<td>1,328,904</td>
<td>1,571,964</td>
<td>9,018</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net cash provided by operating activities</td>
<td>749,375</td>
<td>753,349</td>
<td>880,719</td>
<td>924,442</td>
<td>1,108,407</td>
<td>6,359</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net cash used in investing activities(7)</td>
<td>489,019</td>
<td>629,885</td>
<td>938,850</td>
<td>2,034,678</td>
<td>1,270,077</td>
<td>7,286</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net cash used in (received from) financing activities</td>
<td>230,524</td>
<td>132,832</td>
<td>(170,310)</td>
<td>(649,272)</td>
<td>(306,129)</td>
<td>(1,756)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(1) Translated into U.S. dollars from pesetas at Pesos 174.32 = $1.00, which is the peseta equivalent of the euro Noon Buying Rate of $0.9545 = €1.00 on June 30, 2000.

(2) The unaudited consolidated financial statements as of and for the six-month periods ended June 30, 1999 and June 30, 2000 are based on the Spanish statutorily approved financial statements of the Telefónica group prepared by Telefónica's directors and set forth in a press release dated September 1, 2000 which has been incorporated by reference into the registration statement of which the accompanying prospectus is a part. The selected financial data presented in this table have been adjusted with respect to the effect in both periods of a provision recorded in 1998 which debits certain reserves relating to voluntary preretirements and early retirements expected to take place in subsequent years, in a manner consistent with the adjustments contained in the audited consolidated financial statements included in Telefónica's Annual Report on Form 20-F for the fiscal year ended December 31, 1999.
(3) The reduction of per share data and per ADS data in 1999 is due to the combined effect of the decline in net income and a 3 for 1 stock split.

(4) Each ADS represents three shares. Figures do not include any charges of the ADR Depositary.

(5) U.S. GAAP earnings per share and per ADS have been computed using the weighted average number of shares outstanding for all periods.

(6) Earnings before interest, taxation, depreciation and amortization. EBITDA has been included to provide additional information relating to our ability to generate cash from operations. EBITDA is not a measure of financial performance under Spanish or U.S. GAAP and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles. Management believes that they are useful to an investor in evaluating our company because they are widely used in the telecommunications industry as a measure to evaluate a company’s operating performance before debt expense and its cash flow. EBITDA is not calculated identically by all companies and the presentation here may not be comparable to other similarly titled measures of other companies. Management’s discretionary use of funds depicted by EBITDA may be limited by working capital, debt service and capital expenditure requirements and by restrictions related to legal requirements, commitments and uncertainties.

(7) Includes net cash outflow for capital expenditures and for investments in affiliates.
RISK FACTORS

Before you make an investment in the notes, you should carefully consider the following risk factors in addition to the other information contained or incorporated by reference in this prospectus supplement or the prospectus.

We must successfully implement our business plans as planned, but factors beyond our control may prevent us from doing so, which could have a material adverse effect on our business.

Our ability to increase our revenues and maintain our position as a leading European and Latin American provider of advanced telecommunications and Internet services will depend in large part on the successful, timely and cost-effective completion of our business plan, including our plan to operate our various businesses along global business lines.

Factors beyond our control that could affect the timing of the completion of our business plan include our ability to:

• obtain and maintain applicable government approvals
• enter into necessary contracts with third parties
• secure the timely performance of independent contractors hired to engineer, design and construct portions of our network
• manage costs
• attract and retain highly skilled and qualified personnel

We have embarked upon an aggressive plan to grow our businesses, and we cannot guarantee that we will be successful.

We operate in a highly competitive industry with participants that have significant resources and existing customers, which could intensify price competition and limit our ability to increase our market share.

If we are unable to compete effectively against our competitors, it could lead to price reductions, lower revenue, under-utilization of our services, reduced operating margins and loss of market share. Some of our competitors in certain markets where we operate have, and some potential competitors may enjoy, competitive advantages, including the following:

• greater name recognition
• greater financial, technical, marketing and other resources
• larger installed bases of customers
• well-established relationships with current and potential customers

We are subject to laws and regulations in multiple jurisdictions, and if we fail to comply with them, our business could be materially and adversely impacted.

As a multinational telecommunications company, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. We cannot assure you that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws and regulations before national or local courts. In the event we are found not to have complied with applicable laws and regulations, we may be subject to damage awards, fines, penalties and suspensions, which would increase estimated costs and reduce our ability to compete effectively. It is also possible that future regulatory, judicial and legislative changes concerning various aspects of our business may have an adverse effect on where and how we can provide our telecommunications services.
The industry in which we conduct our business is subject to rapid technological changes and such changes could have a material adverse effect on our ability to provide competitive services.

The telecommunications industry is in a period of rapid technological change. Our future success depends, in part, on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will further develop. These new products and technologies may reduce the prices for our services or they may be superior to, and render obsolete, the products and services we offer and the technologies we use, and may consequently reduce the revenues generated by our products and services and require investment in new technology. As a result, our most significant competitors in the future may be new entrants to our markets which would not be burdened by an installed base of older equipment. It may be very expensive for us to upgrade our products and technology in order to continue to compete effectively.

Loss of key personnel could weaken our business expertise and delay the completion of our network and other business plans.

Our operations throughout the world are managed by a small number of key executive officers. The loss of our key executive officers in the future could significantly impede our financial plans, product development, network completion, marketing and other objectives. We believe that the growth and future success of our business will depend in large part on our continued ability to attract and retain highly skilled and qualified personnel. The competition for qualified personnel in the telecommunications industry is intense. We cannot assure you that we will be able to hire or retain necessary personnel.

The costs and difficulties of acquiring and integrating businesses could impede our future growth and adversely affect our competitiveness.

We intend to evaluate, and may enter into, acquisition transactions in order to, among other things, sell our services in countries in which we do not currently have sales operations or enhance our product portfolio. Any such acquisitions may expose us to the following risks:

- the difficulty of identifying appropriate acquisition candidates in the countries in which we do business or intend to do business
- the difficulty of assimilating the operations and personnel of the acquired entities
- the potential disruption to our ongoing business caused by senior management's focus on the acquisition transactions
- our failure to successfully incorporate licensed or acquired technology into our network and product offerings
- the failure to maintain uniform standards, controls, procedures and policies
- the impairment of relationships with employees as a result of changes in management and ownership

Additionally, in connection with an acquisition, we will generally record goodwill that must be amortized and which would reduce our earnings per share. We cannot assure you that we would be successful in overcoming these risks, and our failure to overcome these risks could have a negative effect on our financial condition.

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

These risks include the following:

- government regulations and administrative policies may change quickly
many countries impose currency restrictions and other restraints on movements of funds
in some countries, there is a risk that the government may expropriate assets
some countries impose burdensome taxes or tariffs
political changes may lead to changes in the business environment in which we operate
in most countries our operations are dependent on concessions and other agreements with the
government, and
economic downturns, political instability and civil disturbances may disrupt operations in individual
markets

In addition, revenues from operations of our Latin American subsidiaries, their market value and the
dividends and management fees collected from them are exposed to material country risk as a result of adverse
economic conditions in the region that may adversely affect demand, consumption and exchange rates. For
example, in January 1999, as a result of adverse economic conditions in Brazil, Telefónica Internacional wrote
down the book value of its investments in Brazil in the amount of Pesos 119,374 million.

As a result of our holding company structure, your rights under the notes and the guarantee will be
effectively subordinated to the claims of creditors of our subsidiaries.

As a holding company, we operate primarily through our subsidiaries and depend on distributions from our
subsidiaries for our cash. In addition, Telefónica Europe will depend on us for cash to make payments of
principal and interest on the notes. Our subsidiaries' ability to pay dividends or make other payments or advances
to us will depend upon their operating results and will be subject to applicable laws and contractual restrictions.
The notes and our obligations under the guarantee will be effectively subordinated to all of our subsidiaries' liabilities
to parties other than Telefónica, including their trade payables. This means that in the event of the
bankruptcy or liquidation of any of our subsidiaries, that subsidiary will have to pay its creditors in full before
its assets are available to us to pay you. The indenture does not contain any restrictions on our ability or the
ability of any of our subsidiaries to incur debt.

Risk of error in forward-looking statements

All statements in this prospectus that are not clearly historical in nature are forward-looking. Examples of
forward-looking statements include:

- statements concerning our operations and prospects
- the size of European and Latin American telecommunications markets
- estimated demand forecasts
- our ability to secure and maintain telecommunications infrastructure licenses, rights of way and other
  regulatory approvals
- our strategic initiatives and plans for business growth
- industry conditions
- funding needs and financing sources
- network completion and product development schedules
- expected characteristics of competing networks, products and services
- other statements of our expectations, beliefs, future plans and strategies, anticipated developments and
  other matters that are not historical facts

These forward-looking statements are uncertain, and we cannot assure you that any such statements will
prove to be correct. Actual results and developments may be materially different from those expressed or implied
by such statements. Readers should carefully review the other risk factors set forth in this section for a discussion
of factors which could result in any of these forward-looking statements proving to be inaccurate.
USE OF PROCEEDS

We estimate that the net proceeds, before deducting the expenses payable by Telefónica Europe, from the sale of the notes will be U.S.$4,963,575,000 and €993,250,000, which Telefónica Europe will on-lend to Telefónica. Telefónica will use approximately €1.35 billion (U.S.$1.2 billion) of the net proceeds to meet the 20% mandatory pre-payment condition of the outstanding balance under the syndicated loan facility described in footnote (1) to the capitalization table of Telefónica, S.A. that appears below, under “Capitalization”. The remaining 80% of the proceeds from the sale of the notes will be used for general corporate purposes. Affiliates of several of the underwriters are lenders under the syndicated loan facility. See “Underwriting”.

S-17
CAPITALIZATION

The following tables set forth the cash and other liquid assets, current debt, long-term debt, shareholders' equity and capitalization of Telefónica and Telefónica Europe at June 30, 2000, in accordance with Spanish GAAP and Dutch GAAP, respectively and as adjusted for the effect of this offering, without deduction of discounts or expenses.

<table>
<thead>
<tr>
<th></th>
<th>At June 30, 2000</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Actual</td>
<td>As Adjusted</td>
</tr>
<tr>
<td></td>
<td>Pesos</td>
<td>Pesos</td>
</tr>
<tr>
<td>(in million pesetas)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

TELEFÓNICA, S.A.

Short-term debt
- Financial debt: 1,267,674
- Other debt: 1,475,746
Total short-term debt: 2,743,420

Long-term debt
- Debentures, bonds and other issues:
  - Convertible bonds: 63,988
  - Non-convertible bonds: 1,033,014
- Debt with credit entities:
  - Loans, credits and notes payable(1): 1,566,822
  - Other long-term debt: 307,346
Total long-term debt: 2,971,170

Shareholder's equity:
- Share capital, each share of 1 euro nominal value: 549,717
- Other unappropriated profits and reserve: 1,897,565
- Undistributed earnings for the year: 154,597
Total shareholders' equity(2): 2,601,879

Minority interests(4): 1,970,277

Total capitalization: 10,286,746

(1) Telefónica and Telefónica Europe have available, under a syndicated loan facility dated as of August 22, 2000, up to €8,000,000,000 which can be drawn in two tranches: (i) up to €6,000,000,000 with a one-year term which the borrower may extend by an additional one year but is subject to mandatory pre-payment in an amount of no less than 20% of the net proceeds from the sales of the notes, and (ii) up to €2,000,000,000 with a three-year term. On September 1, 2000, Telefónica drew approximately €4,900,000,000 from the first tranche, at an interest rate equal to Euribor plus 30 basis points. The proceeds of this loan were used to fund Telefónica's capital requirements in connection with the acquisition of UMTS licenses in Germany.

(2) Since June 30, 2000, Telefónica has issued an additional 947,900,574 shares in the aggregate, increasing its share capital by Pesos 157,717,584,905 and its paid-in surplus by Pesos 1,191,520,032,322, in connection with (a) the tender offers launched by Telefónica for the outstanding shares of Telecomunicações de São Paulo, S.A., Tele Sudeste Celular Participações S.A., Telefónica de Argentina S.A., and Telefónica del Perú S.A.A., (b) an exchangeable bond, and (c) the acquisition of Endemol Entertainment Holding B.V.

(3) The aggregate Peseta amount of the U.S. dollar notes and the euro notes offered hereby has been determined using the September 14, 2000 rate of exchange of US$0.8693 to €1.

(4) In July 2000 we acquired a significant part of the minority interests not held by us in certain Latin American affiliates. See "—Public Tender Offers". Had such acquisitions been reflected in the June 30 capitalization of Telefónica, S.A., the minority interests line item would have decreased by Pesos 1,233,085 million.
TELEFÓNICA EUROPE B.V.

Long-term liabilities

Global Bond — US$5,000,000,000 ..................................... 5,751,754,285
Global Bond — €1,000,000,000 ..................................... 1,000,000,000
Exchangeable bond loan — U.S.$648,087,594 ..................... 644,863,290
EMTN - Floating Rate Notes — Ptas. 15,000,000,000 ............. 74,819,685
EMTN Bonds — U.S.$500,000,000 .................................. 497,512,448
Redemption premium .................................................. 14,885,549
Issuance exchangeable bonds ........................................ 2,649,253
Commission EMTN Floating Rate Notes ..................... 3,341,001
Commission EMTN Bonds ........................................... 51,150
Commission EMTN Bonds ........................................... 393,006
Swap Premium .......................................................... 692,590

Total long-term debt ............................................... 1,239,207,971

Short-term debt

Interest payable on Exchangeable Bond .................. 5,472,272
Interest payable on EMTN — Floating Rate Notes in Ptas. .... 516,563
Interest payable on EMTN — Bonds in U.S.$ .................. 31,009,744
Short-term Redemption Premium on Convertible Bonds ...... 9,676,516
Short-term on Commission Convertible Bonds ............. 2,171,865
Short-term on Commission Loan to Shareholder ............ 13,345
Short-term on Commission Loan to Telefónica Internacional .. 194,401
Short-term on Issue premium EMTN .......................... 1,310,458
Short-term on swap transaction .................................. 342,591
Corporation tax ...................................................... 174,575
Other payables ....................................................... 41,454

Total short-term debt ............................................. 50,923,784

Shareholders’ equity

Authorised and issued share capital (fully paid up) ........ 45,378
Balance as at 1 January ......................................... 670,926
Result for the year .................................................. 1,328,074

Total capitalization as at December 31, 1999 of debt and capital ..... 1,292,176,734

Notes:
(1) December 31, 1999 historical amounts in foreign currencies have been translated into Euro at the exchange rate prevailing at December 31, 1999.
(2) There are no contingent liabilities and no secured debt.
(3) On March 17, 2000, Telefónica Europe issued JPY 6,200,000,000 aggregate principal amount of 1.232% instruments due 2004, unconditionally and irrevocably guaranteed as to payment of principal and interest by Telefónica. Telefónica Europe has used the proceeds of the issue to provide a loan to Telefónica.
On May 30, 2000, Telefónica Europe issued JPY 60,000,000,000 aggregate principal amount of 0.27% instruments due 2001, unconditionally and irrevocably guaranteed as to payment of principal and interest by Telefónica. Telefónica Europe has used the proceeds of the issue to provide a loan to Telefónica.
On June 1, 2000, Telefónica Europe notified Bankers Trust Company, as Trustee, that it had elected to redeem the U.S.$600,000,000 of 2% Exchangeable Bonds due 2002 outstanding on July 15, 2000. In July 2000, Telefónica Europe established a euro commercial paper program of up to €2,000,000,000 and in August 2000 increased its EMTN program to €8,000,000,000.

Except as discussed in the foregoing tables, there has been no material change in the capitalization of Telefónica or Telefónica Europe since the respective dates as of which information is given herein.
BUSINESS

Overview

We are a corporation (sociedad anónima) duly organized and existing under the laws of the Kingdom of Spain. We are:

- a diversified telecommunications and multimedia group which currently provides a comprehensive range of services in Spain and Latin America through one of the world’s largest and most modern telecommunications networks
- the leading provider of fixed-line public voice telephone services, mobile services and data transmission services in Spain
- the largest telecommunications operator in Latin America, with operations principally in Argentina, Brazil, Chile, El Salvador, Guatemala, Peru and Puerto Rico, and a significant telecommunications operator in Austria and Morocco
- a leading Spanish multinational corporation

At December 31, 1999, we managed companies that had approximately 37.6 million access lines in service, 15.5 million cellular subscribers and approximately 1,036,000 pay television subscribers, including approximately 596,000 cable subscribers and 440,100 direct-to-home satellite television subscribers. Including those companies in which we have a minority interest, we had approximately 40.2 million access lines in service, over 19.6 million cellular subscribers and 2.5 million pay television subscribers at that date.

The following table reflects the development of our customer base since 1997, without adjustment to reflect minority or majority interest.

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access lines in service(1)</td>
<td>25,691.3</td>
<td>33,512.7</td>
<td>37,613.2</td>
</tr>
<tr>
<td>Cellular subscribers(2)</td>
<td>4,707.4</td>
<td>8,364.9</td>
<td>15,508.3</td>
</tr>
<tr>
<td>Cable television subscribers</td>
<td>508.7</td>
<td>585.8</td>
<td>596.0</td>
</tr>
<tr>
<td>DTH satellite television</td>
<td>77.0</td>
<td>288.6</td>
<td>440.1</td>
</tr>
</tbody>
</table>

(1) Represents our consolidated entities plus Compahnia Riograndense de Telecomunicacoes, which was accounted for under the equity method.

(2) Represents our consolidated entities plus Tele Leste Celular, which we manage but which we do not consolidate.

We provide a comprehensive range of telecommunications services in Spain and the other countries in which we operate. These services include:

- fixed-line telephone services
- wireless or cellular telephone services
- data transmissions
- Internet services
- media communications
- yellow pages or directory services

During 1999, our group was organized according to seven principal lines of business, each of which was headed by an operating subsidiary that is under our direct control.
These seven principal lines of business are:

- fixed-line telephone services in Spain conducted through Telefónica de España, S.A.
- mobile services in Spain conducted through Telefónica Servicios Móviles, S.A.
- international business in the Americas conducted through Telefónica Internacional, S.A.
- worldwide corporate data transmissions conducted through Telefónica Data, S.A.
- worldwide Internet-related services conducted through Terra Networks, S.A.
- media communications conducted through Telefónica Media, S.A.
- European and Mediterranean business conducted through Telefónica Intercontinental, S.A.

In addition, we have several operating subsidiaries that do not fall under our seven principal lines of business. These include, among others:

- Telefónica Publicidad e Información, S.A., which publishes and develops and sells advertising in telephone directories
- Telefónica Investigación y Desarrollo, S.A., which focuses on research development
- Atento Holding Telecomunicaciones, S.A., which operates call centers in Spain, Latin America and Morocco

In addition, we operate a corporate center. Our corporate center’s objectives are to:

- coordinate the group’s activities
- efficiently allocate resources among the group
- provide managerial guidelines for the group
- manage the portfolio of businesses
- provide cohesion within the group
- foster synergies among the group’s subsidiaries
The chart below shows the organizational structure of the Telefónica group at December 31, 1999.
On January 12, 2000, we announced a reorganization of our business along global business lines to enhance our strategic and competitive position globally and in each of these business lines. As part of this reorganization, our Board formed two new global business divisions, Telefónica Móviles and Telefónica DataCorp. Some or parts of some of our current lines of business, such as Telefónica Internacional and Telefónica Intercontinental, may be combined with other business lines as a result of the reorganization. In addition, we may create new business lines in the future or transfer from a current subsidiary to an existing or newly created subsidiary specific business lines. As a result of this reorganization of its businesses, during 2000 Telefónica has introduced, and expects to continue introducing, changes to its organizational structure.

**Fixed-Line Telephone Services in Spain—Telefónica de España**

As of January 1, 2000, our fixed-line telephone services in Spain are managed by Telefónica de España. The principal services offered by Telefónica de España are:

- fixed-line telephone services, including access lines and local and long-distance calling
- circuit leasing
- value-added services, including call waiting, call barring and conference calling
- private automatic branch exchange services for companies, under the trade name Ibercom, which, through a telephone switch located on a customer's premises provides voice-grade circuits with advanced features for the local premises, including features such as least-cost routing and call-detail recording
- intelligent network services, including services such as caller identification, phone-messaging and call-forwarding
- integrated services digital network, which provides high speed transmission of voice, data and video through existing fixed-line infrastructure
- leasing and sale of terminal equipment and exchanges
- interconnection services
- public telephone services from phone booths

Fixed-line telephone services in Spain remain our leading business in terms of total revenues. However, their relative contribution to total revenues decreased during 1998 and 1999 principally due to the integration of our Brazilian operating subsidiaries in 1998, and the adverse effects of competition, tariff cuts and discount plans in 1998 and 1999.

Telefónica de España is developing a multi-dimensional strategy in order to continue to compete effectively in the Spanish telecommunications market. This strategy involves:

- developing a commercial strategy that:
  - creates customer loyalty through incentive programs
  - increases revenues by introducing new and attractive services
  - offers global solutions through integrated approaches contributed by affiliates of the Telefónica group
  - maintains income levels
  - improves the efficiency of the network by increasing the volume of traffic
- achieving operating efficiencies by streamlining the workforce and reducing costs in order to preserve operating margins. Telefónica de España plans to reduce its workforce from 58,127 employees at year-end 1998 to 41,800 employees by year-end 2000
- decreasing the unit cost of the network and achieving a higher level of asset turnover
Operations

The following table shows the development of Telefónica de España's domestic telecommunications network and growth in usage of that network since 1997:

<table>
<thead>
<tr>
<th></th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Spanish access lines in service (thousands)</td>
<td>16,798.3</td>
<td>17,555.7</td>
<td>19,226.2</td>
</tr>
<tr>
<td>Fixed telephone service, including payphones (thousands)</td>
<td>15,854.4</td>
<td>16,288.6</td>
<td>16,480.4</td>
</tr>
<tr>
<td>Ibercom(1) (thousands)</td>
<td>715.4</td>
<td>762.5</td>
<td>856.5</td>
</tr>
<tr>
<td>Integrated service digital network(2) (thousands)</td>
<td>228.5</td>
<td>504.6</td>
<td>1,889.3</td>
</tr>
<tr>
<td>Growth in fixed telephone lines in service, including payphones</td>
<td>2.9%</td>
<td>2.7%</td>
<td>1.2%</td>
</tr>
<tr>
<td>Fixed lines in service, including payphones, Ibercom and integrated service digital networks, per 100 inhabitants</td>
<td>40.3</td>
<td>41.4</td>
<td>48.1</td>
</tr>
<tr>
<td>Fixed telephone lines, payphones, Ibercom and integrated service digital network lines in service per employee</td>
<td>266.0</td>
<td>313.2</td>
<td>412.4</td>
</tr>
<tr>
<td>Degree of digitalization</td>
<td>80.8%</td>
<td>86.3%</td>
<td>86.5%</td>
</tr>
<tr>
<td>Average days between application and installation</td>
<td>4.9</td>
<td>5.0</td>
<td>7.2</td>
</tr>
<tr>
<td>Average line usage (minutes per day)(3)</td>
<td>10.9</td>
<td>11.85</td>
<td>13.4</td>
</tr>
<tr>
<td>Growth in average line usage(3)</td>
<td>5.9%</td>
<td>9.5%</td>
<td>11.9%</td>
</tr>
<tr>
<td>Number of InfoVía users (thousands)</td>
<td>577.0</td>
<td>960.0</td>
<td>1,579.0</td>
</tr>
<tr>
<td>Growth of outgoing international traffic</td>
<td>20.0%</td>
<td>13.2%</td>
<td>9.2%</td>
</tr>
<tr>
<td>Growth of incoming international traffic</td>
<td>17.9%</td>
<td>16.0%</td>
<td>16.0%</td>
</tr>
<tr>
<td>Fixed telephone lines installed (thousands)</td>
<td>16,393.1</td>
<td>16,766.4</td>
<td>17,259.4</td>
</tr>
<tr>
<td>Coaxial cable (km)</td>
<td>10,120.0</td>
<td>9,990.0</td>
<td>5,059.0</td>
</tr>
<tr>
<td>Fiber optic cable (km)</td>
<td>47,030.0</td>
<td>49,653.0</td>
<td>52,511.0</td>
</tr>
<tr>
<td>Copper cable in domestic long distance lines (km)</td>
<td>58,141.0</td>
<td>57,802.0</td>
<td>57,430.0</td>
</tr>
<tr>
<td>Subscriber networks (thousand km-par)(4)</td>
<td>65,490.0</td>
<td>66,237.0</td>
<td>66,713.0</td>
</tr>
</tbody>
</table>

(1) Ibercom is the tradename for Telefónica de España's private automatic branch exchange service. The number of Ibercom lines is presented on the basis of extensions.

(2) The formula traditionally used to determine the number of integrated service digital networks has been changed. This change entails the addition of third party private automatic branch exchange services that use Telefónica de España's network access services. Application of the previous formula to the period ending December 31, 1999 would result in approximately 978,826 integrated service digital networks and 18,315,781 access lines in service.

(3) Includes interconnection with mobile networks.

(4) The transmission cables in the subscriber networks contain a variable number of conducting filaments, which are insulated from each other and grouped in pairs. Each such pair is called a "par".

Calls to mobile telephones and Internet access through InfoVía, our access service to Internet service providers (ISPs), and to other online information providers, have been the most important factors contributing to the growth in line usage. During 1999, calls to mobile telephones increased 33.8% and calls for Internet access increased 82.3%. Usage of InfoVía Plus (the service "InfoVía" changed its name to "InfoVía Plus" in 1999) totaled approximately 141.2 million connection hours in 1999, up from 94.4 million in 1998. Services such as voice mail are also an important factor in increasing line usage. At December 31, 1999, almost all of Telefónica de España's lines in service were capable of using network-based voice mail, and more than 8.3 million customers took advantage of this service.

Between December 1998 and January 1999, InfoVía was replaced by InfoVía Plus, a new service completely based on the IP (Internet Protocol) network, which can offer a wide range of value-added services.
Telefónica de España anticipates greater customer demand for InfoVía Plus, as Telefónica de España adds new and more varied content offerings and as consumer demand for online and Internet services increases, leading to increased line usage.

The table below sets forth comparative data with respect to the principal European telecommunications operators at December 31, 1999:

<table>
<thead>
<tr>
<th>Company</th>
<th>Lines in Service (thousands)</th>
<th>Level of Penetration (number of lines per 100 inhabitants)</th>
<th>Lines in Service per Employee</th>
<th>Revenues per Line (euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Telecom (United Kingdom)</td>
<td>28,308</td>
<td>47.9</td>
<td>240</td>
<td>658.2</td>
</tr>
<tr>
<td>Telecom Italia (Italy)</td>
<td>26,187</td>
<td>46.3</td>
<td>342</td>
<td>587.6</td>
</tr>
<tr>
<td>Deutsche Telekom (Germany)</td>
<td>48,800</td>
<td>58.8</td>
<td>275</td>
<td>500.5</td>
</tr>
<tr>
<td>France Telecom (France)</td>
<td>34,541</td>
<td>58.7</td>
<td>232</td>
<td>423.1</td>
</tr>
<tr>
<td>Portugal Telecom (Portugal)</td>
<td>4,232</td>
<td>48.2</td>
<td>273</td>
<td>453.2</td>
</tr>
<tr>
<td>Telefónica (Spain)</td>
<td>19,226</td>
<td>48.1</td>
<td>412</td>
<td>526.5</td>
</tr>
</tbody>
</table>

Source: Eurodata, Tarifa and the actual operators.

Despite the growth in Telefónica de España’s domestic telecommunications network in recent years, the level of penetration of fixed telephone service in Spain of approximately 48.1 access lines in service per 100 inhabitants at December 31, 1999, remains relatively low compared to other Western European countries.

International Traffic

Currently, 99.9% of all international traffic originating in Spain is dialed direct. Total revenues from international incoming and outgoing calls decreased during 1997, 1998 and 1999 because of tariff reductions and discount policies, despite an increase in the number of minutes of international traffic. Revenues for outgoing calls are usually derived from tariffs paid by customers in Spain, net of our payments to foreign carriers for the portion of the calls carried over such carriers’ networks. Revenues for incoming calls are derived from payments made by foreign carriers. Payment rates and currencies are agreed upon bilaterally under the general auspices of the International Telecommunications Union. Due to Spain’s geographic location between the United States and the Middle East and between Northern Europe and Africa, we also derive revenues from the use of our network to retransmit voice and data traffic and television signals.

Digitalization

At December 31, 1999, 86.5% of urban lines were digital. In addition, Telefónica de España has completed the upgrade of its telephone exchanges. As a result, Telefónica de España is able to provide basic digital services, such as itemized billing, to 100% of its customers. The high degree of digitalization of Telefónica de España’s network also enables it to provide a broad range of digital services to satisfy customer demands. Telefónica de España’s international switching exchanges and domestic and international transmission links are 100% digitalized.

Public Telephones

At December 31, 1999, Telefónica de España had 67,064 telephone booths in public thoroughfares, all of which use modular technology and accept coins, prepaid cards and credit cards. These phone booths are owned by Telefónica de España and managed by Telefónica Telecommunicaciones Públicas, S.A. During 1999, revenues from pay telephones located in public telephone booths represented 8.0% of Telefónica de España’s total consolidated revenue from operations. Public telephone services were liberalized as of December 1, 1998 and operators possessing a Type A or Type B license may provide public telephone services. See “—Competition”.

S-25
Cable Telecommunications

Telefónica de España, through Telefónica Cable, commenced providing cable telecommunications services in the Spanish regions of Extremadura and Castilla de la Mancha in June 1999, and in Catalonia, Castilla y Leon and Cadiz in August 1999. Telefónica de España began operations by offering a pre-commercial service under which subscribers were not required to pay for such services. Our strategy regarding the offering of cable telecommunications will depend upon the competitive environment and the obligations we would be required to undertake in order to receive the necessary license for each particular region.

Regulation

Overview

Below is a description of the current Spanish telecommunications regulatory framework. This description should be considered in light of certain developments currently underway in the regulatory and competitive environment that will have a material impact on Telefónica de España's business and operations in future years.

Prior to efforts that began in 1987 and that culminated in full market liberalization in December 1998, we operated as the exclusive supplier of telecommunications services in Spain pursuant to government concessions dating to 1946. At present, all telecommunications services provided by us are subject to competition. Retevisión and Lince were the first two operators licensed to provide nationwide fixed-link public voice telephone services, consisting of local, long distance and international telephone services and the corresponding carrier services. Retevisión launched its services in January 1998, and Lince commenced operations under the trade name UNI2 on December 1, 1998. Since January 1998, licensed cable telecommunications operators have been permitted to offer fixed-link public voice telephone services that originate within their regions, using their own networks. Also, since December 1998, the provision of fixed-link public voice telephone services has been open to competition from all sources, subject to basic regulatory licensing requirements.

The Spanish government undertook the process of revising the legislative and regulatory scheme applicable to participants in the telecommunications industry in preparation for the December 1998 market opening. As the main step in this process, on April 24, 1998, the Spanish Parliament passed the new General Law on Telecommunications (Law 11/1998). This law was published in the Official Gazette on April 25, 1998 and took effect on April 26, 1998.

The General Law on Telecommunications repealed and replaced nearly all the existing laws and regulations on telecommunications (including laws regulating satellite and cable telecommunications). However, the General Law on Telecommunications does not govern television and radio broadcasting and cable television, and therefore, certain provisions of previous telecommunications statutes dealing with radio and television broadcasting and cable television remain in force.

In general terms, the General Law on Telecommunications adopted all European Union directives mandating the liberalization of telecommunications services, some of which had already been implemented in Spain. Among other things, the General Law on Telecommunications addresses the following matters relating to our business:

- conditions for granting individual licenses and general authorizations to provide telecommunications services
- The obligation of dominant operators to provide within the national territory, certain basic services to all users at a reasonable price (servicio universal de telecomunicaciones), as well as the obligation of all operators using public telecommunication networks to contribute to the net cost of capital expenditures incurred in connection with such “universal service” obligation.

Since 1991, we have provided telecommunications services under a state contract entered into with the Spanish government in that year, in accordance with the Telecommunications Regulation Law of 1987. We have requested the Spanish government to transform the concession pursuant to which Telefónica de España currently provides telecommunication services into such individual licenses or general authorizations to provide telecommunications services as are the equivalent of the concession pursuant to the General Law on Telecommunications. Until such transformation takes place, Telefónica de España's concession under the state contract will continue in effect to the extent not contrary to the General Law on Telecommunications.
In January 1997, in connection with the final phase of our privatization, the Spanish government adopted a requirement of prior government approval with respect to a limited number of fundamental corporate and control transactions affecting us, including the acquisition of 10% or more of our capital stock or the capital stock of Telefónica Servicios Móviles and the sale of assets material to the provision of fixed telephone services. The approval requirement applied in connection with the transfer of certain assets of Telefónica to its wholly owned subsidiary Telefónica de España in November 1998 and will apply to subsequent transfers by Telefónica de España and Telefónica Móviles España, S.A.

Article 34 of Royal Decree-Law 6/2000 provides that individuals or entities holding more than 3% of the total shareholdings or voting rights of two or more “principal providers” in the fixed and portable telephony business may not exercise more than 3% of the voting rights of one of such companies. Holders of shares subject to these provisions shall notify to the Telecommunications Market Commission the name of the entity in which they elect to exercise voting rights in excess of 3%. Failure to make such election results in inability to vote more than 3% of the total voting rights in all principal providers. Furthermore, individuals or entities are not allowed to appoint members to the administrative bodies of more than one principal provider in the relevant market. For purposes of these provisions, a principal provider is any entity that holds one of the five largest market shares in the relevant market.

The State Contract

Generally, the state contract specifies the terms and conditions under which we are authorized to provide telecommunications services in Spain. The contract may be amended or modified in accordance with the legal regime established by the Spanish General Law of Public Contracts and other regulations governing agreements entered into by the government. The state contract may be superseded by European Union directives. Below is a summary of the material provisions of the state contract.

Term. We and the government entered into the current state contract in 1991 for an initial term of 30 years, subject to the standard termination provisions under Spain’s General Law of Public Contracts (i.e., breach of contract, expiration of term, pre-emption of services by the Spanish government, cancellation of services for reasons of public interest, bankruptcy or suspension of payments and mutual agreement).

Services. The state contract provides that we may continue to render all services that we provided prior to market liberalization, as long as we fulfill the technological and service requirements set forth by the relevant regulations. This provision in effect grants us a non-exclusive concession to provide any service we have provided in the past, including fixed-link services, data transmission services, cellular services and other value-added services.

Other Obligations. The state contract requires us to:

- provide basic telephony service (universal service) to the entire national territory, guaranteeing access to the service to everybody
- pay taxes as required by general tax regulations
- adopt whatever measures are necessary to guarantee privacy in communications
- prepare plans to establish technical conditions, investments, and goals for improvement of services and network upgrades and to present such plans to the Ministry of Science and Technology
- present information to the General Secretariat of Communications regarding internal procedures, an annual audit by independent accountants and financial statements that segregate our industrial activities from our investments in other companies and segregate services provided on a monopoly basis from services open to competition
- pay certain royalties

S-27
European Union Regulations

Since 1995, the European Union has adopted a number of directives that regulate the provision of telecommunications services in European Union member states, including:

• regulations designed to ensure the full liberalization of the telecommunications sector
• regulations which impose standard conditions throughout member states for granting individual licenses and general authorizations
• regulations regarding interconnection between competing operators
• regulations dealing with the universal service obligation
• regulations requiring member states to allocate mobile radio based services according to the DCS 1800 standard

The General Law on Telecommunications and other applicable Spanish law were designed to implement all applicable European Union directives on the provision of telecommunications services.

Regulatory Framework

The provision of telecommunications services in Spain is regulated and overseen by the Spanish government through the State Secretariat of Telecommunications and Information, a unit of the Ministry of Science and Technology. The Ministry has various powers, including the authority to grant licenses for telecommunications services and to impose sanctions for certain infringements of the General Law on Telecommunications. An additional independent oversight body, the Telecommunications Market Commission, was created in 1996. The Telecommunications Market Commission grants individual licenses and general authorizations to telecommunication operators, except when such grant falls within the authority of the above-mentioned ministry, and serves as arbitrator for any conflicts that may arise between operators, subject to the consent of the interested parties. The Telecommunications Market Commission also guarantees free competition, particularly with regard to a plurality of service offerings, access to networks and network interconnection. With regard to the latter, the Telecommunications Market Commission may make a binding decision in any matter of conflict and may fix interconnection charges in the event of disputes.

The Telecommunications Market Commission has advisory and arbitration responsibilities. It reports on all proposals for tariffs, whether maximum, minimum or fixed, and the regulation of prices for telecommunications services. It also reports on tariff proposals for exclusive services or services for which a dominant operator exists.

The General Law on Telecommunications

The General Law on Telecommunications culminates the liberalization process initiated in 1987 with the enactment of the Telecommunications Regulation Law, and establishes a new regulatory framework for telecommunications in accordance with applicable European Union directives. The General Law on Telecommunications provides for free competition in all telecommunications services and for the creation of telecommunications networks, subject to obtaining an individual license or a general authorization. Individual licenses will be required:

• to set up or operate public telecommunications networks
• to render voice telephony services to the public
• to render telecommunications services or set up or operate telecommunications networks using radio spectrum

The Spanish Government may designate other activities and services as requiring an individual license. If there is not enough public radio spectrum available for all individual license applicants, the individual licenses will be allocated by the Ministry of Science and Technology through a bidding contest.
In accordance with the Eighth Transitory Disposition of the General Law on Telecommunications, Telefónica de España has requested that the concessions granted under the State Contract be converted into such individual licenses or general authorizations to provide telecommunication services as are the equivalent of such concessions under the General Law on Telecommunications. Since the resolutions transforming the concessions into individual licenses and general authorizations have not yet been adopted, the rights and obligations of Telefónica are at this time the rights and obligations established in the concessions to the extent they are not contrary to the General Law on Telecommunications. However, the rights and obligations of Telefónica under the new regulatory framework are not supposed to afford it any competitive advantages.

**Tariffs.** A general principle under the General Law on Telecommunications is that operators are free to fix tariffs. Nevertheless, the government’s Delegate Commission for Economic Affairs has the authority, subject to a report by the Telecommunications Market Commission, to set temporarily fixed, maximum or minimum tariffs, or the criteria to fix them and the mechanism for their control. In doing so, the Government’s Delegate Commission for Economic Affairs must take into account:

- the effective cost of the service
- the degree of competition in the market for the applicable service

The General Law on Telecommunications recognized the existence of an imbalance in the tariffs charged for fixed-link telephone services as of the date of its enactment and also recognized the need to rebalance such tariffs. The General Law on Telecommunications further recognized the possibility of compensating the dominant operator for the access deficit which may result from the existing rate imbalance. Because the access deficit problem had not been resolved, on December 1, 1998, the date the market was completely open to free competition, we filed a complaint against the Spanish government before the European Union alleging the Spanish government’s failure to comply with European Union directives that require a rate rebalancing prior to the liberalization of the telecommunications markets. In November 1999, we filed a complaint against the Spanish government seeking compensation for the imbalance in tariffs.

**Interconnection.** The General Law on Telecommunications requires owners of public telecommunications networks to allow competitors to interconnect their networks and services at non-discriminatory rates and under non-discriminatory conditions.

The General Law on Telecommunications provides that the conditions for interconnection are to be freely agreed among the parties while the government has the authority to establish the minimum conditions for interconnection agreements, which must be included in all agreements. On July 24, 1998, the government issued a Royal Decree elaborating the regulations relating to interconnection. Where the parties are unable to reach an agreement, the Telecommunications Market Commission may impose the obligation to interconnect upon the conditions it dictates. Similarly, the Telecommunications Market Commission may release certain public network owners, temporarily and on a case-by-case basis, from the obligation to interconnect where there are technical or commercial alternatives to such interconnection.

Under the General Law on Telecommunications, interconnection prices may be freely negotiated. However, prices charged by Telefónica de España, as the dominant operator, are determined by the Interconnection Offer Framework, which was initially proposed by us and subsequently modified and approved by the Ministry of Science and Technology. Under our proposal, interconnection prices charged to Telefónica de España’s competitors would be consistent with Telefónica de España’s actual costs. However, the Ministerial Order dated October 29, 1998, which approved the Interconnection Offer Framework, lowered interconnection prices below Telefónica de España’s actual costs. In addition, on November 26, 1998, interconnection prices charged to mobile operators were approved, bringing them in line with those approved for the fixed-line operators. These prices, which became effective as of July 1, 1999, also are lower than Telefónica de España’s actual costs. Because it is providing interconnection services to its competitors at prices below its costs, Telefónica de España is not able to compete as effectively in the long distance and international services markets as these companies, which contributed to its decline in market share in 1999. Telefónica de España has filed an appeal with the Sala de lo Contencioso Administrativo de la Audiencia Nacional Sección VII against the Interconnection Offer Framework.
Telefónica's Interconnection Offer Framework has been amended by means of a Resolution issued by the Telecommunications Market Commission, which entered into force on June 17, 2000. The amendment has generally reduced interconnection fees to be paid by holders of Type A and Type B individual licenses.

Further, Royal Decree-Law 7/2000 requires the Telecommunications Market Commission to prepare prior to September 15, 2000, a proposal for the approval of the Delegate Commission for Economic Affairs to amend Telefónica's Interconnection Offer Framework in order to ensure the competitive effect of the measures adopted in that Royal Decree-Law.

Service Standards. The National Telecommunications Plan has defined the objectives for the development of the telephone network, including quality of service standards. The service standards established in the National Telecommunications Plan are binding on us and we have met these service standards for the past five years.

Pursuant to the General Law on Telecommunications, our services must meet standard requirements that established in certain regulations.

Public Service Obligations. The General Law on Telecommunications provides that the owners of public telecommunications networks, as well as operators rendering telecommunications services on the basis of an individual license, are subject to certain public service obligations. In addition, some of these obligations may be imposed on operators whose services require a general authorization.

The public service obligations include:

- the universal service obligation governed by the Royal Decree of July 31, 1998
- the mandatory telecommunications services obligations
- other public service obligations

The universal service obligation consists of the obligation to provide basic telephony to all end-users within Spain, free telephone directory services, public pay phones throughout Spain and access to telephony services for disabled people. These services must be provided by the dominant operator in each territory, or in certain cases, by another operator, pursuant to regulations yet to be issued. At present, we are the dominant operator in each territory and, according to the General Law on Telecommunications, we will be considered to be the dominant operator until at least 2005. If meeting the universal service obligation in a particular territory is loss-producing, all operators in that territory could be obligated to contribute to it through the National Fund for Universal Service. The obligatory telecommunications services obligation enables the government to appoint a telecommunications operator to provide certain essential telecommunications services, such as telex, telegraph and maritime communications, and other telecommunications services to the extent the government determines that such services are not adequately provided. We have been designated as the provider of maritime telecommunications services through April 2002. We may in the future be designated as the provider of other telecommunications services.

Terminal Equipment. In line with former legislation, the General Law on Telecommunications provides that consumers may freely purchase or lease any terminal equipment, including telephone sets, and connect that equipment to the telecommunications network. All terminal equipment is required by the General Law on Telecommunications to meet certain technical specifications and safety requirements to be verified by the Ministry of Science and Technology approval of the General Secretariat of Communications.

Ownership Limitations. Pursuant to the General Law on Telecommunications, direct or indirect investments in us by foreign persons may not exceed 25% of our share capital unless otherwise provided for by the applicable international treaties or authorized by the Spanish government. Pursuant to European Union directives, citizens of other European Union member states, including entities domiciled in such countries, are not considered foreign persons for the purposes of this provision. For legal entities entitled to provide telecommunications services which require the use of the public radio spectrum, the specific sector regulations relating to foreign participation will be applicable.
By virtue of the 1997 GATS Annex on Basic Telecommunications, which has been ratified by Spain, direct or indirect control of 25% or more of Telefónica by non-Spanish persons or entities does not require Spanish governmental approval provided such persons or entities are domiciled in a country which is party to the GATS Annex on Basic Telecommunications. However, the GATS Annex does not cover telecommunications activities relating to the cable or broadcast distribution of radio or television programming.

Further, the previously mentioned ownership limitations, contained in Royal Decree 8/1997 and the Royal Decree-Law 6/2000 on investments and vote restraints will continue to be applicable.

**Cable Telecommunications**

Law 42/1995, the Cable Telecommunications Law, formerly governed the exchange of video, audio and other telecommunications over the cable telecommunications network. The Cable Telecommunication Law has been repealed by the General Law on Telecommunications, except for those provisions dealing with cable television, which remain in force.

Spain has been divided into 43 geographic regions for cable television regulatory purposes. Although we will be able to provide cable television nationally, we are required to wait for a period of time (originally 16 months but extended to 24 months in December 1998) computed from the moment the competitor for that region has been granted a concession in each franchise region. However, we are entitled to commence providing cable telecommunications services in a specific region immediately after the closing of the auction for the other operator's license if following such auction no license is granted. A lobby of cable operators is currently petitioning the Spanish government to increase the moratorium from 24 months to up to five years. Nevertheless, unlike the previous increase from 16 to 24 months, which was recognized as a possibility under the General Law on Telecommunications, the increase sought by our competitors is not contemplated under such law.

**Royal Decree 7/2000**

On June 23, 2000, the government issued a new Royal Decree-Law relating to the provision of telecommunication services. Under the Decree, we will be required, as a dominant telecommunications operator, to:

- beginning January 2001, facilitate access to our local loop. The government, upon the recommendations of the Telecommunications Market Commission, will establish the conditions on which we will be required to offer this access. The Delegate Commission for Economic Affairs, in consultation with the Ministry of Economy and the Ministry of Science and Technology, will establish the conditions and prices under the first Interconnection Offer Framework
- before November 15, 2000, facilitate the use of alternative carriers by persons placing local telephone calls by implementing call selection and preselection in lines connected to digital telephony stations for local calls
- beginning November 1, 2000, offer 600 minutes of local calls between the hours of 6:00 p.m. and 8:00 a.m. on weekdays, and all day Saturday, Sunday and national holidays (reduced tariff) for Ptas. 700 per month and 600 minutes of local calls all day for Ptas. 1,400 per month
- beginning November 1, 2000, offer limited Internet access for Ptas. 2,750 per month (between the hours of 6:00 p.m. and 8:00 a.m. weekdays and all day Saturday, Sunday and national holidays)

**New Tariff Structure**

On July 27, 2000, the Spanish government's Delegate Commission for Economic Affairs established a new tariff structure that will be applicable to Telefónica de España for the two-year period beginning on January 1, 2001. The new regulatory scheme departs from the prior practice of directly setting the prices that Telefónica de España could charge for its services adopting, in its stead, a system of price caps that apply to certain "baskets" and "sub-baskets" of services. Each price cap is defined in the regulation by reference to the tariff in effect for each service in the basket, or sub-basket, as of December 31, 2000, adjusted by a percentage equal to the consumer price index plus or minus a certain number of percentage points ("CPI-X").

S-31
The following is a summary of the new scheme:

- For the "basket" of services that includes connection rates to individual lines, connection rates to link lines, monthly fees per individual lines, monthly fees per link lines, metropolitan, provincial, interprovincial, and international telephone services, information service (number 1003) and fixed-to-mobile calls, the applicable price cap is determined by adjusting the December 31, 2000 tariffs by a percentage equal to CPI-9 in 2001. Assuming rate of inflation of 2% for 2001, application of the new tariff structure would result in a decrease of 7% in the tariffs charged by Telefónica de España for the services listed above. For 2002, CPI-8 will apply, which would result in a further 6% decrease, if the rate of inflation is assumed to stay at 2%.

- A first "sub-basket" of services includes connection rates to individual lines, connection rates to link lines, and the information service number (number 1003). For services in this "sub-basket", the adjustment percentage is CPI-16.5 for each of 2001 and 2002. Therefore, if a 2% inflation rate is assumed for each year, the tariffs charged by Telefónica de España for those services during 2001 and 2002 will be reduced 14.5% each year.

- A second "sub-basket" of services includes monthly fees for individual lines and link lines. For the second "sub-basket", the new tariff structure comes into force in 2002. Until then, the Royal Decree 16/1999 issued on October 15, 1999 continues to be applicable. That Royal Decree allows Telefónica de España to increase these monthly fees by Ptas. 100 on August 1, 2000, Ptas. 100 on March 1, 2001 and Ptas. 100 on August 1, 2001 per line. For 2002, a price cap of CPI-3.5 becomes applicable, which would result in an increase of 5.5% if a 2% inflation rate is assumed for 2002.

- Lastly, a third "sub-basket" of services includes fixed line to mobile connection rates. For the services in this "sub-basket", the percentage variation is CPI-15 for each of 2001 and 2002. Therefore, assuming 2% inflation for each of 2001 and 2002, there will be a reduction of 13% in the tariffs charged by Telefónica de España for those services for each of 2001 and 2002.

In addition, the terms of the new tariff structure prohibit Telefónica de España from, during 2001 and 2002:

- increasing the prices for metropolitan calls;
- decreasing the prices for provincial, interprovincial and international calls by more than 50%; and
- increasing the prices for calls from phone booths more than 35% of the price charged for the same type of calls from an individual line.

**Competition**

In June 1997, Relevisión S.A. received a national license to provide fixed-line voice services. It began providing domestic and international long-distance services in January 1998. Relevisión is controlled by a consortium consisting of Endesa S.A., Unión Eléctrica Fenosa S.A. and the Italian telecommunications provider Telecom Italia. In April 1999, the Spanish government sold its remaining 30% stake in Relevisión, completing its privatization.

Relevisión is able to provide national and international long-distance service to all telephone customers in Spain (both residential and business customers). Relevisión reaches local customers by interconnecting with Telefónica de España's network pursuant to the terms of an interconnection agreement finalized in December 1997. Until January 2001, Relevisión will have to build its own local loop in order to provide local service. According to our estimates, Relevisión attained an approximately 10% market share by year-end 1999 of total national and international long-distance traffic.

The Spanish market for fixed-link telephone service became open to competition from all market entrants, subject to basic regulatory licensing requirements, in December 1998. In May 1998, the consortium Lince received the third license for the provision of fixed-link telephone services. It commenced operations on December 1, 1998 under the trade name UNI2. Lince is comprised of France Telecom, Edatel S.A. and Cable Europa, S.A. As of December 1, 1998, fixed-link public voice telephone services have been open to
competition, subject to basic licensing requirements as provided for in the General Law on Telecommunications. Although cable operators have been permitted to use their networks to provide local telephone service since January 1998, they have only begun to operate in some regional areas. They have not acquired a significant market share to date.

In addition to the licenses granted to Retevisión and Lince, as of December 1999, more than 70 licenses have been granted for the provision of fixed-link telephone services. Approximately an additional 30 licenses have been granted to cable operators.

The Ministerial Order dated September 22, 1998 set forth the rules applicable to individual licensees for telecommunications services and networks in addition to the terms and conditions applicable to such licensees. The Ministerial Order provides for two different types of individual licenses for the provision of public voice telephone services:

- **Type B license**: This license authorizes the provision of telephone service available to the public through the establishment or operation of a fixed telephone public network by the licensee. Two different categories of Type B licenses are contemplated:
  - a Type B1 license for fixed-link public voice telephone services available to the public through the establishment or operation of a fixed telephone network. This type of license also permits the licensee to lease its circuits to third parties
  - a Type B2 license for the provision of mobile voice telephone services available to the public through the establishment or operation of a mobile telephone network

- **Type A license**: This license authorizes the provision of fixed-link public voice telephone service through the use of switching and transmission equipment without the corresponding obligation or right to establish and operate a network as in the case of the Type B license and C licenses

In addition, a third type of license, a Type C license, authorizes the establishment or operation of public networks, but the holder of such license may not provide fixed-link telephone services to the public. Type C licensees will compete with Telefónica de España in providing network access to Type A and B licensees.

Telefónica de España is currently the only significant provider of comprehensive local service. This will change gradually as cable operators develop their networks. In addition, the government has approved a new Decree which may have the effect of increasing competition in the local service market. See "—Regulation—Royal Decree 7/2000” above. Competition in domestic and international long-distance services, particularly in the residential segment, is based on access through interconnection with Telefónica de España. Telefónica de España had an estimated average market share of 94.7% of total Spanish traffic in terms of minutes in 1999, including 85.7% of total domestic long distance traffic and 87.1% of total international long-distance traffic. Telefónica de España’s estimated market share in 1998, both of total domestic long distance traffic and of total international long distance traffic, was approximately 93%.

Telefónica de España faces indirect competition in international services from a number of sources, including calling cards, call-back services and call rerouting by other international operators. In addition, Telefónica de España competes with a number of international operators for the provision of closed user group communications to multinational and large corporate customers and with a number of providers of data transmission services.

Competition in the market for fixed-link public voice telephone services is likely to be based on such distinct factors as:

- the financial strength and operating capacity of competitors
- market conditions, applicable Spanish and European Union regulations with respect to telecommunications services and basic telecommunications infrastructure
• regulations in effect with respect to tariff structures and interconnection rates
• the effectiveness of our efforts to withstand increased competition

Because our capacity to compete will be affected by factors not fully within our control, we cannot predict the degree of any resulting adverse effect on our business and results of operations.

Telefónica de España is fortifying its ability to compete in fixed voice services by:

• Actively participating in the development of the regulatory framework and seeking a neutral framework through recourse to the legal system when necessary. Telefónica has directly petitioned the telecommunications regulators to adopt a schedule for the rate rebalancing mandated by European Union directives. Because the access deficit problem had not been resolved, on December 1, 1998, the date the market was completely open to free competition, we filed a complaint against the Spanish government before the European Union alleging the Spanish government’s failure to comply with European Union directives that require a rate rebalancing prior to the liberalization of the telecommunications markets. In November 1999, we filed a complaint against the Spanish government seeking compensation for the imbalance in tariffs.

• Developing customer loyalty and incentive programs through discount plans, generating new income by introducing new services and offering global solutions through integrated offerings of the Telefónica group, while seeking to maintain income levels and to improve the efficiency of the network by increasing the volume of traffic.

• Achieving operating efficiency by streamlining the workforce and reducing costs in order to preserve operating margins. Telefónica de España plans to reduce its workforce to 41,800 employees by year-end 2000 from 58,127 employees at year-end 1998.

• Lowering the unit cost of the network and achieving a higher level of asset turnover. Telefónica de España anticipates a reduction in investments in infrastructure over the next few years as a result of the elimination of waiting lists for service, the fulfillment of service extension requirements and the high degree of digitalization of the network. After a substantial build-out earlier in the decade, investments in infrastructure decreased 16% in 1999, and we expect a further decrease of approximately 3% in 2000. Consequently, unit costs are similarly expected to decline.

Pricing for Principal Services and the Tariff Structure

The state contract established a structure for tariffs and regulated prices to ensure the overall financial balance under the contract while safeguarding the principle of universality in the rendering of services. Historically, Telefónica de España’s rates were structured so that local telephone services and access lines were subsidized by long distance and international services. Under the framework of the state contract and prior to the General Law on Telecommunications, rates for basic telephone service were approved by the Spanish government at the proposal of the Ministry of Science and Technology and, since the creation of the Telecommunications Market Commission, after a hearing of the Telecommunications Market Commission.

European Directives and the General Law on Telecommunications recognized the existence of an imbalance in the rates, as well as the possibility of compensating the dominant operator for the access deficit which may result from the existing rate imbalance. In view of the rate imbalance, the Ministerial Order of July 31, 1998 established new prices for basic telephone services and approved a plan for discounting principal services. Per-line monthly charges and local tariffs were increased by an average of 16% and 13%, respectively, while prices for provincial, interprovincial and international long-distance calls were decreased by 5%, 15% and 12%, respectively.

We believe that the rate imbalance has not been offset by the prices established in the Ministerial Order of July 31, 1998, which we consider to have been only a first step in the rate rebalancing required for a fully
competitive market. We have also presented an estimate of our access deficit and continue to seek further tariff adjustments in order to avoid harming our competitive position. The Ministerial Order of October 29, 1998, which sets forth the Interconnection Offer Framework approved by the Telecommunications Market Commission, provides that the manner in which the access deficit duly evidenced and justified by us should be compensated, should be established by a ministerial order. Nevertheless, because the access deficit problem has not been resolved, we have, as noted above, filed a complaint against the Spanish government before the European Union alleging the Spanish government’s failure to comply with European Union directives that require a rate rebalancing prior to the liberalization of the telecommunications markets. In November 1999, we filed a complaint against the Spanish government seeking compensation for the imbalance in tariffs.

Currently, tariffs are subject to regulation although general guidelines exist regarding the framework for establishing our prices in a liberalized market. The Urgent Measures Decree Law of April 16, 1999 grants jurisdiction to the Ministry of Science and Technology to develop a new transitory framework for the regulation of Telefónica de España’s prices based on the maximum limitations on annual prices.

Decree-Law 6/99, issued in April 1999, and Decree 16/99, issued in October 1999, established new tariffs for fixed-line telephone services offered by Telefónica de España. These decrees featured aggregate reductions of:

- 4.36% for provincial calls
- 17.56% for interprovincial calls
- 6.68% for international calls
- 11.8% for fixed to mobile calls

In addition, Decree 16/99, as a measure of tariff rebalancing, sets an increase in monthly fees per individual line and link totaling Ptas. 300 to be implemented in three increments on August 1, 2000, March 1, 2001 and August 1, 2001. On January 1, 2000, tariffs for fixed to mobile calls were further reduced by 11.8%.

The following table sets forth tariffs for access to Telefónica de España’s most common services as of December 31, 1999.

<table>
<thead>
<tr>
<th>Rate Category</th>
<th>1999 (pesetas)</th>
<th>Percentage Increase (Decrease) 1998-1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Connection rate:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual telephone line</td>
<td>21,250</td>
<td>–</td>
</tr>
<tr>
<td>Integrated service digital network link:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary access</td>
<td>600,000</td>
<td>–</td>
</tr>
<tr>
<td>Basic access</td>
<td>28,000</td>
<td>–</td>
</tr>
<tr>
<td>Monthly subscription rate:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual telephone line</td>
<td>1,442</td>
<td>–</td>
</tr>
<tr>
<td>Integrated service digital network:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Primary access</td>
<td>57,000</td>
<td>–</td>
</tr>
<tr>
<td>Basic access</td>
<td>3,800</td>
<td>–</td>
</tr>
<tr>
<td>4 Km 64KB/s national digital circuit</td>
<td>43,769</td>
<td>(8) %</td>
</tr>
</tbody>
</table>

(1) Excludes value-added taxes.
The table below sets forth Telefónica de España’s pricing structure as of June 1, 2000 for local and domestic long-distance calls:

<table>
<thead>
<tr>
<th></th>
<th>Connection Charge (Ptas)</th>
<th>Ptas for Three-Minute Calls(1)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local(4)</td>
<td>11.4(5)</td>
<td>12.73 11.95</td>
</tr>
<tr>
<td>Provincial(4)</td>
<td>15</td>
<td>55.32 35.1</td>
</tr>
<tr>
<td>Interprovincial(4)</td>
<td>15</td>
<td>90 46.14</td>
</tr>
</tbody>
</table>

(1) Includes call connection charge.
(2) For local calls weekdays from 8 a.m. to 6 p.m., and for provincial and interprovincial calls from 8 a.m. to 8 p.m. on weekdays.
(3) For remaining time periods and national holidays.
(4) Price per minute, although calls are billed per second.
(5) Includes 160 seconds of talk time.

The surcharge applied by Telefónica de España for calls made from public phone booths is 35%, in accordance with approved tariffs.

The table below sets forth, as of the dates indicated, Telefónica de España’s average prices for a three-minute international call to the indicated regions at peak hours at the dates specified. This table illustrates the decline in international rates, which has led to a gradual decline in international revenues:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Europe</td>
<td>290.7</td>
<td>250.8</td>
<td>228.0</td>
<td>197.0</td>
<td>182.0</td>
<td>170</td>
<td>152</td>
</tr>
<tr>
<td>Rest of Europe and North Africa</td>
<td>410.4</td>
<td>336.3</td>
<td>330.6</td>
<td>284.0</td>
<td>236.0</td>
<td>284</td>
<td>236</td>
</tr>
<tr>
<td>United States, Canada and the Caribbean</td>
<td>438.9</td>
<td>336.3</td>
<td>285.0</td>
<td>242.0</td>
<td>194-218</td>
<td>197</td>
<td>182</td>
</tr>
<tr>
<td>Latin America</td>
<td>615.6</td>
<td>575.7</td>
<td>558.6</td>
<td>500.0</td>
<td>374.0</td>
<td>407</td>
<td>347</td>
</tr>
<tr>
<td>Japan and Australia</td>
<td>735.3</td>
<td>632.7</td>
<td>587.1</td>
<td>536.0</td>
<td>491.0</td>
<td>536</td>
<td>491</td>
</tr>
<tr>
<td>Rest of the world</td>
<td>855.0</td>
<td>798.0</td>
<td>718.2</td>
<td>602.0</td>
<td>548.0</td>
<td>602</td>
<td>548</td>
</tr>
</tbody>
</table>

(1) Includes flat connection charge.
(2) Applies weekdays during peak hours.
(3) Applies off-peak hours.

Telefónica de España's marketing efforts in response to competition have focused on quality of service and relied on discount plans and the introduction of new services in order to increase consumption. Accordingly, during 1998, Telefónica de España introduced several discount plans for its residential customers for domestic and international long-distance calls to a limited set of numbers selected by the customer. These plans, which featured various terms and conditions, were marketed under the name “Planex Claros”. As of December 31, 1998, customers had subscribed to 4.8 million of these plans. During the first months of 1999, certain discount plans were revised, increasing the set of telephone numbers selected by the customer to which discounts are applicable and applying discounts to local calls to the InfoVia Plus service for access to the Internet. As of December 31, 1999, residential customers subscribed to more than 8.6 million of these plans. Because the plans are not necessarily exclusive, the same customer can take advantage of more than one plan. Any discount plan must be submitted by Telefónica de España to the regulatory agency for prior administrative approval.

S-36
The following table sets forth the composition of Telefónica de España’s domestic fixed-link telephone revenues for the last three years for the categories shown below. Telefónica de España’s revenues from leased circuits and sales of terminals are not shown.

<table>
<thead>
<tr>
<th>Rate Category</th>
<th>Percentage of Domestic Fixed-Link Revenue 1997 (Percentages)</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Monthly rate</td>
<td>22</td>
<td>21</td>
<td>24</td>
</tr>
<tr>
<td>Local calls</td>
<td>17</td>
<td>20</td>
<td>21</td>
</tr>
<tr>
<td>Provincial calls</td>
<td>10</td>
<td>9</td>
<td>8</td>
</tr>
<tr>
<td>Interprovincial calls</td>
<td>29</td>
<td>21</td>
<td>16</td>
</tr>
<tr>
<td>International calls</td>
<td>10</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Fixed-to-mobile and other</td>
<td>12</td>
<td>20</td>
<td>22</td>
</tr>
</tbody>
</table>

During 1998, revenues from interprovincial long-distance and international calls were adversely affected by increased competition and discounted pricing. These trends continued in 1999, but revenues improved due to a strong increase in traffic. Since the beginning of 1999, following the introduction of competition, Telefónica de España has also experienced some loss in market share for provincial and fixed-to-mobile calls.

Comparative Pricing Information

The table below provides comparative monthly fee pricing information with respect to the other principal European operators:

<table>
<thead>
<tr>
<th>Rate Category</th>
<th>Telefónica</th>
<th>Deutsche Telekom</th>
<th>France Telecom</th>
<th>Telecom Italia</th>
<th>British Telecom</th>
</tr>
</thead>
<tbody>
<tr>
<td>Residential(1)</td>
<td>1,442</td>
<td>1,820</td>
<td>1,641</td>
<td>1,547</td>
<td>2,109</td>
</tr>
<tr>
<td>Business(1)</td>
<td>1,442</td>
<td>1,820</td>
<td>1,902</td>
<td>2,269</td>
<td>3,407</td>
</tr>
</tbody>
</table>

The table below shows the prices for three minute calls of other principal European operators:

<table>
<thead>
<tr>
<th>Rate Category</th>
<th>Business Hours</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Telefónica</td>
</tr>
<tr>
<td>Local</td>
<td>13</td>
</tr>
<tr>
<td>National long distance</td>
<td>90</td>
</tr>
<tr>
<td>International</td>
<td>170</td>
</tr>
</tbody>
</table>

(1) Tariffs are stated in pesetas. Excludes value-added taxes.
Source: Eurodata, Tarifa, and the operators.

The table above shows that rates charged by Telefónica de España are generally higher than those charged by the other principal European operators for domestic and international long-distance calls and lower for local calls. This reflects the failure to complete the rate rebalancing prior to the liberalization of the fixed-link telecommunications market in accordance with European Union directives.

Interconnection Prices

The tariffs that Telefónica de España is permitted to charge other operators of fixed-link voice telephone services for access to its local network were initially established by the Ministerial Order dated March 18, 1997. The tariffs that Telefónica de España was permitted to charge mobile operators were based on agreements entered into with the mobile operators within the framework of prior administrative provisions.

Under the General Law on Telecommunications, interconnection prices may be freely negotiated. However, prices charged by Telefónica de España, as the dominant operator, are determined by the Interconnection Offer.
Framework, which was initially proposed by us in 1998 and subsequently modified and approved by the Ministry of Science and Technology. Under our proposal, interconnection prices charged to Telefónica de España’s competitors were consistent with Telefónica de España’s costs. However, the Ministerial Order dated October 29, 1998, which approved the Interconnection Offer Framework, lowered interconnection prices below Telefónica de España’s actual costs. In addition, on November 26, 1998, interconnection prices charged to mobile operators were approved, bringing them in line with those approved for the fixed-line operators. These prices became effective as of July 1, 1999. Because it is providing interconnection services to its competitors at prices below its costs, Telefónica de España is not able to compete as effectively in the long distance and international services markets as these companies, which contributed to its decline in market share in 1999. Accordingly, Telefónica de España filed an appeal with the Sala de lo Contencioso Administrativo de la Audiencia Nacional Sección VII against the Interconnection Offer Framework.

Telefónica’s Interconnection Offer Framework has been amended by means of a Resolution issued by the Telecommunications Market Commission on May 2000, which entered into force on June 17, 2000. The amendment has generally reduced interconnection fees to be paid by holders of Type A and Type B individual licenses.

The table below sets forth interconnection prices for switched traffic established by the Ministerial Order dated October 29, 1998. These prices were in effect until June 16, 2000.

<table>
<thead>
<tr>
<th>Interconnection Tariffs (Access and Termination)</th>
<th>Peak Rate(1)</th>
<th>Standard Rate(2)</th>
<th>Discounted Rate(3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type B licenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local</td>
<td>1.65</td>
<td>1.65</td>
<td>1.05</td>
</tr>
<tr>
<td>Single transit(4)</td>
<td>2.65</td>
<td>2.31</td>
<td>1.62</td>
</tr>
<tr>
<td>Double transit(5)(6)</td>
<td>5.11</td>
<td>4.44</td>
<td>3.11</td>
</tr>
<tr>
<td>Type A licenses</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Single transit(4)</td>
<td>3.45</td>
<td>3.00</td>
<td>2.10</td>
</tr>
<tr>
<td>Double transit(5)</td>
<td>6.64</td>
<td>5.77</td>
<td>4.04</td>
</tr>
</tbody>
</table>

(1) Applies weekdays from 8:00 a.m. to 5:00 p.m. and Saturdays between 8:00 a.m. and 2:00 p.m.
(2) Applies weekdays, from 5:00 p.m. to 10:00 p.m.
(3) Applies Sundays and national holidays, Saturdays after 2:00 p.m. and weekdays from 10:00 p.m. to 8:00 a.m.
(4) Principally provincial service.
(5) Principally interprovincial service.
(6) Applies only to operators with a Type B national license.

S-38
On May 25, 2000, the Telecommunications Market Commission approved new interconnection tariffs, which took effect on June 17, 2000. These new tariffs are set forth below.

<table>
<thead>
<tr>
<th></th>
<th>Interconnection Tariffs (Access and Termination) Plato/minute</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Standard Rate(1)</td>
</tr>
<tr>
<td>Local</td>
<td>1.50</td>
</tr>
<tr>
<td>Single transit</td>
<td>2.50</td>
</tr>
<tr>
<td>Double transit</td>
<td>3.60</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Interconnection Tariffs (Transit) Plato/minute</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Standard Rate(1)</td>
</tr>
<tr>
<td>National transit</td>
<td>3.10</td>
</tr>
<tr>
<td>National transit and local extension</td>
<td>3.60</td>
</tr>
<tr>
<td>Uncentral transit</td>
<td>0.68</td>
</tr>
</tbody>
</table>

(1) Applies weekdays from 8:00 a.m. to 8:00 p.m.
(2) Applies on Saturdays, Sundays and national holidays, and weekdays from 8:00 p.m. to 8:00 a.m.

Customer Service

In order to adequately respond to the new competitive environment, considerable efforts were undertaken during 1998 and 1999 to improve the quality of customer service. Customers were segmented so that the specific needs of each segment could be served. In addition, we increased our call-center capacity to further focus on customer service. After creating 80 new products and services in 1998, we developed 70 additional products and services in 1999. Some of the new products created in 1999 were New Domos and Familiel terminals, new discount calling plans, such as Europa 15, and new calling plans aimed at businesses offering reduced rates on local and long-distance calls. These programs have helped slow Telefónica de España’s loss of market share. Another new product offering is Telefónica de España’s asymmetric digital subscriber line, or ADSL service, which is offered indirectly through Gigacom ASDL. This service increased to approximately 4.6 million lines in 1999, or 28% of total lines. We expect to expand our offering of this service in 2000.

The business customer service model developed by Telefónica de España, which is aimed at achieving the highest degree of efficiency in customer service, includes the following:

- A 24-hour personal customer service line for purchasing any type of product and service, as well as for handling customer queries.
- The Tiendas Telefónica (“Telefónica stores”) (105 at year-end 1999) where customers can test and buy all of the products marketed by Telefónica.
- Telefónica’s “virtual” store, accessible from InfoVía Plus and the Internet, which offers the ability to order and purchase online all of the services and products offered by Telefónica.
- Catalog sales through which any customer can buy a product by placing a toll-free call to a commercial customer service number.

Telefónica is devoting special attention to the corporate customer market, with a sales force that exclusively handles this segment and seeks customized solutions for each type of customer.
**Telefónica Telecomunicaciones Públicas**

Telefónica Telecomunicaciones Públicas, S.A. (formerly known as Cabinas Telefónicas, S.A. or "Cabilte") is a wholly owned subsidiary of Telefónica de España, S.A. which operates pay telephones in outdoor and indoor locations, including airports, bus stations, train stations, recreational parks, hospitals and gas stations. In addition, Telefónica Telecomunicaciones Públicas:

- manages phone booths in public thoroughfares and public payphones that are contracted from Telefónica de España
- markets prepaid telephone cards
- generates revenues from advertising on public phone booths

Telefónica de España continues to own the public phone booths although such assets may be transferred to Telefónica Telecomunicaciones Públicas in the future.

At December 31, 1999, Telefónica Telecomunicaciones Públicas had 37,445 pay telephones installed in indoor locations, 66,889 payphones installed in outdoor locations and 668 mobile call centers installed in special tourist locations. On average, a premium of 35% over the price of a basic telephone call is charged for calls placed from pay telephones located on private premises.

For the year ended December 31, 1999, Telefónica Telecomunicaciones Públicas sold 12.8 million prepaid cards for a net total of Ptas. 16,662 million. Revenues from advertising totaled Ptas. 1,875 million for the year ended December 31, 1999.

**Mobile Services in Spain—Telefónica Servicios Móviles**

Telefónica Servicios Móviles offers analog cellular service, known as ETACS 900 or extended total access communications system, and digital cellular services, known as GSM or global system for mobile communications, in Spain. Telefónica Servicios Móviles offers analog service under the name "MoviLine" and digital cellular services under the name "MoviStar".

The Spanish mobile communications market grew significantly in 1999, experiencing one of the highest growth rates in Europe. At December 31, 1999, there were more than 15 million domestic mobile telephony users in Spain, and the level of penetration in the Spanish wireless market was more than 37% by such date. At December 31, 1999, Telefónica Servicios Móviles had 9,052,347 active customers, of whom 8,362,209 subscribed to the MoviStar Service and 690,138 of whom subscribed to the MoviLine Service. The two services had a combined increase in subscribers of 85% over the previous year.

During 1999, Telefónica Servicios Móviles consolidated its leadership position in Spain in terms of market share. At December 31, 1999, Telefónica Servicios Móviles had a market share of 60.3% in the overall Spanish cellular market and a market share of 58.4% for digital cellular services. As a result of having increased its client base by 4.1 million subscribers in 1999, Telefónica Servicios Móviles was the fastest growing cellular operator in Europe during 1999 in terms of number of subscribers added. Such growth was principally due to the success of its MoviStar Activa pre-paid cellular card service.

Telefónica Servicios Móviles offers its subscribers a broad range of mobile communications services in each of its two principal services:

- MoviLine, Telefónica Servicios Móviles' analog service, is the optimum service for those customers who require the most expansive coverage throughout Spain
- MoviStar, a digital cellular service, is the leader in the Spanish market with the largest customer base and the most expansive coverage and variety of service among the providers of digital cellular service
At December 31, 1999, Telefónica Servicios Móviles had approximately 3,400 employees.

Revenues from the consolidated operations of Telefónica Servicios Móviles for the year ended December 31, 1999 increased 35.2% to Pesos 452,809 million from Pesos 334,468 million. This represented 11.9% of Telefónica's consolidated revenue from operations for 1999. Including inter-company sales, revenue from operations for the year ended December 31, 1999 increased 32.9% to Pesos 622,112 million from Pesos 468,019 million. This represented 14.4% of Telefónica's consolidated revenue from operations for 1999. Income before tax increased Pesos 18,899 million, or 15.8%, to Pesos 138,472 million from Pesos 119,573 million in 1998. At December 31, 1999, Telefónica Servicios Móviles managed total assets of Pesos 570,732 million. During 1999, Telefónica Servicios Móviles made tangible and intangible investments of Pesos 130,572 million. In 1999, traffic through Telefónica Servicios Móviles' network was 11,152 million minutes, representing an increase of 57.9% over the previous year.

The table below sets out information with respect to the development of Telefónica Servicios Móviles' business for the periods indicated:

<table>
<thead>
<tr>
<th>Year ended December 31,</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cellular penetration in Spain(1)</td>
<td>11.1%</td>
<td>17.9%</td>
<td>37.6%</td>
</tr>
<tr>
<td>Subscribers at period end</td>
<td>3,187,696</td>
<td>4,894,264</td>
<td>9,052,347</td>
</tr>
<tr>
<td>Analog</td>
<td>1,100,595</td>
<td>893,192</td>
<td>690,138</td>
</tr>
<tr>
<td>Digital</td>
<td>2,087,101</td>
<td>4,001,072</td>
<td>8,362,209</td>
</tr>
<tr>
<td>Subscriber growth</td>
<td>35.9%</td>
<td>53.5%</td>
<td>85%</td>
</tr>
<tr>
<td>Average minutes of use per subscriber per month</td>
<td>142</td>
<td>140</td>
<td>130</td>
</tr>
<tr>
<td>Average revenue per subscriber per month (pesetas)</td>
<td>10,327</td>
<td>9,652</td>
<td>7,761</td>
</tr>
<tr>
<td>Minutes sent through the networks (millions)</td>
<td>4,700</td>
<td>6,400</td>
<td>11,332</td>
</tr>
<tr>
<td>Network locations</td>
<td>4,833</td>
<td>6,927</td>
<td>9,120</td>
</tr>
<tr>
<td>Points of sale</td>
<td>9,200</td>
<td>11,000</td>
<td>13,000</td>
</tr>
<tr>
<td>Geographical coverage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Analog</td>
<td>95%</td>
<td>98%</td>
<td>98%</td>
</tr>
<tr>
<td>Digital</td>
<td>87%</td>
<td>98%</td>
<td>98%</td>
</tr>
<tr>
<td>Population coverage</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Analog</td>
<td>99%</td>
<td>99%</td>
<td>99%</td>
</tr>
<tr>
<td>Digital</td>
<td>97%</td>
<td>99%</td>
<td>99%</td>
</tr>
</tbody>
</table>

(1) Subscribers per 100 inhabitants.

Telefónica Servicios Móviles offers several different pricing options for cellular service. Approximately 39% of our subscribers have contracts with us, while 61% use prepaid calling cards. Of our contracted subscribers, approximately 65% are residential customers and 35% are business customers. The “personal” pricing option is available for both analog and digital subscribers and features a relatively low monthly fixed fee and relatively high air time usage charges. The “general” pricing option also available for both analog and digital subscribers, is designed for high volume users and therefore combines a relatively high monthly fee with relatively low air time usage charges. For large corporate users, Telefónica Servicios Móviles frequently negotiates discounts based on the general pricing option. In addition, for digital service Telefónica Servicios Móviles offers family, multiline and multiplan pricing options.

In order to stimulate usage among subscribers who would like to use cellular service without committing to a monthly service charge, Telefónica Servicios Móviles launched a calling-card based prepayment option in February 1997 for digital subscribers (the Activa Clásica card). Subsequently, new Movistar prepaid card options were added (the Activa Joven, Activa 4 and Activa Próxima cards), offering a range of options capable of meeting the requirements of all types of customers. Currently, subscribers have the option to migrate between...
cards, therefore making it easier for the customer to choose the card that is most convenient at any given time. At December 31, 1999, Telefónica Servicios Móviles had 5,339,590 active prepaid cards for the Movistar service.

Since September 1998, MoviLine has offered a prepayment service similar to that offered by Movistar. At December 31, 1999, MoviLine had 165,565 customers using prepaid cards. The number of customers with prepaid cards rose from 16% at December 1997 to 37% at December 1998 to approximately 61% at December 31, 1999. Telefónica Servicios Móviles expects this trend to continue in the near future.

In addition, Movistar Consumer Plans are being marketed in order to supplement the range of available pricing options for customers. For example, multiplan pricing options offer lower per-minute fees (which do not vary between peak and off-peak) than average per-minute rates under the personal or general options, in exchange for higher fixed monthly fees.

MoviLine's pricing changed significantly as a result of the publication of new tariffs for analog cellular telephony by the Ministry of Science and Technology in September 1998. These tariffs had not been revised since 1995. The tariff reductions will allow MoviLine to compete more effectively with digital cellular services on the basis of price. Nevertheless, MoviLine's rates are still subject to prior regulatory approval.

Telefónica Servicios Móviles has continuously sought to achieve the highest degree of customer satisfaction through emphasizing the following factors:

- **Broad Coverage:** For international coverage, at year-end 1999 Telefónica Servicios Móviles had roaming agreements with 181 operators in 93 foreign countries. In addition, Telefónica Servicios Móviles offers its clients the Americas service for those countries in the Americas that do not use GSM technology, and the Global service which provides customers with an Inmarsat terminal that makes it possible to have worldwide coverage.

- **Network Quality:** In order to improve the coverage and degree of effectiveness of the network, Telefónica Servicios Móviles continued its investment process in 1999 with the installation of over 2,000 new locations. In addition, Telefónica Servicios Móviles devoted significant efforts to expanding vertical coverage, including by improving coverage inside buildings and in underground parking garages in large cities. Telefónica Servicios Móviles had cellular service capital expenditures of Ptas. 100.1 billion in 1997, Ptas. 92.3 billion in 1998 and Ptas. 130.6 billion in 1999.

- **Customer Service:** Although the quality and number of services are the starting points for customer satisfaction, direct customer service is of particular importance in the philosophy of Telefónica Servicios Móviles. Telefónica Servicios Móviles has a customer relations center which is available to the customer, free of charge, 24 hours per day, 365 days per year. In order to provide better communication with its customers, Telefónica Servicios Móviles has staff members who speak English, French, German, Italian and Portuguese, in addition to each official language of Spain. In addition to the increased number of persons devoted to customer service, a continuous training program has been developed in order to handle the over 52.3 million calls received in 1999 (approximately 85% more than 1998) at a high standard of quality.

- **Market Innovation:** The constant effort to determine new customer needs and develop products and services that satisfy these needs has been a critical factor in differentiating Telefónica Servicios Móviles' services from those of its competitors. As a result of this market-oriented focus, Telefónica Servicios Móviles offers a portfolio of over 150 value-added services and facilities, approximately 1/3 of which were launched in the past two years, a significant number of which were designed in the past year and 40 of which were designed in 1998. This wide range of services addresses the needs of Telefónica Servicios Móviles' special customers and its corporate clients.

The continued search for improvements in service quality and corporate processes has led Telefónica Servicios Móviles this year to develop an ambitious investment plan for research and development. In the areas of services development, marketing and network development, Telefónica Servicios Móviles benefited from
collaboration with TIDSA, a member of the Telefónica group, in addition to internal research and development. Research and development expenses totaled approximately Pesos 19,543 million in 1999 and Pesos 14,300 million in 1998.

New mobile services developed by Telefónica Servicios Móviles in 1999 include:

- **MoviStar Internet Premium**—permits billing on kbps of data transmitted rather than air time.
- **MoviStar Net**—enables users to reply to e-mails via their mobile phones.
- **Correo MoviStar**—full e-mail functionalities from users’ handsets.
- **Oleada.com**—first wireless application protocol, or WAP, portal introduced in the Spanish market, designed in collaboration with Terra Networks.

The services developed in 1998 include the following:

- **MoviStar Corporativo**—2000 allows companies to integrate communications between their fixed and mobile telephones.
- **MoviStar Enlace Oro**—offers companies the ability to connect their exchange to the MoviStar network.
- **MoviStar Datos Corporativos**—offers direct connection between MoviStar exchanges and companies’ routers.
- **MoviStar Datos Express**—groups a series of features aimed at improving the quality of data connections through increased access speed and increased reliability.
- **MoviStar Telemática, MoviStar InfoVia Plus, MoviStar Net, Asistente MoviStar**—feature data communications services upgrades providing for faster transmission speed and Internet services, among others.
- **MoviLine Óptima**—new prepayment arrangement for the MoviLine service that is marketed in a package along with a telephone without contracts and without monthly fees.
- **MoviStar Activa Próxima and Activa Elección**—other prepayment options.
- **Agenda Vocal MoviLine**—enables voice recognition dialing.
- **High Quality Service (Enhanced Full Rate codec)**—enables sound quality comparable to that offered by a fixed telephone.

**Regulation**

In June 1999 and July 2000, the Telecommunications Market Commission determined that Telefónica Servicios Móviles and Airtel were dominant operators in the mobile services market and imposed certain additional obligations on them. Telefónica Servicios Móviles and Airtel must:

- provide interconnection to their networks on a non-discriminatory basis
- allow open access to telecommunications networks and special access to closed groups of users
- submit to the Telecommunications Market Commission on an annual basis, separate audited accounts related to the different activities of each company, further, Decree-Law 7/2000 requires the dominant mobile operators to submit before the 31st of July of each year, their operating expenses for the last reported period to the Ministry of Economy, Ministry of Science and Technology and to the Telecommunications Market Commission.

In addition, in March 2000 and July 2000, the Telecommunications Market Commission determined that Telefónica Móviles España is a dominant operator in the national interconnection market, and imposed the following obligations.
• provide interconnection to its networks on a non-discriminatory basis
• set its prices in a transparent manner and on a cost-oriented basis
• submit to the Telecommunications Market Commission on an annual basis, separate accounts of the interconnection services, distinguishing those interconnection services internally provided and those provided to third parties, and accounts for the other services.

Competition

Telefónica Servicios Móviles has one of the two operating licenses in Spain for providing GSM mobile services on the 900 MHZ wavelength. Airtel, whose shareholders include Vodafone Airtouch and British Telecom, has the other GSM license and commenced service in October 1995. At December 31, 1999, Airtel had 4,938,000 cellular subscribers, while Telefónica Servicios Móviles had 9,052,347. Royal Decree 1252/1997 of July 24, granted GSM license holders (Telefónica Servicios Móviles and Airtel) the possibility of providing personal communications services using GSM technology on the 1800 MHZ wavelength. Telefónica Servicios Móviles acquired the DCS 1800 license for Pesos 28,814 million in 1998 and commenced offering services pursuant to this license at the beginning of 1999.

On June 24, 1998, the third license for personal communications services using the DCS 1800 standard was granted to the consortium Retevisión Móvil, which commenced operations in January 1999 under the trade name Amena. Telefónica Servicios Móviles experienced some loss of market share in 1998 and 1999 as a result of the entrance of this new competitor into the market.

Telefónica Servicios Móviles seeks to achieve the highest degree of customer satisfaction by emphasizing:
• broad coverage
• network quality
• customer service
• market innovation

The government has announced that it is studying alternatives to increase competition in the mobile communications sector. However, as a result of the significant barriers to entry into the mobile telephony business as well as the limited nature of the radio frequency spectrum, Telefónica Servicios Móviles does not expect that the Spanish market will have more than four competitors in the medium term.

On July 8, 1999, the Telecommunications Market Commission granted to Telefónica Servicios Móviles for a period of 20 years a Type B1 license for the provision of fixed-line telephone service. Telefónica Servicios Móviles applied for this license in order to compete on equal terms with Airtel, the second largest mobile services operator in Spain, which had already been granted a license of this type. Telefónica Servicios Móviles' license requires it to maintain its fixed-line and mobile service accounts separately in order to ensure that the Telecommunications Market Commission is able to clearly identify whether Telefónica Servicios Móviles cross-subsidizes its operations and the rates it charges for each service.

Under this Type B1 individual license, Telefónica Móviles España has, among others, the obligations of providing services for a minimum of 4 years, and assume certain quality service commitments, the breach of which will result in indemnity for its subscribers. Telefónica Móviles España started the provision of fixed telephone services on November 16, 1999. Airtel Móvil, S.A. has disputed the resolution granting the B1 individual license to Telefónica Móviles España, S.A.

MensaTel

MensaTel, the national paging operator of Telefónica Servicios Móviles, is the leader in the Spanish market for radio paging with a customer base of approximately 123,402 at December 31, 1999, of which 59,649 are
professional or business segment customers and 63,753 are residential users of MensaTel Beeper. This customer base represents an estimated market share of 63%, compared to an estimated market share of 78% in 1998.

**Radiored**

Radiored is the only provider of closed user group radio telephony services, or trunking, operating throughout Spain. Radiored had an estimated market share of approximately 80% in 1999. The number of subscriber terminals in operation at December 31, 1999 was 30,004, an increase of 22.6% over 1998.

**New Telephony Licenses**

In March 2000, Telefónica Servicios Móviles was awarded a license in Spain for the use of third-generation cellular telephone technology. This technology known as universal mobile telecommunications system, or UMTS, allows cellular telephones to carry data and Internet services. Telefónica Servicios Móviles paid approximately Pes. 21,750 million for this license. Telefónica Servicios Móviles expects to have to make significant investments in the future in order to develop these services. Some operators who were unsuccessful in their own bids to win UMTS licenses have contested the decision that awarded the four UMTS licenses, including the license awarded to Telefónica Servicios Móviles.

We intend to participate in the selection process for UMTS licenses in France, Switzerland, Germany and Italy. For each of these countries, we have entered into arrangements with local partners to compete for UMTS licenses. Our local partners are as follows: Compagnie Suez Lyonnaise des Eaux (France), Sonera Corporation and One Tel (Switzerland), Sonera Corporation (Germany), and ACEA, Sonera Corporation, Banco di Roma and others (Italy). We have recently decided to also compete for UMTS licenses in Sweden and Austria and we will consider, on a case-by-case basis, whether to participate in other European UMTS licensing contests. On August 17, 2000, we, and our partner Sonera Corporation, were awarded one of the six UMTS licenses auctioned in Germany. The consortium won the license with a final offer of approximately €8.5 billion.

**Media Communications—Telefónica Media**

Telefónica Media conducts our audiovisual and media business in Spain and Latin America. During 1998 and 1999, we strengthened our position in the audiovisual market in order to take advantage of synergies between our various areas of activity, including media, broadcasting and audiovisual content offerings.

**Vía Digital**

In September 1997, we began to offer direct-to-home (DTH) satellite television service in Spain through DTS Distribuidora de Televisión Digital, S.A. ("DTS"), a joint venture along with a number of television broadcasters. DTS markets its services under the Vía Digital trademark. At December 31, 1999, Vía Digital had approximately 440,000 subscribers. For the year then ended, Vía Digital had operating revenues of approximately Pes. 23,000 million and a net loss of Pes. 31,424 million. We account for our interest in Vía Digital by the equity method.

During 1999, we increased our ownership interest in Vía Digital to 68.6%. In January 2000, Vía Digital issued additional ordinary shares. We purchased some of these shares, but fewer than our proportionate interest in the company. As a result, our interest in Vía Digital declined to 48.6%. As part of the capital increase, we gave a new shareholder of Vía Digital who subscribed for the majority of the capital increase the right to require that we either (i) repurchase, if legally permitted, or (ii) identify a buyer who will purchase on June 30, 2003, its interest in Vía Digital at the price paid by it plus interest as provided in the agreement. We also have the right exercisable through that date to require such shareholder to sell to our designee its interest at such price.

Vía Digital offers more than 65 video broadcast channels, 30 audio channels, 16 radio broadcast channels, as well as interactive services through its nationwide direct-to-home satellite service. Vía Digital’s programming
offerings and interactive television service provide its subscribers with an integrated offering of high-quality entertainment, information and services.

In March 1999, Via Digital acquired from TVE Temática the exclusive rights to broadcast the United European Football Association Champions League on pay-per-view through the 2002-2003 season. In June 1999, Sogecable and Telefónica Media entered into an agreement relating to joint broadcast rights for the “National Championship Soccer League” and the “King’s Cup of Spain” through the 2008-2009 season. These matches were previously broadcast on an exclusive basis by Canal Satellite Digital and Canal Plus España. As part of this agreement, Telefónica Media granted to Sogecable joint rights to broadcast the United European Football Association Champions League. These matches were previously broadcast by Telefónica Media on an exclusive basis.

Via Digital is subject to competition from Canal Satellite Digital, which is owned by Sogecable. Sogecable’s shareholders include Grupo Prisa, a Spanish media company, Canal Plus France and other financial shareholders. Canal Satellite Digital began offering satellite-based broadcasting service in March 1997. Via Digital also competes with Quiero TV, which was launched by Retevisión in May 2000. In the near future, with the entrance of new cable TV operators, Via Digital expects the number of competitors and services on offer to increase.

**Antena 3**

Antena 3 was one of the leading private commercial television stations in Spain in 1999 in terms of advertising share and audience share. Antena 3 was launched in December 1989 and began to broadcast in January 1990 shortly after the introduction of commercial television in Spain. In July 1997, the Telefónica group acquired a stake in Antena 3. In February 1999, Telefónica Media acquired an additional 17.1% stake in Antena 3 for Ptas. 19,538 million. In July 1999, it acquired an additional 6.4% interest for Ptas. 7,468 million. As a result, as of December 31, 1999, Telefónica Media directly owned 47.2% of Antena 3. We account for our interest in Antena 3 by the equity method.

Since we acquired a stake in Antena 3 TV in 1997, Antena 3’s operating revenues have increased from Ptas. 64,297 million in 1997 to Ptas. 73,698 million in 1998 and Ptas. 90,967 million in 1999. After-tax profits also reflect the corporate reorganization that was undertaken at Antena 3, helping Antena 3 to achieve Ptas. 20,112 million in net profits in 1999 compared to net profits of Ptas. 13,143 million in 1998 and Ptas. 3,648 million in losses in 1997.

Antena 3’s objectives during 1999 were three-fold:

- strengthening its leadership among private Spanish television stations and among the most attractive audiences for advertisers. Antena 3 is the leader among viewers who are 55 years of age and under, in the middle and upper income class and reside in towns with more than 10,000 inhabitants (representing over half of the Spanish population) with 22.8% of the market
- substantially reducing Antena 3’s cost basis
- diversifying into new areas of business such as theme channels and interactive television

The development of new audiovisual broadcasting technologies such as digital terrestrial television as well as the granting of licenses to new television operators may adversely affect Antena 3’s advertising revenues as advertisers reallocate their advertising budgets.

**Telefónica Media’s Holdings in Latin America**

As a result of our decision to reallocate all media and audiovisual assets to Telefónica Media, Telefónica Internacional has transferred to Telefónica Media its holdings in the following entities:
• **Torneos y Competencias.** Torneos y Competencias, in which Telefónica Internacional held a 20% stake at December 31, 1999, holds the exclusive broadcasting rights for Argentine soccer. It is also the lead company in a group which is involved in the sporting events business.

• **Atlántida Comunicaciones S.A.** In 1998, Telefónica Internacional acquired a 30% stake in this Argentine holding company, which owns the publishing company Atlántida and the Argentine television channels, Telefé and Televisoras Provinciales, as well as Radio Continental. This interest later declined to 26.8% as a result of the issuance by Atlántida Comunicaciones of additional ordinary shares. Telefónica Media has agreed to purchase the remaining interest in Atlántida Comunicaciones.

In January 2000 Telefónica Media agreed with affiliates of The Walt Disney Company and Grupo Clarín to purchase a 30% interest in Patagonik Film Group for Ptas. 1,428 million. Patagonik is a film content production company, based in Argentina, that produces audiovisual content for Hispanic markets in Latin America and the United States.

**Other Activities**

Telefónica Servicios Audiovisuales is the principal provider in Spain and Latin America of satellite and television audiovisual technical services and signal compression and up-links for satellites.

In 1999 Telefónica Media acquired all of the shares of Uniprex, which owns the Onda Cero radio network, for Ptas. 18,040 million. Onda Cero is a trademark of Uniprex under which approximately 100 radio stations operate. These stations maintain association agreements with approximately 80 additional radio stations.

In addition, we and Pearson plc, a multinational media company, entered into an agreement in June 1999 to broaden our strategic alliance, through Recoletos Compañía Editorial, to include Internet content and audiovisual services in the Spanish and Portuguese-speaking markets. Under this agreement, we acquired a 5% stake in Pearson plc for Ptas. 103,391 million and Pearson plc acquired our 20% stake in Recoletos.

**International Business in the Americas—Telefónica Internacional**

The Telefónica group's international business in Latin America is conducted through Telefónica Internacional. Under the reorganization of our business along global business lines announced by our Board on January 12, 2000, some or all of some of our current lines of business, including Telefónica Internacional, may be combined with other business lines.

In 1999, Telefónica Internacional solidified its leadership position in the telecommunications sector in Latin America by:

• strengthening the competitive position of the operators under its management
• widening its geographical area of operations throughout Latin America

As of December 31, 1999, the companies managed by Telefónica Internacional had 6.7 million cellular subscribers and approximately 600,000 cable television subscribers, and managed 18.2 million access lines in service.
The following tables set forth information (including market share data to the extent such information is available) with respect to the principal telecommunications operators that are members of the Telefónica Internacional group. Information is given as of December 31, 1999, unless otherwise specified.

<table>
<thead>
<tr>
<th>Company</th>
<th>Country</th>
<th>Population (in Millions at December 31, 1999)</th>
<th>Services Provided and Market Share</th>
<th>Competition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compañía de Telecomunicaciones de Chile</td>
<td>Chile</td>
<td>15.0</td>
<td>Basic telephone (86%) Domestic long distance (37%) International long distance (28%) Public telephone (49%) Mobile telephone Leasing and sale of equipment and terminals Cable television Paging Data transmission</td>
<td>All existing telephone services in Chile are deregulated</td>
</tr>
<tr>
<td>Telefónica de Argentina</td>
<td>Argentina</td>
<td>36.6</td>
<td>Basic telephone (100%) Domestic long distance (54%) International long distance (55%) Mobile telephone (24%) Paging Yellow pages Internet-related services Value-added services</td>
<td>Free competition for domestic and international basic and long-distance telephone services.</td>
</tr>
<tr>
<td>Telefónica del Perú</td>
<td>Peru</td>
<td>25.2</td>
<td>Basic telephone Long distance Mobile telephone (70%) Cable television Yellow pages Paging Data transmission</td>
<td>Local and domestic and international long-distance telephone services have been open to competition since August 1998. The remainder of the services were already provided on a competitive basis.</td>
</tr>
<tr>
<td>Compañía Riogrande de Telecomunicações</td>
<td>Brazil</td>
<td>9.5(1)</td>
<td>Basic telephone (100%) Leasing of data transmission lines Value-added services Domestic long distance (71%) Public telephone</td>
<td>Monopoly in basic telephone services until the commencement of operations of mirror licensees (authorized to provide local and intra-regional service) and Embratel (only intra-regional) as of July 1999. Duopoly in mobile telephony.</td>
</tr>
<tr>
<td>CRT Celular</td>
<td>Brazil</td>
<td>9.5(1)</td>
<td>Cellular telephone (84%)</td>
<td>Duopoly until 2000/2001 when personal communications services licenses will be auctioned.</td>
</tr>
<tr>
<td>Compañía Anónima de Teléfonos de Venezuela</td>
<td>Venezuela</td>
<td>23.8</td>
<td>Basic telephone Mobile telephone Yellow pages</td>
<td>Monopoly until November 2000 in basic telephony and yellow pages. The remainder of the service liberalized.</td>
</tr>
<tr>
<td>Telefónica Larga Distancia de Puerto Rico, Inc.</td>
<td>Puerto Rico</td>
<td>3.8</td>
<td>Long-distance services</td>
<td>Free competition.</td>
</tr>
<tr>
<td>Company</td>
<td>Country</td>
<td>Population (in Millions as of December 31, 1999)</td>
<td>Services Provided and Market Share</td>
<td>Competition</td>
</tr>
<tr>
<td>-------------------------------</td>
<td>---------</td>
<td>-------------------------------------------------</td>
<td>---------------------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Telecomunicações de São Paulo</td>
<td>Brazil</td>
<td>34.6(1)</td>
<td>Basic telephone (100%) Basic telephone (77%) Public telephony Data transmission Value-added services</td>
<td>Monopoly of basic telephone services until the commencement of operations of miniature licensees (authorized to provide local and intra-regional service) and Embratel (only intra-regional) as of July 1999. Duopoly in mobile telephony.</td>
</tr>
<tr>
<td>TELESP</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Telesul Celular Participações</td>
<td>Brazil</td>
<td>16.2(1)</td>
<td>Cellular telephony (67%)</td>
<td>Duopoly until 2000/2001 when personal communications services licenses will be auctioned.</td>
</tr>
<tr>
<td>Teleleste Celular Participações</td>
<td>Brazil</td>
<td>14.6(1)</td>
<td>Cellular telephony (63%)</td>
<td>Duopoly until 2000/2001 when personal communications services licenses will be auctioned.</td>
</tr>
<tr>
<td>Telesp Celular Participações</td>
<td>Brazil</td>
<td>34.6(1)</td>
<td>Cellular telephony (63%)</td>
<td>Duopoly until 2000/2001 when personal communications services licenses will be auctioned.</td>
</tr>
<tr>
<td>Telmónica El Salvador</td>
<td>El Salvador</td>
<td>6.2</td>
<td>Comprehensive telecommunications services(2) Cellular telephony (35%)</td>
<td>Free competition.</td>
</tr>
<tr>
<td>Telmónica de Centroamérica S.A.</td>
<td>Guatemala</td>
<td>11.8</td>
<td>Comprehensive telecommunications services(4) Cellular telephony (15%)</td>
<td>Free competition.</td>
</tr>
</tbody>
</table>

(1) Population of coverage area.
(2) Market share for outgoing international long distance was 22.5% through November 1999.
(4) Market share for outgoing international long distance was 24.7% through November 1999.
The following table sets forth additional information regarding the principal telecommunications operators that are members of the Telefónica Internacional group. Information is as of or for the year ended December 31, 1999, unless otherwise specified.

<table>
<thead>
<tr>
<th>Company</th>
<th>Total Equity (millions of $)</th>
<th>Employees</th>
<th>Total Revenues (millions of $)</th>
<th>Net Profit (loss) (millions of $)</th>
<th>Market Capitalization (millions of $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compañía de Telecomunicaciones de Chile</td>
<td>2,412</td>
<td>7,742</td>
<td>1,604</td>
<td>(95.2)</td>
<td>4,367</td>
</tr>
<tr>
<td>Telefónica de Argentina</td>
<td>3,340</td>
<td>12,206</td>
<td>3,398</td>
<td>458.4</td>
<td>15,648</td>
</tr>
<tr>
<td>Telefónica del Perú</td>
<td>1,342</td>
<td>5,289</td>
<td>1,241.9</td>
<td>196.3</td>
<td>2,815</td>
</tr>
<tr>
<td>Companhia Riograndense de Telecomunicações</td>
<td>806</td>
<td>n.d.</td>
<td>632.3</td>
<td>(76.1)</td>
<td>562</td>
</tr>
<tr>
<td>CRT Celular</td>
<td>231</td>
<td>760</td>
<td>369.0</td>
<td>(33.7)</td>
<td>516</td>
</tr>
<tr>
<td>Compañía Anónima de Teléfonos de Venezuela</td>
<td>4,740.3</td>
<td>14,769</td>
<td>2,642</td>
<td>137</td>
<td>3,518</td>
</tr>
<tr>
<td>Telefónica Larga Distancia de Puerto Rico, Inc.</td>
<td>101</td>
<td>276</td>
<td>77.9</td>
<td>(2.9)</td>
<td>not listed</td>
</tr>
<tr>
<td>Telecomunicações de São Paulo TELESPI</td>
<td>7,574</td>
<td>14,974</td>
<td>2,548</td>
<td>528</td>
<td>11,944</td>
</tr>
<tr>
<td>Tele Sudeste Celular Participações</td>
<td>504</td>
<td>2,415</td>
<td>820.4</td>
<td>23.7</td>
<td>2,596</td>
</tr>
<tr>
<td>Tele Leste Celular Participações</td>
<td>84.9</td>
<td>N/A</td>
<td>177.7</td>
<td>(44.9)</td>
<td>284</td>
</tr>
<tr>
<td>Teleesp Celular Participações</td>
<td>1,246.3</td>
<td>1,927</td>
<td>1,216</td>
<td>62</td>
<td>5,668</td>
</tr>
<tr>
<td>Telefónica El Salvador</td>
<td>82.1</td>
<td>296</td>
<td>54.3</td>
<td>(15.2)</td>
<td>not listed</td>
</tr>
<tr>
<td>Telefónica de Centroamérica</td>
<td>34.5</td>
<td>175</td>
<td>14.3</td>
<td>(23.5)</td>
<td>not listed</td>
</tr>
</tbody>
</table>

(1) Consolidated data.
(2) Data for the twelve-month period ended September 30, 1999.
The following table sets forth additional information regarding the principal telecommunications operators that are members of the Telefónica Internacional group. Information is as of or for the year ended December 31, 1999, unless otherwise specified.

<table>
<thead>
<tr>
<th>Company</th>
<th>Year Acquired</th>
<th>Interest(1)</th>
<th>Investment Costs(2)</th>
<th>Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compañía de Telecomunicaciones de Chile</td>
<td>1990</td>
<td>43.64%</td>
<td>585</td>
<td>Telefónica Internacional appoints the majority of board members.</td>
</tr>
<tr>
<td>Telefónica de Argentina</td>
<td>1990</td>
<td>27.2%</td>
<td>983</td>
<td>Telefónica Internacional has control of Telefónica de Argentina through its stake in COINTEL pursuant to a partnership agreement. In addition, Telefónica has a management contract with Telefónica de Argentina.</td>
</tr>
<tr>
<td>Telefónica del Perú</td>
<td>1994</td>
<td>40%</td>
<td>2,018</td>
<td>Telefónica Internacional appoints the majority of board members and has a management contract.</td>
</tr>
<tr>
<td>Companhia Riograndense de Telecomunicações</td>
<td>1996</td>
<td>15.36%</td>
<td>590.4</td>
<td>The consortium led by Telefónica Internacional has a management contract.</td>
</tr>
<tr>
<td>CRT Celular</td>
<td>1999</td>
<td>36.97%</td>
<td>471.7</td>
<td>The consortium led by Telefónica Internacional has a management contract.</td>
</tr>
<tr>
<td>Compañía Anónima de Teléfonos de Venezuela</td>
<td>1991</td>
<td>6.40%</td>
<td>301</td>
<td>Managed by GTE.</td>
</tr>
<tr>
<td>Telefónica Larga Distancia de Puerto Rico, Inc.</td>
<td>1992</td>
<td>98%</td>
<td>156.9</td>
<td>Telefónica Internacional appoints the majority of the board of directors.</td>
</tr>
<tr>
<td>Telecommuicações de São Paulo TELESPP</td>
<td>1998</td>
<td>19.29%</td>
<td>3,690</td>
<td>Managed by Telefónica Internacional, which has a management contract.</td>
</tr>
<tr>
<td>Tele Sudeste Celular Participações</td>
<td>1998</td>
<td>17.57%</td>
<td>1,190</td>
<td>Management by Telefónica Internacional with receipt of a management fee contract.</td>
</tr>
<tr>
<td>Tele Leste Celular Participações</td>
<td>1998</td>
<td>8.99%</td>
<td>142</td>
<td>Managed by Telefónica Internacional, which has a management contract.</td>
</tr>
<tr>
<td>Telesp Celular Participações</td>
<td>1998</td>
<td>5.53%</td>
<td>1,104</td>
<td>Managed by Portugal Telecom.</td>
</tr>
<tr>
<td>Telefónica El Salvador</td>
<td>1998</td>
<td>44.22%</td>
<td>52.0</td>
<td>Telefónica Internacional appoints the majority of the board of directors.</td>
</tr>
<tr>
<td>Telefónica de Centroamérica</td>
<td>1999</td>
<td>26.01%</td>
<td>26.3</td>
<td>Telefónica Internacional appoints the majority of the board of directors.</td>
</tr>
</tbody>
</table>

(1) Direct and indirect stake held by Telefónica, S.A.
(2) In millions of U.S. dollars at historical cost.

**Recent Tender Offers**

We recently completed tender offers for some of our Latin American affiliates. See "---Public Tender Offers" for a description of these tender offers.

S-51
Brazilian Activities

On July 29, 1998, Telefónica Internacional successfully bid for four of the 12 operators that were auctioned during the privatization of Telebrás, the Brazilian state-owned telecommunications monopoly. Telefónica Internacional-led consortiums acquired 51.79% of the voting shares of Telesp, Tele Sudeste Celular and Tele Leste Celular. In addition, Telefónica Internacional acquired a significant stake in the consortium, Portelcom, which successfully bid for Telesp Celular. The total purchase price paid for the acquisition of its interests in Telesp, Tele Sudeste Celular, Tele Leste Celular and Telesp Celular totaled Ptas. 825,557 million. Also during 1998, Tele Brasil Sul Participações, S.A., in which Telefónica Internacional holds a 52.93% stake, increased its stake in Companhia Riograndense de Telecomunicações to 85% of the voting shares.

In January 1999, as a result of adverse economic conditions in Brazil, Telefónica Internacional wrote down the book value of its investments in Brazil in the amount of Ptas. 119,374 million. In addition, on January 27, 1999, Telefónica Internacional prepaid its debt to the Brazilian government in connection with financing the acquisition of the privatized entities. As a result of the devaluation of the Brazilian real, Telefónica Internacional paid Ptas. 165,391 million less than the outstanding book value of its debt at December 31, 1998.

As of January 1999, we began including the results of Telesp, Tele Sudeste Celular and Tele Leste Celular in our results of operations on a fully consolidated basis in accordance with Spanish accounting principles. The remaining Brazilian interests held through Telefónica Internacional continue to be accounted for under the equity method.

Telesp

Telesp is one of the companies formed as a result of the breakup in May 1998 of Telebrás, the Brazilian state-owned telecommunications monopoly. Telesp provides fixed-line and other telecommunications services in the Brazilian state of São Paulo under concessions and licenses from Brazil’s federal government.

Prior to its corporate restructuring, Telesp was legally known as Telesp Participações S.A. and was a holding company made up of two principal operating company subsidiaries: Telecomunicações de São Paulo S.A. and Companhia Telefónica de Borda do Campo S.A. On November 30, 1999, these operating companies merged into Telesp Participações S.A. Certain other business combinations were effected and the new entity was named Telecomunicações de São Paulo S.A.—TELESP, as it is known today.

At December 31, 1999, SP Telecomunicações Holding S.A. owned approximately 46.20% of the voting capital of Telesp. Telefónica Internacional is the controlling shareholder of SP Telecomunicações and held, as of that date, through one of its subsidiaries, an additional 7.84% of the Telesp common stock. We therefore indirectly control Telesp.

At December 31, 1999, Telesp managed approximately 8,250,861 million access lines in service and had 9,548,289 million lines installed at that date. Access line penetration in Telesp’s area of service at December 31, 1999 was 23.8%.

Telesp is subject to competition for local telephone services from a “mirror” license holder. It is subject to competition for interprovincial long-distance services from a “mirror” license holder, Embratel and Embratel’s mirror license holder. Data transmission and value-added services have been liberalized in Brazil.

Telefónica Internacional has entered into a management contract pursuant to which Telefónica Internacional receives 1% of Telesp’s revenues until 2000, which amount will then be reduced to 0.5% through 2002, and then to 0.2% beyond that date. The contract expires December 31, 2003 and may be renewed.

Equity securities of Telesp are traded on the São Paulo, Rio de Janeiro and New York stock exchanges.
Tele Sudeste Celular

Tele Sudeste Celular is one of the companies formed as a result of the break up of Telebrás. Tele Sudeste Celular provides cellular telecommunication services in the Brazilian states of Rio de Janeiro and Espírito Santo under concessions from Brazil’s federal government. At December 31, 1999, Tele Sudeste Celular had approximately 1,852,000 subscribers and was the leading provider of cellular telecommunications services in the region.

At December 31, 1999 Sudesteccel Participações S.A. owned approximately 49.97% of the voting capital of Tele Sudeste Celular and had, together with Iochu Corporation, voting control over Tele Sudeste Celular. Telefónica Internacional is the controlling shareholder of Sudesteccel and held, through one of its subsidiaries, an additional 0.79% of the Tele Sudeste Celular equity capital at such date. We therefore indirectly control Tele Sudeste Celular.

Telefónica Internacional has entered into a management contract pursuant to which Telefónica Internacional will receive a variable amount depending upon changes in the market price for Tele Sudeste Celular’s shares and Tele Sudeste Celular’s pre-tax results and revenues from operations. In no event will the combined amount exceed 2% of Tele Sudeste Celular’s net revenues. The contract expires on August 4, 2003, and may be renewed.

Equity securities of Tele Sudeste Celular are traded on the São Paulo and New York stock exchanges.

Tele Leste Celular

At December 31, 1999, Telefónica Internacional held a 9% stake in Tele Leste Celular Participações S.A. Tele Leste Celular is the holding company which controls the cellular operators Telebahia Celular, which operates in the state of Bahia, and Telegipe Celular, which operates in the state of Sergipe. Tele Leste Celular had approximately 535,000 cellular customers at December 31, 1999. The operators controlled by Tele Leste Celular have been subject to competition since April 1998 from digital cellular operators.

Telefónica Internacional has agreed with Iberdrola, the majority shareholder in the consortium that controls Tele Leste Celular, to assume management responsibilities for Tele Leste Celular in exchange for a variable amount depending upon changes in:

- the market price for Tele Leste Celular’s shares
- Tele Leste Celular’s pre-tax results
- revenues from operations

This amount has been capped at 2% of Tele Leste Celular’s net revenues. The contract expires on August 4, 2003 and may be renewed.

Equity securities of Tele Leste Celular trade on the São Paulo and New York stock exchanges.

Teleesp Celular

As of December 31, 1999, Telefónica Internacional held a 6.9% stake in Teleesp Celular Participações S.A., the holding company which controls the cellular operator Teleesp Celular, which operates in the state of São Paulo. Telecom Portugal holds a majority stake in Teleesp Celular. At December 31, 1999, Teleesp Celular had approximately 2.9 million subscribers. Teleesp Celular has been subject to competition since November 1998 from digital cellular operators.

Equity securities of Teleesp Celular are traded on the São Paulo and New York stock exchanges.
Companhia Riograndense de Telecomunicações

Companhia Riograndense de Telecomunicações S.A. is the largest fixed-link telephone and value-added services operator in the Brazilian state of Rio Grande do Sul. Companhia Riograndense de Telecomunicações had approximately 1,630,157 access lines in service at December 31, 1999.

Under Brazilian regulations, Telefônica Internacional was obliged to sell its indirect ownership in Companhia Riograndense de Telecomunicações due to its acquisition of Telesp. On August 4, 2000, Telefônica Internacional closed the sale to Brasil Telecom of its entire stake in TBS Participações, S.A., representing approximately 85.12% of the voting shares of Companhia Riograndense de Telecomunicações, the fixed-line telephone operator in the state of Rio Grande do Sul, for approximately $500 million. The sale was necessary to comply with Brazilian regulations which do not allow ownership of more than one fixed-line telephone operator in Brazil. The sale of Telefônica's stake in TBS Participações, S.A. was a condition to ANATEL's approval of Telefônica's purchase of Telecomunicações de São Paulo, S.A., Telesp, the fixed-line telephone operator in the state of São Paulo.

CRT Celular

CRT Celular S.A., in which Telefônica Internacional indirectly held a 36.97% stake at December 31, 1999, was spun-off from Companhia Riograndense de Telecomunicações in January 1999. CRT Celular provides cellular services in the Rio Grande do Sul region in Brazil. CRT Celular had approximately 968,000 cellular subscribers at December 31, 1999.

Telefônica Internacional has entered into a management contract with CRT Celular under which TBS Celular receives 1% of CRT Celular's net revenues. The contract will expire in 2001 and may be renewed for an additional 5-year term upon agreement of the parties.

Equity securities of CRT Celular trade on the São Paulo stock exchange.

Other Principal Subsidiaries

Compañía de Telecomunicaciones de Chile

Compañía de Telecomunicaciones de Chile, in which Telefónica Internacional held a 43.6% stake at December 31, 1999, is the largest telecommunications operator in Chile. According to its estimates, Compañía de Telecomunicaciones de Chile owns approximately 89% of the access lines in service in Chile. Compañía de Telecomunicaciones de Chile provides:

- local telephone service
- domestic and international long-distances services
- mobile services
- multimedia services
- cable television services

Compañía de Telecomunicaciones de Chile managed 2,592,397 million lines in service at December 31, 1999, and had 1,153,794 million mobile and 268,970 cable television subscribers at that date.

In October 1998, Compañía de Telecomunicaciones de Chile acquired 100% of VTR Larga Distancia S.A. for $50 million in order to increase its share of the domestic and international long-distance markets.

In 1996, the cellular operations of Compañía de Telecomunicaciones de Chile and of the Chilean telecommunications company, VTR S.A., were merged to form Startel S.A. In December 1997, Compañía de
Telecomunicaciones de Chile acquired from VTR 45% of Startel and, as a result, Startel became a wholly-owned subsidiary of Compañía de Telecomunicaciones de Chile.

Compañía de Telecomunicaciones de Chile holds a 40% stake in the new company formed as a result of the merger between Metrópolis and Intercom. This company has become the second largest cable TV provider in Chile. In January 1999, Compañía de Telecomunicaciones de Chile and Sonda, the leading data transmission provider in Chile, signed a strategic alliance pursuant to which Compañía de Telecomunicaciones de Chile acquired a 60% stake in Sonda.

Equity securities of Compañía de Telecomunicaciones de Chile trade on the Santiago and New York stock exchanges under the symbol “CTC”.

Telefónica de Argentina

Telefónica de Argentina is a leading provider of fixed-line public telecommunications services and basic telephone services in Argentina. Until recently, Telefónica de Argentina owned virtually all public exchanges, the network of local telephone lines and the principal domestic long distance telephone transmission facilities in the southern half of Argentina, which includes most of the province of Buenos Aires and more than half of the city of Buenos Aires, including most of the downtown business district.

Recently, there has been a liberalization of the restrictions on competition in the market for telecommunications services in Argentina. New competitors are now operating in the southern region and throughout Argentina. As a result of the liberalization, Telefónica de Argentina is expanding its operations outside the southern region into the rest of Argentina, commonly known as the northern region. Currently, Telefónica de Argentina is licensed to provide local and domestic long-distance and international services, international data transmission and domestic and international telex services throughout Argentina.

Telefónica de Argentina’s telephone system had approximately 3.9 million lines in service at September 30, 1999. Based on net revenues during the fiscal year ended September 30, 1999, Telefónica de Argentina was the second largest private sector company in Argentina.

As of December 31, 1999, we held a 27.2% economic interest in Telefónica de Argentina through our 50% interest in Compañía de Inversiones en Telecomunicaciones, which in turn holds a 51.01% stake in Telefónica de Argentina.

By virtue of a shareholders’ agreement relating to Compañía de Inversiones en Telecomunicaciones, we exercise significant influence over Telefónica de Argentina’s planning, budgeting and dividend policy. We also have a management contract with Telefónica de Argentina under which we have agreed to manage Telefónica de Argentina’s business and provide services and expertise regarding Telefónica de Argentina’s entire range of activities in return for a percentage of Telefónica de Argentina’s operating margin equivalent to 9% of its gross margin prior to amortization and interest expenses.

Basic telephone services. Telefónica de Argentina held a license to provide basic telephone services on an exclusive basis in the southern region from November 8, 1990 through November 8, 1997. Argentine regulatory authorities subsequently extended the term of this exclusive license to October 10, 1999. The period between November 1997 and October 1999 is commonly known as the transition to competition. During this two-year transition period, Telefónica de Argentina and Telecom Argentina STET-France Telecom S.A. each continued to hold an exclusive license to provide basic telephone services in a defined region:

- Telefónica de Argentina in the southern region
- Telecom Argentina in the northern region

Following the transition period, these two companies no longer held exclusive licenses.
On March 31, 1999, Telefónica de Argentina was awarded a license to provide local as well as domestic and international long distance telephone services as well as international data transmission and domestic and international telex services in the northern region as of October 10, 1999, for an indefinite period of time. As a result, Telefónica de Argentina now provides basic telephone services throughout Argentina. Similarly, Telecom Argentina, Compañía de Teléfonos del Interior S.A., an affiliate of GTE Mobile International Inc., and Compañía de Teléfonos del Plata S.A., an affiliate of BellSouth, were awarded licenses to provide the same basic telephone services throughout Argentina as of October 10, 1999.

*Cellular and personal communications services.* Telefónica de Argentina provides cellular services and personal communication services through its wholly-owned subsidiary Telefónica Comunicaciones Personales S.A., which had approximately 1 million subscribers at December 31, 1999. Competition for both cellular telephone services and personal communication services varies by region.

Equity securities of Telefónica de Argentina trade on the Buenos Aires and New York stock exchanges under the symbol “TAR”.

*Telefónica del Perú*

At December 31, 1999, Telefónica Internacional held a 40.03% stake in Telefónica del Perú, the leading global communications operator in Peru. At such date, Telefónica del Perú had approximately 1.7 million lines in service, including public telephone lines operated by Telefónica del Perú, 712,000 mobile subscribers and 327,000 cable television subscribers. Telefónica del Perú was the largest company in Peru during the nine months ended September 30, 1999, in terms of revenue and net income.

Under a management contract between Telefónica Internacional and Telefónica del Perú, Telefónica Internacional provides Telefónica del Perú with management and technical support in exchange for management and technology transfer fees equivalent to 9% of its operating margin before depreciation and amortization and 1% of its revenues.

Equity securities of Telefónica del Perú trade on the Lima and New York stock exchanges under the symbol “TDP”.

*Telefónica Larga Distancia de Puerto Rico*

In June 1999, Telefónica Internacional purchased an additional 19% of the capital of Telefónica Larga Distancia de Puerto Rico, Inc. for Ptas. 7,049 million, increasing its interest in that company to 98%. At December 31, 1999, Telefónica Larga Distancia held an estimated 29% share of Puerto Rico’s long-distance market and an estimated 19% share of the Virgin Island’s long-distance market. In 1999, Telefónica Larga Distancia’s customers consumed 459.2 million minutes, 40.6% of which related to traffic with the United States.

During 1998, Telefónica Larga Distancia commenced offering fixed-link basic telephone service within Puerto Rico, following the rescission of the regulatory regime pursuant to which the local operator held exclusive rights with respect to the provision of intra-island fixed-link telephone service.

*Telefónica El Salvador*

In July 1998, Telefónica Internacional and Mesotel, an investment holding company formed by U.S. and Central American investors, acquired 51% of INTEL El Salvador S.A., now known as Telefónica El Salvador S.A. This company holds the second license for the provision of all telecommunications services throughout El Salvador. The total purchase price paid for the 51% stake in INTEL was approximately $41 million. A management contract and a technology transfer agreement between Telefónica Internacional and Telefónica El Salvador has been approved by the government of El Salvador. Under the management contract, Telefónica
Internacional provides Telefónica El Salvador with management support in exchange for management fees equivalent to 9% of its operating margin before depreciation and amortization and 1% of its revenues.

**Telefónica de Centroamérica**

In March 1999, Telefónica de Centroamérica, S.A., in which Telefónica Internacional and Mesotel have a stake, was awarded a mobile telecommunications license for personal communications services in Guatemala for $33 million. Telefónica Internacional had previously acquired a Guatemalan telecommunications company that held licenses for all telecommunications services except cellular services. All services are offered through Telefónica Guatemala, a subsidiary of Telefónica de Centroamérica.

**Impresora Comercial Publiguías**

On January 4, 1993, Telefónica Internacional and Compañía de Telecomunicaciones de Chile acquired 51% and 9%, respectively, of Impresora Comercial Publiguías, S.A., a telephone directory publisher in Chile. Telefónica Internacional invested approximately $6.3 million. Other partners include the Colombian group, Publicar, which holds a 19.6% stake and the Chilean group, Cochran-RR Donnelley, which holds a 20.4% stake. Impresora Comercial Publiguías entered into a contract with Compañía de Telecomunicaciones de Chile, which expires in 2002, pursuant to which Compañía de Telecomunicaciones de Chile receives 40% of Publiguías's overall billing. During 1999, Compañía de Telecomunicaciones de Chile received $27.7 million pursuant to this contract.

**Other Investments**

Telefónica Internacional also owns equity stakes in a number of other Latin American service providers, which are not under its management, including:

- **Compañía Anónima de Teléfonos de Venezuela (CANTV)**. CANTV, in which Telefónica Internacional held a 6.4% stake at December 31, 1999, is the leading provider of telecommunication services in Venezuela. At December 31, 1999, CANTV had 2,585,861 million access lines in service and 1,181,273 cellular customers.

- **Cablevisión S.A.** Cablevisión is an Argentine cable company in which Telefónica Internacional acquired a 33% stake in October 1997 and held a 35.7% stake at December 31, 1999. Cablevisión is the lead company in a group with 1,453,070 customers. This interest in Cablevisión is to be sold during 2000.

- **Infonet Services Corporation**. On December 16, 1999, Infonet Services Corporation, a data telecommunications firm that uses telecommunications tools to electronically link offices within a global company and to speed the transfer of information between them, completed its initial public offering. Our interest in Infonet declined to 14.35% as a result of the issuance of new shares in the offering.

**Worldwide Corporate Data Transmission—Telefónica Data**

Telefónica Data manages our data transmission business on a global basis. The Telefónica Data group consists of subsidiaries operating in each of the countries where data transmission services are being developed. The Spanish operating subsidiary of Telefónica Data group was renamed Telefónica Data España, S.A. and merged with Telefónica Servicios Avanzados de Información, S.A. and Telefónica VSAT, S.A. during 1999.

Telefónica Data has entered into collaboration agreements with Telefónica Internacional under which Telefónica Data has agreed to manage with Telefónica Internacional the data transmission operations of Telefónica Internacional's affiliates in some Latin American countries, including Argentina, Brazil and Chile.
Telefónica Data intends to become an overall provider of corporate communications solutions. As technological development permits, Telefónica Data will provide a single connection to data, voice and fax services, and through interconnection with the Internet protocol network, to:

- mobile services
- the traditional fixed-line network
- content available through the Internet

In July 1999, Telefónica Data España obtained an individual Type A license which will permit it to offer its corporate customers bundled voice and data services packages via one single connection. The license also allows interconnection with other operators and their users.

Telefónica Data's strategy includes the following objectives:

- emphasis on customer service with direct responsibility for customer satisfaction and the management of new distribution channels
- geographic expansion as a multinational company
- development of a single network infrastructure, with centralized management, and a platform of common services for all countries
- centralization of technological and development strategies
- development of a catalog of global services, including solutions customized for each market segment

Revenues from corporate data transmission in Spain totaled approximately Ptas. 95,000 million in 1999 and Ptas. 75,000 million in 1998. These amounts derive from services such as:

- *Iberpac Básico*—a data transmission service based on X.25 protocol which enables a reliable interchange of information between multiple destinations
- *UNO Service*—a data transmission service based on the X.25 protocol and on the Virtual Private Network (VPN). This service is marketed to large corporate customers like banks and insurance companies
- *Frame Relay*—a data transmission service designed to satisfy the use and interconnection requirements of Local Area Networks (LAN)
- *Infointernet*—a gateway to Internet service using the IP Network. Users access the Internet through a permanent connection to the IP Network
- *UNO IP Voz*—enables the transportation of voice and data using an exclusive line on the IP Network
- *Data&Voz*—permits integrations of voice and data transmission in one single line

During 1999, Telefónica Data's total number of end-user connections totaled 144,624. Its estimated market share for network services in Spain was approximately 91.4%. Most data transmission services are currently provided through a switch network that is independent from the fixed-line network.

In June 1998, Telefónica Data launched the new Internet Protocol network, which enhances our ability to market value-added services such as e-mail and other messaging and posting services. Telefónica Data has established itself as a leading provider of global services based on the Internet Protocol and value-added services for corporate customers. In addition, Telefónica Data is responsible for traditional data transmission services, maximizing their value and managing service migration within the Internet Protocol environment.

In June 1999, we and Azienda Comunale Energie e Ambiente agreed to establish a new company called Acea Telefónica Spa to provide voice, data and Internet services to business and residential customers in the
Lazio region of Italy, which includes the city of Rome. In June 2000, Acea Telefónica announced its intention to merge with Telexis, a member of the Fiat group. We expect to invest approximately €100 million as part of the transaction. We expect to own 34% of the resulting company and have management control.

In June 2000, we announced that we had reached an agreement with Bertelsmann AG to acquire its affiliate MediaWays GmbH, a company specializing in internet services, data transmission and other value-added services for business, which will become the platform for the development of Telefónica Data in Europe. We will buy 100% of MediaWays with shares of Telefónica Data or, if Telefónica Data is not listed before December 31, 2000, with shares of Telefónica, S.A. Bertelsmann will be able to rely on us to monetize the shares, through an investment bank, from January 31, 2001. The purchase price is $1.6 billion, with an adjustment mechanism linked to the achievement of projected revenue levels during the year 2000. The transaction will be carried out through the exercise of a sale (“put”) option held by Bertelsmann in January, 2001. If this option is not exercised, we have a purchase (“call”) option, which can be exercised, at a higher price, in April, 2001. The agreement is subject to approval by regulatory authorities.

MediaWays is the second largest Internet Protocol network services provider in Germany. Its network consists of 270 nodes and 150,000 gateways, with nationwide coverage in Germany. MediaWays manages the internet access network for online services for the main ISP’s in Germany and offers a corporate networks and complete Internet and Intranet solutions for companies, integrating voice and data services over IP.

Internet-Related Services—Terra Networks

Our worldwide Internet-related services business is led by Terra Networks, formerly known as Telefónica Interactiva. Terra Networks is a leading provider of Internet access and local-language interactive content and services to residential and small office/home office users in the Spanish- and Portuguese-speaking world.

Terra Networks currently provides Internet access services in Spain, Brazil, Mexico, Peru, Chile, Guatemala and the United States. Terra Networks currently operates Internet portals serving these countries and Venezuela, Argentina, Costa Rica, El Salvador, Honduras, Nicaragua and Panama. It plans to launch or acquire portals serving one or more additional Latin American countries by the end of 2000. It also plans to launch Internet access in Colombia, Argentina and El Salvador. In all of its markets, Terra Networks is developing online interactive solutions for advertising and marketing, and electronic commerce and related activities.

Terra Networks offers a suite of Internet services that provides its customers in Spain and Latin America with:

- Internet access services
- a wide variety of content built on its multi-local/global model
- online advertising and marketing solutions, such as services that provide its advertising customers with information on the effectiveness of their online advertising campaigns
- a range of e-commerce opportunities
- multiple solutions for its customers’ Internet needs, such as Web design and hosting

Terra Networks was created in December 1998 to operate the Spanish residential and small office/home office Internet access business carried on by the Telefónica group since December 1995. At December 31, 1999, it provided Internet access to more than 1.3 million customers and its portals generated more than 434 million page views in December 1999. It has achieved this growth through:

- its assumption of direct management responsibility for the Internet activities of the Telefónica group companies in Spain in April 1999, and in Peru and Chile in October 1999
its acquisition of strong local providers of Internet services, including:

- 100% of Ordenamientos de Links Especializados S.L., known as Olé, the leading Spanish portal, which was acquired in April 1999
- 100% of Nutec Informática, S.A., known as ZAZ, a leading Brazilian portal and Internet service provider and an e-commerce provider, which was acquired in June 1999
- 100% of Informática Selectiva, S.A. de C.V., known as Infosel, a leading Mexican portal and an Internet service provider and e-commerce provider, which Terra Networks agreed to acquire in October 1999
- the rapid growth of the business lines that it operates

On November 16, 1999, Terra Networks completed an initial public offering of approximately 30% of its ordinary shares, which is one of the largest European Internet initial public offerings to date.

Terra Networks entered into a number of important contracts and joint-ventures during 1999 and the first half of 2000. The most significant of these were:

- a strategic alliance between Terra Networks and Banco Bilbao Vizcaya Argentaria signed on January 4, 2000, whereby Terra Networks acquired a 20% stake in Uno-e, Banco Bilbao Vizcaya Argentaria’s online bank, and Banco Bilbao Vizcaya Argentaria purchased a 3% interest in Terra Networks for Pesos 80,000 million
- a strategic alliance between Terra Networks and Remate.com, a leading online auction provider in Latin America, signed on February 5, 2000, whereby Terra Networks acquired a 30% interest in Remate.com
- an agreement between Uno-e and First-e signed on March 6, 2000 to create UnoFirst Group, the first global online bank (See “—Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria Uno First Group”)

Terra Networks’ Acquisition of Lycos

On May 16, 2000, we and Terra Networks announced that Terra Networks would acquire Lycos, Inc. for approximately $12.5 billion, payable in Terra Networks shares. Lycos is a leading web media company and the owner of Lycos Network, one of the most visited hubs on the Internet.

Under the agreement and plan of reorganization, Lycos shareholders will receive $97.55 in Terra Networks shares in exchange for each Lycos share, subject to a maximum of 2.150 and a minimum of 1.433 Terra Networks shares per Lycos share. Upon completion of the transaction, Terra Networks shareholders (including Telefónica) will own between approximately 48% and 58% of the combined entity, and Lycos shareholders will own the remainder. We will own between approximately 33% and 42% of Terra Lycos. The transaction is expected to be completed in the fourth quarter of 2000, subject to shareholder and regulatory approval.

In addition, as part of the transaction:

- Bertelsmann, the third largest media company in the world, has entered into an agreement to purchase advertising, placement and integration services from Terra Lycos. Bertelsmann is obliged to pay $325 million to Terra Lycos for these services during the first two years following consummation of the combination. From the third to the fifth year following consummation of the combination, Bertelsmann will buy up to $675 million in additional services. Taking into account the joint projects to be developed between Telefónica and Bertelsmann, we have agreed to purchase, if it were necessary, any portion of those services that Bertelsmann does not buy, up to $675 million. In addition, Terra Lycos will have access to Bertelsmann’s premier content on preferred terms.
- we have agreed to underwrite a €2.2 billion rights offering to be completed by Terra Networks prior to the closing of the Lycos transaction. The rights offering subscription will generate approximately Ptas. 40,000 million in goodwill which will be amortized over seven years.
• we and Terra Networks will establish a joint venture to develop portals accessible from wireless application protocol-enabled mobile telephones. We will have a 51% stake in the joint venture and Terra Networks will have the remaining stake.

European and Mediterranean Business—Telefónica Intercontinental

We have recently begun to explore business opportunities in Europe and the Mediterranean region through our subsidiary Telefónica Intercontinental.

In January 1999, Telefónica Intercontinental acquired European Telecom International GmbH, an Austrian telecommunications services provider, for Ptas. 4,800 million. European Telecom International is the third operator in Austria with a license to provide all telecommunications services on a nationwide basis. European Telecom International offers primarily long-distance national and international fixed-line telephone service to small and medium-sized businesses.

As a result of the reorganization approved by our Board of Directors on January 12, 2000, we expect to transfer European Telecom International to Telefónica Data. In addition, some or all of Telefónica Intercontinental’s operations may be combined with other business lines in the future.

In July 1999, a consortium including Telefónica Intercontinental, Telecom Portugal and a Moroccan banking group, won the auction for the second mobile license in Morocco. The consortium’s bid price was $902 million. It began offering mobile telephony services in March 2000.

Other Activities

Telefónica Publicidad e Información

Telefónica Publicidad e Información publishes and develop advertising in telephone directories in Spain and Brazil. In addition to printed directories, it offers directories online and in telephone-based format. On June 21, 1999, Telefónica Publicidad e Información completed an initial public offering of approximately 35% of its ordinary shares to institutional and retail investors. On June 23, 1999, Telefónica Publicidad e Información’s shares commenced trading on the Spanish stock exchanges, becoming the first Spanish advertising company and Internet server to be publicly traded.

Its core products are:

• Páginas Amarillas (“Yellow Pages”), an annual advertising directory containing certain information on all companies, businesses and professionals in a particular geographical area classified by sector, location and alphabetical order. The directory contains 1,600,000 listings and over 324,000 paid advertisements. Páginas Amarillas was consulted by 20 million users (18.5 million residential users and 1.5 million businesses) in 1999, according to market research carried out by Qindice on behalf of Telefónica Publicidad e Información. According to this research, there were more than 1 million daily consultations during 1999. In 1999, there were a total of 61 books published and 15 million copies printed.

• Páginas Blancas (“White Pages”), which includes residential, professional and business telephone numbers in a particular geographic area, classified by location and alphabetical order. The directory has been redesigned and new content and information has been added, offering information of general interest to users. According to a study by Qindice, for the period of January to October 1999, 22 million users consulted the directory, 21.2 million of which were residential users. During 1999, there was a total of 47 white page guides published and 12 million copies printed.

• Páginas Amarillas Online (PAOL) (“Yellow Pages Online”), the largest and most complete online database of Spanish businesses in terms of number of listings (1,600,000) and with the largest number of online advertisers in Spain. The web site received an average of 331,000 visits per month in 1999,
with 643,000 visits in December 1999. According to an independent audit carried out by Oficina de Justificación de Medios, Páginas Amarillas Online ranked as the fifth most visited web site in Spain (with 13 million page views in December 1999). Páginas Amarillas Online is the first online directory to use the new digital geographical information system (GIS) which enables the user to print maps showing the location of businesses.

- Páginas Amarillas Habladas (operator-assisted Yellow Pages), launched in March 1999, offers operator-assisted information over the telephone for all companies, businesses, professionals, products and services located in the Páginas Amarillas. In 1999, this service received over 900,000 calls.

- Europages, available in paper, CD-Rom and over the Internet is the most comprehensive trans-European directory containing information on major European export companies, classified by activity and then grouped by country of origin. The Europages are edited annually by Euredit, a company in which Telefónica Publicidad e Información has a stake. Telefónica Publicidad e Información is responsible for managing the advertising business and the distribution of the directory in Spain.

Telefónica Publicidad e Información has acquired from us substantially all brand names related to its business activities except Europages, for which it is the exclusive agent in Spain. Under a May 1999 assignment deed with Telefónica, Telefónica Publicidad e Información acquired approximately 300 trademarks, including Páginas Amarillas Online, Páginas Amarillas Habladas, Páginas Amarillas and Páginas Azules (the map section contained within Páginas Amarillas). Registration of these trademarks in Telefónica Publicidad e Información’s name is pending before the Spanish Office of Patents and Trademarks.

As part of our 1999 corporate reorganization, Telefónica Publicidad e Información has sold or liquidated certain of its subsidiaries. Following this corporate restructuring, Telefónica Publicidad e Información only maintains an interest in three subsidiaries:

- TMP Worldwide, which sells advertising in Yellow Pages to large clients and in which Telefónica Publicidad e Información has a 75.6% interest
- Euredit, which publishes European directories and in which Telefónica Publicidad e Información has a 5% interest
- Telefónica Publicidad e Informação, which markets, edits and distributes white pages in Brazil, in which Telefónica Publicidad e Información has a 51% interest

We and Telefónica Publicidad e Información have also recently entered into new contracts governing the publication, marketing and sale of Páginas Amarillas and Páginas Blancas. Under the new Páginas Amarillas contract, Telefónica Publicidad e Información is no longer required to pay us a fixed annual fee and will now pay us a variable fee based on the number of registers and individual updates. Such fees were approximately Ptas. 600 million in 1999. Under the new Páginas Blancas contract, Telefónica Publicidad e Información is no longer required to pay us a fixed annual fee and will now pay us a commission determined by the revenues generated from advertising and the costs associated with the Guías Básicas de Referencia (“Basic Guides”).

For the year ended December 31, 1999, the Telefónica Publicidad e Información’s sales exceeded Ptas. 44,800 million (excluding sales to other members of the group), representing an increase of 16.5% over the previous year. The Telefónica Publicidad e Información Group’s sales represented 1.5% of our total consolidated revenues in 1999. If sales to other members of the group are included, Telefónica Publicidad e Información’s total sales exceeded Ptas. 60,100 million, representing an increase of 27.7% over the previous year.

Atento

We formed Atento in 1999 to hold and develop our call center business. Atento offers integrated telephone assistance services and telemarketing services, as well as provides staff and rents call center positions to third parties. It currently operates in Spain, Latin America and Morocco.
International Strategic Partnerships

MCI/WorldCom. In March 1998, we announced a partnership to create strategic business ventures with MCI Communications Corporation ("MCI") and WorldCom, Inc. ("WorldCom") in order to exploit telecommunications opportunities in Latin America, the United States and Europe. The agreement with MCI/WorldCom builds upon the core terms of the Latin American joint venture created by Telefónica and MCI in April 1997.

Portugal Telecom. In 1997, we acquired 3.5% of Portugal Telecom S.A., the exclusive provider of fixed-link public telephone services in Portugal, for Ptas. 41.2 billion. Portugal Telecom acquired 1% of us in open-market transactions. In connection with these transactions, we granted Portugal Telecom an option, subject to certain conditions, to acquire 10% of Telefónica Internacional’s interest in Companhia Rio-grandense de Telecomunicações. In March 1998, we and Portugal Telecom agreed to form a joint venture to exploit telecommunications opportunities in certain emerging markets, including Morocco. In 1999, a consortium including Telefónica Intercontinental, Portugal Telecom and a Morocco banking group won the auction for the second mobile license in Morocco.

Lucent Technologies. In January 1999, we and Lucent Technologies entered into a strategic cooperation agreement to establish a framework for joint product development, services and market initiatives. In addition, we sold to Lucent 50% of our stake in Amper, S.A., representing 12.2% of Amper’s outstanding shares, for Ptas. 6,800 million. In February 2000, we sold a 6.1% interest in Amper, S.A. for Ptas. 2,794 million, which reduced our interest in Amper from 12.2% to 6.1%. Amper is Spain’s largest manufacturer of telecommunications equipment and systems.

IBM. In March 1999, we and International Business Machines Corporation entered into an agreement to offer business solutions to companies in Spain and Latin America based on information technologies. This project will be managed by Telefónica Data.

Ariba.com. On February 10, 2000, we and Ariba.com, a leading provider of Intranet and Internet based business-to-business electronic commerce solutions for operating resources, reached an alliance agreement under which we will provide business-to-business e-commerce services on the Ariba platform network through our subsidiaries. These virtual marketplaces, also known as B2B marketplaces, are commerce sites on the Internet that allow large communities of buyers and suppliers to meet and trade with each other.

Cisco Systems. In July 1999, we and Cisco Systems, a leader in providing networking products and services for corporate customers, agreed to explore opportunities to design, develop and provide new telecommunications services and products. This agreement with Cisco Systems contemplates the possibility of collaborating on:

- developing Internet/Intranet networks, broadband access and on-line services
- providing solutions for internetworking based on asynchronous transfer mode technology, which enables broadband transmission of high-capacity telecommunication signals
- integrating telephone services into a data network through:
  - Internet protocol technology
- the use of advanced technologies, such as asymmetrical digital subscriber lines, which permit data to be transmitted across conventional telephone lines, for new services

Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria

On February 11, 2000, we announced a broad strategic global alliance with Banco Bilbao Vizcaya Argentaria, S.A., which we believe is the first of its kind between a major telecommunications company and a bank. The strategic alliance provides a broad framework that needs to be implemented with specific agreements
in order to pursue the identified projects. These projects are currently in the process of being developed. Under the terms of the strategic alliance, we and Banco Bilbao Vizcaya Argentaria plan initially to jointly develop 14 projects.

**UnoFirst Group.** The first of these projects was the creation of Spain's first internet bank, Uno-e Bank. On March 6, 2000, we announced the proposed merger of Uno-e Bank and First-e group plc to create UnoFirst Group, expected to become the first global on-line bank and financial services provider. Terra Networks and Banco Bilbao Vizcaya Argentaria will own through a holding company 67.5% of UnoFirst Group. Banco Bilbao Vizcaya Argentaria will own 51% and Terra Networks will own the remaining 49% of such holding company. First-e's current sole shareholder, Enba plc, an Irish e-finance incubator company, or Enba's existing shareholders will own the remaining stake of UnoFirst. Under the agreement, which is subject to certain conditions and approvals, Terra Networks and Banco Bilbao Vizcaya Argentaria will contribute their interests in Uno-e Bank to UnoFirst, subscribe to a €362 million capital increase in UnoFirst and pay Enba €291 million. Enba will contribute its interests in First-e to UnoFirst.

**Other Alliance Projects.** Other important projects contemplated by the strategic alliance include:

- electronic commerce, where Banco Bilbao Vizcaya Argentaria intends to purchase a 40% interest in Telefónica B2B, our business-to-business electronic commerce subsidiary. In addition, we and Banco Bilbao Vizcaya Argentaria have agreed to jointly develop business-to-customer and customer-to-customer electronic commerce projects

- methods of payment, where we and Banco Bilbao Vizcaya Argentaria will form a new entity, Móvilpago Internacional, in which Banco Bilbao Vizcaya Argentaria will own a 51% stake and we will hold a 49% interest. Through Móvilpago Internacional we and Banco Bilbao Vizcaya Argentaria will jointly develop projects designed to exploit new methods of payment, such as through mobile telephone networks

- mobile telephone platforms, where Banco Bilbao Vizcaya Argentaria acquired a 5% interest in consortia led by us bidding in Europe for cellular phone licenses that use third-generation mobile communications technology, known as universal mobile telecommunications system, which allows cellular phones to carry data and Internet services

- wireless application protocol where we and Banco Bilbao Vizcaya Argentaria intend to jointly develop projects using wireless application protocol technology, which allows mobile telephones to connect to the Internet

- call centers, where we and Banco Bilbao Vizcaya Argentaria have signed a protocol for Banco Bilbao Vizcaya Argentaria to purchase up to a 20% interest in Atento, our subsidiary that conducts all of our call center business in Spain and Latin America. Banco Bilbao Vizcaya Argentaria intends to transfer its call center business to Atento

- Internet start-up businesses, where Banco Bilbao Vizcaya Argentaria has agreed to invest up to $200 million in Communicapital Partners, an investment fund led by us that invests in new technology and Internet businesses

**Supervision Committee.** We and Banco Bilbao Vizcaya Argentaria have established a supervisory committee to oversee and implement the strategic alliance. The supervisory committee is headed by Banco Bilbao Vizcaya Argentaria's co-chairmen and our chairman and consists of other senior officers of the two companies. This committee has ratified agreements relating to some of the projects discussed above. It also has approved new agreements relating to the establishment by Telefónica Publicidad e Información and Banco Bilbao Vizcaya Argentaria of a new platform for the exchange of products and services among small and medium-sized businesses and to the creation by us and Banco Bilbao Vizcaya Argentaria of an electronic procurement portal for large companies.
Other. Banco Bilbao Vizcaya Argentaria will increase its interest in us to up to 10% less one share through open market purchases of additional Telefónica shares, and we expect to purchase in the market up to a 3% interest in Banco Bilbao Vizcaya Argentaria and become Banco Bilbao Vizcaya Argentaria’s largest shareholder. Banco Bilbao Vizcaya Argentaria will have two vice-chairmen on our Board of Directors and we will have one vice-chairman on Banco Bilbao Vizcaya Argentaria’s Board of Directors.

Several Spanish government agencies, including the Spanish anti-trust authorities, are reviewing the effects of the strategic alliance. It is possible that governmental approval, including approval of the Spanish anti-trust authorities, may be required for some of the projects on an individual basis.

Our Joint Venture with Caja de Ahorros y Pensiones de Barcelona

On February 23, 2000, we announced a 50-50 joint venture with Caja de Ahorros y Pensiones de Barcelona, which is known as La Caixa, to develop new payment methods. The joint venture is being entered into under a wide-ranging agreement we entered into with La Caixa on January 12, 2000 to develop financial services. The new payment systems are expected to include mobile telephones, the Internet and credit cards. La Caixa, which is an approximately 5% shareholder of Telefónica, also has agreed to participate in our strategic alliance with Banco Bilbao Vizcaya Argentaria through:

- a 20% interest in Telefónica B2B
- an investment of up to $200 million in Communicapital Partners
- a 5% interest in consortia led by us bidding for third-generation mobile communications technology licenses in Europe

La Caixa may participate in additional aspects of our strategic alliance with Banco Bilbao Vizcaya Argentaria in the future. La Caixa will also participate actively in the design and development of our real estate project, Telefónica Inmobiliaria, to optimize its management.

Employees and Labor Relations

The table below sets forth the number of employees at the dates indicated for each of the categories listed below:

<table>
<thead>
<tr>
<th>At December 31</th>
<th>Telefónica (parent company only)</th>
<th>Managed Companies in Spain (unaudited)</th>
<th>Latin American Companies (unaudited)</th>
<th>The Telefónica Group (unaudited)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999</td>
<td>542</td>
<td>71,991</td>
<td>54,660</td>
<td>127,193</td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td>76,563</td>
<td>27,732</td>
<td>101,809</td>
</tr>
<tr>
<td>1997</td>
<td></td>
<td>75,001</td>
<td>15,459</td>
<td>92,022</td>
</tr>
</tbody>
</table>

Management believes that labor relations are generally good. In May 1997, Telefónica de España entered into a new collective bargaining agreement which provided for a 2.6% increase in wage levels during 1997, a 2.1% increase during 1998 and a 2.9% increase in 1999, with an additional productivity bonus per active employee, of Ptas. 50,000 per employee.

Our retired employees are provided with certain pension benefits. While Telefónica de España contributes the required amounts to fund these benefits over time, there remains an unfunded past service liability, which is estimated to be approximately Ptas. 77 billion. We have agreed to fund this obligation over a period ending in 2007.

In June 1998, management and the Intercenter Committee of Unions, which represents our employees, reached an agreement to put into effect new measures for voluntary workforce reductions. During 1998, we
implemented an extraordinary pre-retirement and early retirement plan that affected approximately 5,741 workers. In 1999, Telefónica de España offered a similar plan and 6,247 employees elected to participate in this plan and were terminated before December 31, 1999 at a cost of Ptas. 223,775 million. On July 16, 1999, a layoff plan calling for the termination of an additional 10,849 employees by December 31, 2000 (5,380 in 1999 and 5,469 in 2000) was approved by the Ministry of Labor. During 1999, 5,378 employees were terminated under this plan, of which 5,026 generated a cost to the company. Considering the accrual of the cost of the employees expected to be terminated in 2000, the total discounted and accrued cost as of December 31, 1999 amounted to Ptas. 444,172 million, which is covered by provisions recorded by Telefónica in 1999.

Description of Property

Domestic Network

In order to provide residential and other telecommunications services in Spain, we operate a full service telecommunications network. We benefit from an intensive capital investment program carried out over the last decade, which focused on network expansion as well as network upgrading. As a result, we now have:

- a network consisting of fiber optic cable to the curb in every Spanish city with a population of more than 50,000
- switching including synchronous digital hierarchy
- an asynchronous transfer mode rollout launched in 1996
- System 7 signaling throughout

Our infrastructural development objective is to achieve a fully digital system which permits simultaneous voice, data, text and image transmission, and which permits cost-efficient network management and maintenance. Consistent with this aim, we are moving towards a simplified two-level network hierarchy through the use of remote units and we are presently increasing operational efficiencies through centralizing our network monitoring and management functions.

Digitalization has also made it possible to provide an increasing number of value-added and other services that stimulate increased usage, such as multiservice lines capable of offering:

- call waiting
- three-way calling
- call transfer
- credit card calls
- voice mail
- the InfoVia online
- Internet access service

The local digitalization rate in our network has increased from 56.7% in 1995 to 86.5% at December 31, 1999, and our long-distance lines are now 100% digitalized. All international services are also 100% digitalized.

We have continued to increase the number of integrated service digital network lines in our network. At December 31, 1999, we had approximately 978,800 integrated service digital network lines, a 94% increase compared with the number of integrated service digital network lines in service at December 31, 1998. This will enable provision of a further range of services over the network, including simultaneous image transmission and voice telephony over the same line. Currently, we are marketing integrated service digital network primarily to commercial and high-usage residential customers. We expect that integrated service digital network costs will
decline significantly in the coming years, thereby making integrated service digital network services more attractive to a larger customer base and increasing overall traffic over our network.

In carrying out our infrastructural development program, we have increased the use of fiber optic cables in our network. The table below shows the total length of the four basic types of cable in our network as of the dates indicated.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Coaxial cable (km)</td>
<td>10,329</td>
<td>10,234</td>
<td>10,120</td>
<td>9,990</td>
<td>5,059</td>
</tr>
<tr>
<td>Fiber optic cable (km)</td>
<td>36,041</td>
<td>43,086</td>
<td>47,030</td>
<td>49,653</td>
<td>52,511</td>
</tr>
<tr>
<td>Copper cable in domestic long distance lines (km)</td>
<td>58,828</td>
<td>58,439</td>
<td>58,141</td>
<td>57,802</td>
<td>57,430</td>
</tr>
<tr>
<td>Subscriber networks (thousand km-par) (1)</td>
<td>63,154</td>
<td>64,556</td>
<td>65,490</td>
<td>66,237</td>
<td>66,713</td>
</tr>
</tbody>
</table>

(1) The transmission cables in the subscriber networks contain a variable number of conducting filaments, which are insulated from each other and grouped in pairs. Each such pair is called a "pair".

In carrying out our infrastructural development program we have consistently used a core group of primary equipment suppliers, including AT&T/Lucent Technologies, Ericsson and Alcatel, in order to maintain technological compatibility while at the same time decreasing dependence on any one vendor. We believe that our relationships with our primary vendors are stable and exhibit a high degree of cooperation with respect to our particular infrastructural needs.

Spain’s demographic makeup and topography present significant challenges to the provision of basic telephone service throughout the country, particularly in rural areas. Our continuing rural expansion program has been funded in part by local Spanish authorities. We are able to use alternative technologies in order to extend service into remote and thinly populated areas in compliance with our universal service obligation, and we have installed fixed cellular access lines where these are more cost-efficient than extending land line service.

**International Network**

We operate four international switches, all of which are digital. In addition, all of our international circuits are digital. We also have interests in four international satellite communications organizations, including:

- Intelsat (0.8%), the global satellite consortium
- Inmarsat (1.2%), the maritime satellite organization
- Eutelsat (2.43%), the European regional satellite organization
- Hispasat (22.7%), the communications satellite organization which carries the Via Digital DTH satellite television service

We are also one of the world’s leading submarine cable operators. We are currently participating in the following projects: SAT-3/Penca 7, Wesc, Alpal 2, Maya 1 and SAM-1. We currently participate in 38 international underwater cable systems (13 of which are moored in Spain) and own 13 domestic cables (12 of which are fiber optic).

The SAT-3/Penca 7 cable, a fiber-optic undersea cable system linking southern Europe and the West Coast of Africa, is being built by a consortium consisting of Telefónica de España, Marconi, Telekom South Africa, Concert and more than 20 other carriers. We expect to fund $32 million of the estimated $278 million cost of the project, which will span 7,019 miles.

In May 1999, we announced the sale of our stake in Telecommunicaciones Marinas S.A., which is responsible for laying and maintaining submarine cables. We sold this stake to Tyco Submarine Systems Ltd. for approximately $280 million.
On July 5, 1999, Tyco Submarine Systems Ltd. agreed with Telefónica Internacional to build and install an optic fiber network comprised of submarine and terrestrial cable. This cable will start in Las Toninas, Argentina and Valparaíso, Chile and end in Boca Raton, Florida. The total cost for the marine and terrestrial parts of this installation is expected to reach $1.32 billion.

On October 27, 1999 an agreement was signed with Tyco for the management and maintenance of the SAM-1 cable for an initial period of five years. Under an agreement dated December 22, 1999, the submarine cable is to be owned and operated by our affiliate, Telefónica SAM Uruguay, in which Tyco will have a 15% stake and we will have the remaining stake. We expect cable operations to begin in July 2000 and to be completed by January 2001. This agreement is subject to clearance by the EU Commission. Until the EU Commission grants clearance, both the Telefónica SAM Uruguay shares to be purchased by Tyco and the purchase price to be paid by Tyco for these shares are being held in escrow.

Legal Proceedings

We are party to various lawsuits arising in the normal conduct of our business. We do not believe that the outcome of any of these lawsuits, individually or in the aggregate, will have a significant effect on our consolidated financial position or results of operations.

Since December 1999, a number of former employees of Telefónica de España have filed claims against it in connection with its voluntary early retirement plans. If the maximum number of employees affected by such plans were to file similar actions, and if all of such employees were to prevail in such actions, we believe our maximum liability would be Ptas. 15.0 billion. We believe, however, that the likelihood of these employees prevailing in such actions is remote.

In March 2000, we were fined Ptas. 1.4 billion by the Spanish competition court for certain of our 1998 advertisements that the court found misleading. The court also found us guilty of unfair competition. We are appealing this ruling.

We have been informed of the existence of a legal proceeding to contest the validity of the resolutions adopted by our extraordinary shareholders’ meeting of February 4, 2000. This proceeding derives from our alleged failure to comply with the shareholder plaintiff’s right to information, our alleged failure to comply with the regulations relating to the celebration of shareholders’ meetings and our alleged failure to comply with the necessary requirements to validly exclude pre-emptive rights in connection with the capital increases. We believe that this proceeding will be resolved in such a way that is entirely satisfactory to Telefónica, S.A.

On June 5, 2000, eight administrators of the pension fund for Compañía de Telecomunicaciones de Chile, S.A., a subsidiary of Telefónica, S.A., filed a complaint in a Chilean court against nine directors of Compañía de Telecomunicaciones de Chile and CTC Mundo. The complaint seeks $28,695,813 for economic damage suffered as a result of the sale of Telefónica, S.A.’s subsidiary, CTC Internet.

Capital Expenditures and Divestitures

We have invested over Ptas. 2.6 trillion in capital expenditures since January 1, 1997 (Ptas. 5.3 trillion including financial investments). Of this amount, Ptas. 1.2 trillion was invested in 1999 (Ptas. 2.0 trillion including financial investments).

Our principal capital expenditures in 1999 were intangible investments (Ptas. 138,247 million), tangible investments made by Telefónica Internacional (Ptas. 678,606 million), tangible investments made by Telefónica de España (Ptas. 249,259 million), tangible investments made by Telefónica Servicios Móviles (Ptas. 115,669 million) and tangible investments made by Atento (Ptas. 20,041 million).

Tangible (property and equipment) and intangible asset divestitures in 1997, 1998 and 1999 were not material.
Financial Investments and Divestitures

Our principal financial investments in 1999 were made by Telefónica Internacional (Pts. 340,704 million), Telefónica Media (Pts. 101,077 million) and Terra Networks (Pts. 147,407 million).

We have also made significant divestitures during this period. Our principal divestitures in 1999 were:

- divestiture in consolidated companies of Ptas. 168,821 million, comprised principally of Telefónica Publicidad e Información (Pts. 101,397 million) and Temasa (Pts. 43,358 million)
- divestiture in companies accounted for under the equity method of Ptas. 60,360 million, comprised of Recolotos (Pts. 30,000 million), Infonet (Pts. 22,356 million) and Amper (Pts. 6,811 million)

During the first six months of 2000, our principal financial investments were made by Telefónica (Pts. 83,122 million), Atento (Pts. 41,658 million) and Terra Networks (Pts. 7,406 million). During the same period, our most significant divestitures were in Terra Networks (Pts. 81,528 million) and in Telefónica Sistemas Ingeniería de Productos, S.A.

Public Tender Offers

On June 17, 1999, Telefónica Internacional launched public tender offers for the outstanding shares of Telerj Celular S.A. and Telest Celular S.A. that were not held by it. In addition, together with its partner, Iberdrola, Telefónica Internacional launched public tender offers for all outstanding shares of Telebahía Celular S.A. and Telerigpe Celular S.A. that were not held by them. In connection with these tender offers, which were concluded in early July 1999, and open market purchases, Telefónica Internacional increased its interest in:

- Telerj Celular to 18.92% at a cost of approximately Ptas. 28,131 million
- Telest Celular to 5.92% at a cost of approximately Ptas. 783 million
- Telebahía Celular to 2.14% at a cost of approximately Ptas. 557 million
- Telerigpe Celular to 2.48% at a cost of approximately Ptas. 53 million

On January 12, 2000 we announced our intention to launch respective tender offers under which we would offer to exchange our shares and ADSs for 100% of the outstanding ordinary shares, preferred shares and American Depositary Receipts of Telecomunicações de Sa Paolo S.A.—TELESP, Tele Sudeste Celular Participações S.A., Telefónica de Argentina, S.A. and Telefónica del Perú, S.A.A. These exchange offers were formally launched on May 31, 2000 and expired on June 30, 2000. During the month of July, 2000, Telefónica accepted all shares, preferred shares and ADSs tendered in each of the tender offers, and consummated capital increases for an aggregate of 700,774,917 shares issued in exchange for all securities tendered. The following table shows Telefónica's ownership interest prior to the tender offers, the percentage of securities not owned by Telefónica and tendered in each of the tender offers and Telefónica's ownership interest following the closing of each of the tender offers:

<table>
<thead>
<tr>
<th>Company</th>
<th>Telefónica's Ownership Interest prior to Tender Offer</th>
<th>Percentage of Securities Not Owned by Telefónica and Tendered in the Offering</th>
<th>Telefónica's Ownership Interest after Tender Offer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecomunicações de São Paulo, S.A.</td>
<td>24.7%</td>
<td>83.2%</td>
<td>87.5%</td>
</tr>
<tr>
<td>Telest Sudeste Celular</td>
<td>20.9%</td>
<td>86.5%</td>
<td>89.3%</td>
</tr>
<tr>
<td>Participações S.A.</td>
<td>53.7%</td>
<td>91.8%</td>
<td>96.0%(1)</td>
</tr>
<tr>
<td>Telefónica de Argentina, S.A.</td>
<td>43.9%</td>
<td>94.7%</td>
<td>97.0%</td>
</tr>
</tbody>
</table>

(1) Includes CET's indirect holding.

Following the conclusion of the tender offers, the shares of Telefónica began to be traded on the stock exchanges of Buenos Aires, São Paolo and Lima.
In furtherance of its strategy to increase its ownership share in companies that it already controls, Telefónica Internacional announced on July 20, 2000 that it had entered into an agreement with Portugal Telecom to exchange the latter’s 23% interest in SP Telecomunicações Holding, S.A., the holding company that controls Telecomunicações de São Paulo, S.A., Telesp, for Telefónica Internacional’s 35.8% interest in Portelcom Participações S.A., the holding company that controls Telesp Celular S.A. Under the terms of the agreement, Telefónica Internacional will pay Portugal Telecom an additional US$59.9 million. The agreement, which has to be approved by ANATEL, the Brazilian telecommunications regulator, will give Telefónica Internacional control over an additional 4.74% of Telesp, bringing its total ownership percentage to 92.24%.

On June 29, 2000, Telefónica launched a public exchange offer outside the United States for 100% of the outstanding shares of Endemol Entertainment Holding BV, one of Europe’s leading independent television producers. Telefónica offered 6.2 of its shares for each Endemol share, subject to the receipt of all necessary regulatory approvals and acquisition in the exchange offer of not less than 75% of Endemol’s total share capital. On July 24, 2000, Telefónica announced that over 97% of Endemol’s outstanding shares had been tendered, and on August 2, 2000 consummated the acquisition issuing 213.4 million shares to effect the exchange. Telefónica anticipates that Endemol will develop television content for Telefónica Media, as well as content for some of its other lines of business, such as its Internet-related services and our third-generation mobile telephone business.
OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Presentation of Financial Information

The information in this section should be read in conjunction with our consolidated financial statements, and the notes thereto, included in Telefónica’s Annual Report on Form 20-F for the fiscal year ended December 31, 1999. Our consolidated financial statements have been prepared in accordance with Spanish GAAP, which differ in certain respects from U.S. GAAP. Please refer to note 25 to our consolidated financial statements for a discussion of these differences.

Changes in the Composition of the Group

In accordance with Spanish regulation, the companies directly or indirectly over 50%-owned by us or whose management is effectively controlled by us are consolidated by the global integration method. In 1999, Telesp and Tele Sudeste, our principal Brazilian subsidiaries, which were acquired in August 1998, were consolidated for the first time. They were accounted for under the equity method in 1998. Unless otherwise indicated, financial information for 1999 reflects the full effect of the consolidation of Telesp and Tele Sudeste.

In 1998, Compañía de Inversiones en Telecomunicaciones and Telefónica de Argentina, in which Compañía de Inversiones en Telecomunicaciones has a 58.4% stake, were consolidated by the global integration method as a result of:

- the increase to more than 50% of Telefónica Internacional’s stake in Compañía de Inversiones en Telecomunicaciones in 1997
- the agreements entered into with Compañía de Inversiones en Telecomunicaciones’s shareholders

Unless otherwise indicated, financial information for 1998 reflects the full effect of the consolidation of Telefónica de Argentina and Compañía de Inversiones en Telecomunicaciones. In 1997, Telefónica de Argentina and Compañía de Inversiones en Telecomunicaciones were accounted for under the equity method.

The basis of presentation and principles of consolidation are described in detail in note 2 to our consolidated financial statements.

Other Significant Accounting Changes

Several accounting changes affected results during 1999. The principal changes were:

- Due to a change in accounting principles regarding the amortization period for goodwill, during 1998 goodwill was amortized over ten years while during 1999 goodwill was amortized over 20 years.

- Due to the liberalization of the Spanish market for fixed telephone services in December 1998, the significant increase in competition, resulting from 70 new licenses being granted during the first nine months of 1999 to new entrants for the provision of fixed telephony, and regulatory measures, we decided to write-off or to accelerate the amortization of certain assets used by us to provide fixed telephone services. See note 4 to our consolidated financial statements. Below is further information about these write-offs:

<table>
<thead>
<tr>
<th>Fixed Assets</th>
<th>Change in Useful Life</th>
<th>Extraordinary Provisions (in millions of pesetas)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and development assets</td>
<td>5 to 3</td>
<td>6,006.5</td>
</tr>
<tr>
<td>Curb to customer wiring</td>
<td>10 to 5</td>
<td>28,002.8</td>
</tr>
<tr>
<td>Terminals</td>
<td>7 to 4</td>
<td>6,505.7</td>
</tr>
<tr>
<td>Research and development (project revision)</td>
<td>—</td>
<td>9,800.1</td>
</tr>
<tr>
<td>Software (project revision)</td>
<td>—</td>
<td>8,036.4</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>58,351.5</td>
</tr>
</tbody>
</table>

S-71
• We made a provision at the end of 1999 of Ptas. 444.2 billion to cover the costs of expected streamlining of our work force during the period 1999-2000. The financing costs of the streamlining plan were provisioned and charged to results of operations in 1999.

General Information

The discussion below should be considered in light of the following important business and regulatory and competitive developments that affected our group during the periods discussed below.

Business Developments

• The Spanish market for cellular services grew significantly during 1999. Our cellular subscribers increased by approximately 85% to 9.05 million at December 31, 1999 from 4.89 million at December 31, 1998 despite the entrance into the market of an additional strong competitor.

• The aggregate contribution to our results by our Latin American affiliates remained relatively unchanged during 1999 as compared with 1998 as a result of the recession of the Latin American economies. Some of the Latin American countries in which we operate began to open gradually to competition. For instance, in Argentina long-distance service was opened to competition and in Brazil intrastate long-distance service was opened to competition. Our interests in Latin America will increase as a result of our exchange offers for some of our Latin American affiliates.

• We expanded into markets other than Latin America by:
  • acquiring the Austrian operator European Telecom
  • obtaining the second cellular telephone licence in Morocco
  • establishing a joint venture with ACEA in the Lazio area in Italy, our gateway into the Italian market
  • Telefónica Publicidad e Información and Terra Networks conducted initial public offerings and we divested some non-strategic assets.

Regulatory and Competitive Developments

The discussion below should be considered in light of recent changes in the regulatory framework and competitive environment for fixed-link public telephone services (which consists of local, long distance and international telephone services) and cellular telephone services.

Fixed-Link Public Telephone Services. In January 1998, Retevisión commenced operations, initially providing domestic and international long-distance services. Retevisión also provides local telephone services as of September 1998. This marked the end of our monopoly on such services. In addition, throughout 1998, regionally-licensed cable operators began providing cable television as well as offering local telephone service and access lines.

On December 1, 1998, a second domestic operator, Lince, commenced offering national and international long-distance telephone services in Spain under the trade name UNIZ.

As of December 1, 1998, the provision of fixed-link services was opened to competition from all market entrants, subject to basic regulatory licensing requirements. Also as of that date, the Telecommunications Market Commission has the exclusive responsibility for regulating the telecommunications market.

As of January 1999, the Telecommunications Market Commission granted 11 additional licenses for the provision of telephone services throughout Spain and 5 additional licenses for the provision of telephone services in provincial and regional areas. The Telecommunications Market Commission has tended to apply policies
favoring new entrants into the telecommunications market. Moreover, as the dominant operator, we will be subject to certain obligations through December 31, 2003, including the requirement to provide our competitors access to our network. During 1999 new competitors entered the market such as Jazztel, RSL Com, British Telecom, Comunitel, Airtel and COLT, among others. As of December 31, 1999, our competitors had an estimated market share of approximately 48% of provincial traffic, 14.3% of interprovincial traffic and 9.7% of fixed-mobile traffic. We expect this competition to intensify in the future. Moreover, certain of our competitors, including Retevision and Lince, have common shareholders with the cable operators and have entered into collaboration agreements.

The full liberalization of the telecommunications market was undertaken without the rate rebalancing that we consider necessary. As a result, tariffs are not in line with our real costs. Instead tariffs are presently below our real costs for those services for which competition barely exist and above our costs for those services, such as long-distance, that are highly competitive. The maintenance of a charge for access lines below our costs has led to an access deficit. In addition, interconnection prices which we charge our competitors for access to our network are lower than our costs. Consequently, our competitors are able to obtain a sufficient operating margin for long distance services and are able to capture a large volume of traffic with limited investment.

In order to maintain competitive prices, we have applied discounts which totaled over Ptas. 28 billion in 1998 and Ptas. 45 billion in 1999. We anticipate that in the near future we will lose some market share in access lines and local traffic when cable operators deploy their networks. Additionally, losses of market share for domestic and international telephone services may be significant if the current tariff structure is not adjusted and we remain subject to restrictions by virtue of our position as the dominant operator.

In addition, we anticipate that, as a consequence of competition, prices for the recently liberalized services will decline and operating margins may diminish. The exact scope of increased competition and any adverse effects on our results and market share will depend on a variety of factors that cannot now be assessed with precision and that are beyond our control.

In addition, in June 2000 the government issued a new Royal Decree relating to the provision of telecommunication services. Under this Decree, we will be required, as a dominant telecommunications operator, to:

- beginning January 2001, facilitate access to our local loop. The government, upon the recommendations of the Telecommunications Market Commission, will establish the conditions on which we will be required to offer this access. The Delegate Commission for Economic Affairs, in consultation with the Ministry of Economy and the Ministry of Science and Technology, will establish the conditions and prices under the first Interconnection Offer Framework

- before November 15, 2000, facilitate the use of alternative carriers by persons placing local telephone calls by implementing call selection and preselection in lines connected to digital telephony stations for local calls

- beginning November 1, 2000, offer 600 minutes of local calls between the hours of 6:00 p.m. and 8:00 a.m. all day Saturday, Sunday and holidays (reduced tariff) for Ptas 700 per month and 600 minutes of local calls all day for Ptas 1,400 per month

- beginning November 1, 2000, offer limited Internet access for Ptas 2,750 per month (between the hours of 6:00 p.m. and 8:00 a.m. weekdays and all day on Saturday, Sunday and holidays)


On July 27, 2000, the Spanish government’s Delegate Commission for Economic Affairs established a new tariff structure that will be applicable to Telefónica de España for the two-year period beginning on January 1, 2001. The new regulatory scheme departs from the prior practice of directly setting the prices that Telefónica de
España could charge for its services adopting, instead, a system of price caps that apply to certain "baskets" and "sub-baskets" of services.

**Mobile Services.** Currently, we face competition from Airtel and Retevisión Móvil. Retevisión Móvil was granted the third digital cellular service license and commenced operations under the trade name Amena in January 1999. Our market share declined from approximately 70% to 60% in 1999 due to the entry of this competitor. Beginning in August 2001, we will face a fourth competitor under the UMTS standard. We believe that the existence of more than four operators would significantly reduce operating margins.

In June 1999 and July 1999, the Telecommunications Market Commission declared that Telefónica Servicios Móviles and Airtel were dominant operators in the mobile telephone market. At the same time, it declared that Telefónica Servicios Móviles was the dominant operator in the interconnection market, with a market share in excess of 25%. As a result, the price Telefónica Servicios Móviles charges to other operators terminating calls in its network must be related to the costs of providing the service. In addition, the Telecommunications Market Commission may set the maximum price that Telefónica Servicios Móviles may charge such operators.
Results of Operations

A summary of our results of operations during 1997, 1998 and 1999 are shown below.

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
</tr>
<tr>
<td></td>
<td>(in billions of pesetas, except per share data)</td>
</tr>
<tr>
<td>Revenue from operations</td>
<td>2,363.1</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,263.1</td>
</tr>
<tr>
<td>Operating profit</td>
<td>660.5</td>
</tr>
<tr>
<td>Pretax income (loss)</td>
<td>337.6</td>
</tr>
<tr>
<td>Net income</td>
<td>190.1</td>
</tr>
<tr>
<td>Net income per share</td>
<td>202.3</td>
</tr>
<tr>
<td>Number of shares outstanding (millions)</td>
<td>939.5</td>
</tr>
</tbody>
</table>

The table below sets forth certain consolidated revenue and expense items as a percentage of consolidated revenue from operations for the periods indicated.

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
</tr>
<tr>
<td></td>
<td>100%</td>
</tr>
<tr>
<td>Revenue from operations</td>
<td></td>
</tr>
<tr>
<td>Goods purchased</td>
<td>14</td>
</tr>
<tr>
<td>External services and local taxes</td>
<td>13</td>
</tr>
<tr>
<td>Personnel costs</td>
<td>24</td>
</tr>
<tr>
<td>Provision for depreciation and amortization</td>
<td>25</td>
</tr>
<tr>
<td>Trade provisions</td>
<td>2</td>
</tr>
<tr>
<td>Other operating income</td>
<td>7</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>1</td>
</tr>
<tr>
<td>Total operating costs before financial expenses and goodwill amortization</td>
<td>79</td>
</tr>
<tr>
<td>Operating profit</td>
<td>28</td>
</tr>
<tr>
<td>Financial income (expense)</td>
<td>7</td>
</tr>
<tr>
<td>Exchange losses (gains)</td>
<td>1</td>
</tr>
<tr>
<td>Income from associated companies</td>
<td>—</td>
</tr>
<tr>
<td>Amortization of goodwill on consolidation</td>
<td>1</td>
</tr>
<tr>
<td>Profit from ordinary activities</td>
<td>19</td>
</tr>
<tr>
<td>Extraordinary income</td>
<td>2</td>
</tr>
<tr>
<td>Losses on sale of fixed assets</td>
<td>1</td>
</tr>
<tr>
<td>Extraordinary expenses</td>
<td>6</td>
</tr>
<tr>
<td>Income (loss) before tax and minority interests</td>
<td>14</td>
</tr>
<tr>
<td>Corporate income tax</td>
<td>3</td>
</tr>
<tr>
<td>Minority interests</td>
<td>3</td>
</tr>
<tr>
<td>Net income</td>
<td>8</td>
</tr>
</tbody>
</table>
The tables below set forth an analysis of consolidated revenue from operations for the periods indicated.

<table>
<thead>
<tr>
<th>Service/Service</th>
<th>1997</th>
<th>1998</th>
<th>1999</th>
</tr>
</thead>
<tbody>
<tr>
<td>Domestic fixed telephone service</td>
<td>1,007,844</td>
<td>1,005,981</td>
<td>968,107</td>
</tr>
<tr>
<td>Leased circuits</td>
<td>98,133</td>
<td>112,938</td>
<td>115,455</td>
</tr>
<tr>
<td>Ibercom</td>
<td>62,858</td>
<td>62,566</td>
<td>80,922</td>
</tr>
<tr>
<td>Digital exchanges, intelligent network, ISDN and other</td>
<td>86,583</td>
<td>119,529</td>
<td>134,977</td>
</tr>
<tr>
<td>Equipment</td>
<td>73,456</td>
<td>64,143</td>
<td>57,524</td>
</tr>
<tr>
<td>Advertising</td>
<td>12,050</td>
<td>13,381</td>
<td>14,270</td>
</tr>
<tr>
<td>Total domestic fixed telephone service</td>
<td>1,340,924</td>
<td>1,378,535</td>
<td>1,371,255</td>
</tr>
<tr>
<td>Telephone service</td>
<td>120,653</td>
<td>115,901</td>
<td>130,808</td>
</tr>
<tr>
<td>Leased circuits</td>
<td>11,588</td>
<td>12,276</td>
<td>14,268</td>
</tr>
<tr>
<td>Retransmissions</td>
<td>2,418</td>
<td>1,445</td>
<td>605</td>
</tr>
<tr>
<td>Total international service</td>
<td>134,659</td>
<td>129,622</td>
<td>145,681</td>
</tr>
<tr>
<td>Pay telephone service</td>
<td>68,193</td>
<td>70,579</td>
<td>71,494</td>
</tr>
<tr>
<td>Data transmission</td>
<td>54,513</td>
<td>60,278</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>6,812</td>
<td>13,375</td>
<td>16,134</td>
</tr>
<tr>
<td>Total revenue from operations for Telefónica de España</td>
<td>1,605,101</td>
<td>1,652,389</td>
<td>1,604,564</td>
</tr>
<tr>
<td>Atento</td>
<td>10,885</td>
<td>18,062</td>
<td>33,624</td>
</tr>
<tr>
<td>Telefónica Internacional</td>
<td>443,131</td>
<td>893,073(1)</td>
<td>1,615,047(2)</td>
</tr>
<tr>
<td>Terra Networks</td>
<td>.163</td>
<td>926</td>
<td>6,680</td>
</tr>
<tr>
<td>Telefónica Servicios Móviles</td>
<td>362,938</td>
<td>468,019</td>
<td>622,112</td>
</tr>
<tr>
<td>Telefónica Data</td>
<td>7,146</td>
<td>76,358</td>
<td>95,627</td>
</tr>
<tr>
<td>Telefónica Media</td>
<td>8,041</td>
<td>11,528</td>
<td>16,056</td>
</tr>
<tr>
<td>Telefónica Publicidad e Información</td>
<td>36,238</td>
<td>43,344</td>
<td>55,709</td>
</tr>
<tr>
<td>Special purpose subsidiaries</td>
<td>100,872</td>
<td>103,846</td>
<td>123,883</td>
</tr>
<tr>
<td>Other subsidiaries</td>
<td>125,905</td>
<td>123,217</td>
<td>155,888</td>
</tr>
<tr>
<td>Total revenue from operations for consolidated subsidiaries</td>
<td>2,700,420</td>
<td>3,390,762</td>
<td>4,329,550</td>
</tr>
<tr>
<td>Intercompany sales</td>
<td>(337,318)</td>
<td>(484,741)</td>
<td>(509,826)</td>
</tr>
<tr>
<td>Total revenue from operations</td>
<td>2,363,102</td>
<td>2,906,021</td>
<td>3,819,724</td>
</tr>
</tbody>
</table>

S-76
The table below shows the contribution to our consolidated net income of our principal business lines:

(1) Includes the full effect of the consolidation of Telops and Telco Estates in 1998.

(2) Includes the full effect of the consolidation of Telco de Espera in 1999.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>TrafficManagement</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Other Subsidiaries</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Special Purpose Subsidiaries</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Telecommunication Radio</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Telecommunication Media</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Telecommunication Services</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
<tr>
<td>Traffic Networks</td>
<td>4.0%</td>
<td>4.0%</td>
<td>4.0%</td>
</tr>
</tbody>
</table>
| Other
domestic telephone service | 4.0% | 4.0% | 4.0% |
| International telephone service | 4.0% | 4.0% | 4.0% |
| International defence service | 4.0% | 4.0% | 4.0% |
| Definitive exchanges, international network, ISDN and other | 4.0% | 4.0% | 4.0% |
| Local transmission | 4.0% | 4.0% | 4.0% |
| Domestic telephone service | 4.0% | 4.0% | 4.0% |
| Total consolidated net income | 30.0% | 30.0% | 30.0% |
The table below shows the impact of consolidation of Telesp and Tele Sudeste in 1999 on our results of operations:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating revenues</td>
<td>3,164.4</td>
<td>8.89</td>
<td>655.3</td>
<td>3,819.7</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>1,696.8</td>
<td>22.62</td>
<td>373.5</td>
<td>2,070.3</td>
</tr>
<tr>
<td>EBITDA</td>
<td>1,521.1</td>
<td>(1.27)</td>
<td>290.1</td>
<td>1,811.2</td>
</tr>
<tr>
<td>Operating profit (loss)</td>
<td>677.7</td>
<td>(16.87)</td>
<td>117.0</td>
<td>794.8</td>
</tr>
<tr>
<td>Income (loss) before tax</td>
<td>(56.0)</td>
<td>(139.30)</td>
<td>50.6</td>
<td>(5.4)</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>11.6</td>
<td>(94.67)</td>
<td>0.0</td>
<td>11.6</td>
</tr>
</tbody>
</table>

(1) Historical 1999 data for Telefónica, S.A. and its consolidated subsidiaries adjusted to show Telesp and Tele Sudeste accounted for under the equity method.
(3) Impact of the full consolidation of Telesp and Tele Sudeste in 1999.

**Year Ended December 31, 1999 Compared with Year Ended December 31, 1998**

**Revenue from operations**

Our revenue from operations, which accounted for 95.5% and 95.0% of our consolidated total revenue for 1999 and 1998, respectively, increased by 31.4% to Ptas. 3,819,724 million in 1999 from Ptas. 2,906,021 million in 1998. Of the increase in 1999, approximately Ptas. 655 billion was due to the consolidation in 1999 of Telesp and Tele Sudeste. If these companies had not been consolidated, revenues from operations would have increased 8.9% during 1999 mainly due to the operations of Telefónica Servicios Móviles and Telefónica Data.

Whereas we calculate revenues from operations both before and after adjustments for sales to other members of the group, we have historically limited our analysis in such area strictly to revenues from operations before adjustments for sales to other members of the group. Accordingly, in the following sections we disclose revenues from operations both before and after adjustments for sales to other members of the group and limit our discussion solely to revenues before adjustments for sales to other members of the group. In the aggregate, we believe that sales to other members of the group did not have a significant impact on the percentage fluctuations during the periods discussed. It is our intention going forward to focus our discussion on revenues from operations excluding sales to other members of the group.

Telefónica de España’s revenue from operations (including sales to other members of the group) increased 0.8% or Ptas. 12,661 million to Ptas. 1,604,564 million during 1999, compared to a decrease of 0.8% in 1998. This increase was principally due to:

- A 3.6% increase in the average number of lines in service (including ISDN lines and Ibercon lines) combined with a 11.9% increase in telephone usage, as measured on the basis of minutes of use per day per line (including ISDN lines and Ibercon lines), to 13.4 minutes per day (including interconnection traffic)
- A 64.4% increase in revenues from supplementary services (ISDN, intelligent networks, Centrex, broadband services and VPN), which collectively made up 10.3% of Telefónica de España’s revenue from operations for 1999
• a 3.7% increase in revenues from leased circuits

The increase in the average number of lines in service was partly due to the introduction of new products such as the ASDL service. The growth in line usage was attributable to:

• a 34.5% increase in usage of the InfoVía service from 105.0 million hours in 1998 to 141.2 million hours in 1999
• a 15% increase in voicemail services to approximately 8.3 million users as of December 31, 1999 from 7.2 million users as of December 31, 1998
• a 8.4% increase in interconnection with other operators

Telefónica de España’s revenue growth was partially offset by tariff reductions imposed during 1999 of 10.6% for intra-provincial calls, 26.3% for inter-provincial calls and 12.5% for international calls and a reduction of 7.1% in interconnection prices charged the mobile networks which took effect July 1, 1999, the loss of market share for domestic long-distance to other carriers, and the introduction of discount calling plans. As of December 31, 1999, there were nearly 12 million active plans.

Telefónica de España’s revenue from operations excluding sales to other members of the group increased 1.1% or Ptas. 15,158 million to Ptas. 1,436,817 million during 1999.

Telefónica Móviles’ revenue from operations (including sales to other members of the group) increased 32.9% or Ptas. 154,093 million to Ptas. 622,112 million during 1999. This increase was principally due to an increase of 85.0% in cellular subscribers to approximately 9.05 million at December 31, 1999 compared with approximately 4.89 million at December 31, 1998. The number of subscribers per 100 inhabitants also increased from 12.2% at December 31, 1998 to 22.6% at December 31, 1999.

This growth was principally due to a threefold increase in the number Movistar Active (pre-paid) users and a more than doubling of contracts with companies and professionals. Revenues from operations also increased due to a 69.4% increase in wireless traffic from approximately 8.0 billion minutes in 1998 to 13.6 billion minutes in 1999. The overall increase in revenues from operations was offset in part by a 19% decline in average revenue per user due to deep price reductions and the growth of lower-priced prepaid calls.

Telefónica Móviles’ revenue from operations excluding sales to other members of the group increased 35.4% or Ptas. 118,331 million to Ptas. 452,706 million during 1999.

Telefónica Internacional’s revenues from operations (including sales to other members of the group) increased by 14.9% to Ptas. 1,026,579 million during 1999, without giving effect to the consolidation of the Brazilian subsidiaries. This increase was principally due to the following:

• Revenues from operations from our Chilean subsidiaries denominated in local currency increased by approximately 12% to Chilean pesos 850,301 million during 1999, while revenues in pesetas increased by 5%. This 12% increase was due principally to the consolidation of Globus and Sonda in 1999 and the revenues of Startel, which more than doubled its mobile customers in 1999. The increase was offset in part by a tariff decrease approved in August, which negatively impacted revenues by approximately Ptas. 24,000 million in 1999. The increase in the revenues in pesetas was lower than the increase in local currency due to the depreciation of the Chilean peso against the U.S. dollar of approximately 12% on average, which was partially offset by the depreciation of the peseta against the dollar.

• Revenue from operations generated by Telefónica del Perú denominated in pesetas increased by approximately 3% during 1999. If denominated in local currency, revenues from operations increased by 9% during 1999. The depreciation of the Peruvian nuevo sol against the U.S. dollar by over 11% on average was the principal reason for the smaller increase in revenues from operations in pesetas. Revenues from operations in local currency were positively affected by an increase in the number of lines in service of approximately 9% and an increase in the number of cellular subscribers of 41.1%. 

S-79
• Revenue from operations generated by Telefónica de Argentina denominated in pesetas increased 7%, while revenue denominated in local currency increased by 3%. The increase in revenue was mainly due to an increase of 96.8% in mobile telephone subscribers and, to a lesser extent, a 4.5% increase in fixed-line customers. Revenues from operations were offset in part by negative macroeconomic conditions in Argentina and the entry of new competitors into the marketplace.

Telefónica Internacional’s revenue from operations excluding sales to other members of the group increased 14.9% or Ptas. 132,582 million to Ptas. 1,024,224 million during 1999, without giving effect to the consolidation of the Brazilian subsidiaries.

Telesp and Tele Sudeste generated revenue from operations (including sales to other members of the group) of approximately Ptas. 460,000 million and approximately Ptas. 130,000 million, respectively, in 1999.

Telefónica Data’s revenue from operations (including sales to other members of the group) increased by 25.2% to Ptas. 95,627 million during 1999 principally due to increases in the number of client connections and Internet traffic through its network. Telefónica Data group’s revenue from operations excluding sales to other members of the group increased 21% or Ptas. 13,532 million to Ptas. 77,897 million during 1999.

Terra Networks’ revenue from operations (including sales to other members of the group) was Ptas. 6,680.3 million in 1999 compared with 925.8 million in 1998. At December 31, 1999 Terra Networks had approximately 1.3 million subscribers. It generated approximately 434 million page views during December 1999.

**Operating expenses**

Operating expenses, which consist of inventories (net), supplies purchased, subcontracted services, local taxes and personnel costs, increased by 49.7% during 1999 principally due to the impact of the consolidation of Telesp and Tele Sudeste, which represented approximately Ptas. 370,000 million, or 27.0 percentage points of the 49.7% increase. Without giving effect to the consolidation of the Brazilian subsidiaries, our personnel expenses increased by 0.4% during 1999, with a strong decrease at Telefónica de España, supplies expenses increased by 43.4%, principally at Compañía de Telecomunicaciones de Chile and Telefónica de Argentina, and subcontractors expense increased by 58.9%, principally due to a strong increase at Telefónica Servicios Móviles and Telefónica de Argentina.

Telefónica de España’s operating expenses increased by 7.6% during 1999 to approximately Ptas. 897,000 million from Ptas. 834,000 million in 1998. Supplies expense at Telefónica de España increased by 38.2% due to higher interconnection costs, and subcontractors expense increased due to increased expenses relating to the promotion of telephone usage and customer loyalty (principally commissions and advertising). Personnel expenses declined 10.3% during 1999 as a result of the streamlining of Telefónica de España’s workforce, which had 46,619 employees at December 31, 1999, a decrease of 19.8% from the number of employees at December 31, 1998. As a result, Telefónica de España had a productivity ratio of 412 lines per employee at December 31, 1999, a 31% improvement over the productivity ratio of 313 lines per employee at December 31, 1998.

Operating expenses at Telefónica Móviles increased by 44.6% during 1999. Supplies expense grew due to higher interconnection charges due to the strong increase in customers and the resulting increase in traffic through other networks, both fixed and mobile. Subcontractors expense increased by 65% during 1999 due to the increase in expenses related to marketing and advertising to promote customer loyalty. Personnel expenses increased by approximately 30% due to the addition of 515 new employees.

Telefónica Internacional’s operating expenses increased by 21.4% to Ptas. 862,330 million during 1999 principally for the reasons described below. Note that the percentage increases or decreases below were calculated based on local currency amounts as opposed to amounts that have been converted into pesetas.

• Compañía de Telecomunicaciones de Chile’s operating expenses increased by 52% mainly due to a 28% increase in personnel expenses, a 79% increase in supplies expenses and a 30% increase in
subcontracting expenses. The increase in personnel expenses was due in part to severance costs associated with a headcount reduction of 1,008 employees. The increase in subcontracting expenses and supplies expenses was mainly due to the acquisition of Sonda. Operating expenses also increased due to higher expenses associated with the implementation of new policies for controlling bad debts.

- Telefónica del Perú's operating expenses decreased by approximately 1% principally as a result of a 13% increase in personnel expenses and a 29% increase in subcontracting expenses. These increases were offset by a 68% decrease in provisions for doubtful accounts in 1999. Provisions for doubtful accounts decreased in 1999 compared with 1998 primarily because of higher provisions recorded in the earlier period to eliminate all accounts that were over 120 days past due, which better reflected Telefónica del Perú's experience. This charge followed an extensive review by Telefónica del Perú of its customer base prompted by weak economic conditions in Peru. Telefónica del Perú now fully provides for all accounts that remain outstanding for more than 120 days.

- Telefónica de Argentina's operating expenses increased by 6% during 1999, principally due to a 28% increase in subcontracting expenses principally due to expenses incurred as a result of the liberalization of the telecommunications market and an increase in personnel expenses of approximately 1%. These factors were offset in part by a decrease in provisions for doubtful accounts of 54%.

Telefónica Data's operating expenses increased by 17.9%, or Ptas. 75,584 million, during 1999 due to:

- a 33.4% increase in personnel expenses due to a 33.2% increase in headcount to 850 individuals at December 31, 1999 compared to 638 individuals December 31, 1998

- an increase in subcontracting expenses during 1999 of 93.7% principally due to increased marketing expenses

**EBITDA**

EBITDA consists of earnings before interest, taxation, depreciation and amortization. Our EBITDA increased by 17.6% or Ptas. 270,470 million to Ptas. 1,811,182 million during 1999. If Telesp and Tele Sudeste had not been consolidated during 1999, our EBITDA would have decreased by 1.3% or approximately Ptas. 19,600 million in 1999.

Telefónica de España's EBITDA decreased by 4.4% or approximately Ptas. 38,500 million during 1999. This decrease was mainly due to tariff reductions affecting Telefónica de España's results.

Telefónica Servicios Móviles' EBITDA rose 15.9% or approximately Ptas. 30,800 billion during 1999. The ratio of EBITDA to operating revenues decreased from 41.5% in 1998 to 36.2% in 1999 due to an approximately 45% increase in operating expenses resulting from a strong growth in the client base. Average revenue per user decreased 19% due to increased costs associated with the increased client base.

Telefónica Internacional's EBITDA increased by 61.2% or Ptas. 279,700 million during 1999. If Telefónica Internacional and Tele Sudeste had not been consolidated during 1999, Telefónica Internacional's EBITDA would have decreased 2.3% or approximately Ptas. 10,400 million. In 1999, the EBITDA of Telefónica de Argentina increased by 4.3% or Ptas. 9,658 million to Ptas. 235,524 million, the EBITDA of Telefónica del Perú increased by 15.3% or Ptas. 12,630 million to Ptas. 95,209 million and the EBITDA of Compañía de Telecomunicaciones de Chile decreased by 26.6% or Ptas. 34,289 million to Ptas. 94,823 million.

Telefónica Data's EBITDA increased by 68.0% or Ptas. 8,100 billion due to an increase in the number of internet product offerings, a market in which Telefónica Data has a market share estimated to be in excess of 60%. In addition, Telefónica Data benefitted from its strong relationship with its largest clients.

S-81
Operating profit

Operating profit, which consists of revenue from operations, capitalized internal expenditures, operating expenses, other operating revenue, provision for depreciation and amortization, other operating expenses and trade provisions, decreased by 2.5% during 1999 to Ptas. 794,764 million from Ptas. 815,278 million in 1998 due to a sharp increase in depreciation, which rose 40.1% compared with the 17.8% rise in EBITDA. Of this increase in depreciation, 23.9 percentage points, or approximately Ptas. 173,100 million, was contributed by the consolidation of Telesp and Tele Sudeste. Our operating profit, excluding Telesp and Tele Sudeste, decreased by 16.9% during 1999. This decrease was due principally to a 24.3% decrease in operating profit at Telefónica de España resulting from a 13.6% increase in depreciation due to its new policy of depreciating certain fixed assets used to provide fixed-line telephony services. If the depreciation criteria had remained the same, our overall operating profit would have increased by 2.5%.

Operating profit of Telefónica Servicios Móviles increased 16.5% to approximately Ptas. 150,300 million during 1999 from approximately Ptas. 129,000 million in 1998.

Profit from ordinary activities

Profit from ordinary activities, which consists of operating profit, amortization of goodwill on consolidation, financial income (expense), exchange (losses) gains and income from associated companies, increased by 1.6% or Ptas. 9,354 million to Ptas. 586,060 million during 1999 from Ptas. 576,706 million in 1998. If Telesp and Tele Sudeste had not been consolidated during 1999, our profit from ordinary activities would have decreased 21.2%.

Income (loss) before tax and minority interest

Income (loss) before tax and minority interest, which consists of profit from ordinary activities, extraordinary income, losses on sales of fixed assets and extraordinary expenses, decreased from income before tax and minority interest of Ptas. 402,010 million in 1998 to a loss before tax and minority interest of Ptas. 5,434 million in 1999. This reduction was principally due to the recording of pre-retirement and early retirement provisions of Ptas. 444,172 million in 1999. Additionally, other extraordinary expenses rose by Ptas. 57,058 million in 1999. These increases in extraordinary expenses were partially offset by extraordinary revenues from gains obtained on disposals of holdings in consolidated companies of approximately Ptas. 263,600 million in 1999. These gains principally consisted of Ptas. 99,741 million from the sale of Telefónica Publicidad e Información, Ptas. 82,885 million from the sale of Terra Networks and Ptas. 35,852 million from the sale of Ternasa. We had gains on disposals of holdings of approximately Ptas. 23,900 million in 1998.

Corporate income tax

We recorded a corporate income tax credit at the consolidated level of Ptas. 126,115 million in 1999 compared to a corporate income tax expense of 91,875 million in 1998. This change was principally due to the tax credit associated with the above-mentioned pre-retirement and early retirement provision recorded in 1999. This provision, being tax deductible, generated a tax income of Ptas. 155,460 million in 1999. The reduction was also due to the write-offs related to the Brazilian investments, which are deducted when calculating corporate tax and cancelled in the process of consolidation adjustments. In addition, capital gains on the sale of our investments, such as the Terra Networks or Telefónica Publicidad e Información public offerings, did not form part of the taxable income base.

Minority interests

Minority interests increased 17.9% to Ptas. 109,100 million in 1999 from Ptas. 92,551 million in 1998, primarily due to the full effect of the consolidation of Telesp and Tele Sudeste in 1999. Had Telesp and Tele Sudeste not been consolidated during 1999, minority interests would have decreased by 59.3% to Ptas. 37,649 million.
Net income

Consolidated net income decreased by Ptas. 206,003 million, or 94.7%, from net income of Ptas. 217,584 million in 1998 to Ptas. 11,581 million in 1999. This decrease was due to the various factors described above, most notably the increase in extraordinary expenses due to the recording of the pre-retirement and early retirement provisions discussed above.

Year Ended December 31, 1998 Compared to Year Ended December 31, 1997

Revenue from Operations

Revenue from operations, which accounted for 95.0% and 93.5% of consolidated total revenues for 1998 and 1997, respectively, increased by 23.0% at the consolidated level to Ptas. 2,906.0 billion in 1998 from Ptas. 2,363.1 billion in 1997. The growth in revenue from operations was primarily attributable to the significant increase in revenues from Telefónica Internacional due to the full effect of the consolidation of Telefónica de Argentina and increased revenues from Telefónica Servicios Móviles for 1998. Had Telefónica de Argentina been consolidated during 1997, revenues would have increased by 5.7% in 1998. Growth in consolidated total revenues from operations slowed during 1998 primarily as a result of:

- the slowdown in the growth of revenues from fixed-link telephone services in Spain as a result of the introduction of competition and tariff reductions
- the slowdown in the growth rate of the major Latin American economies, which adversely affected revenues from operations of Telefónica Internacional

Revenue from domestic fixed telephone service, which accounted for 40.6% and 49.6% of consolidated revenue from operations in 1998 and 1997, respectively, grew by 2.8% in 1998 to Ptas. 1,378.5 billion from Ptas. 1,340.9 billion in 1997. This growth was primarily due to:

- a 4.2% increase in the average number of lines in service combined with a 9.5% increase in telephone usage, as measured on the basis of minutes of use per day per line, to 11.85 minutes per day (including interconnection traffic)
- a 38.1% increase in revenues from supplementary services (Intelligent Network and ISDN) to Ptas. 119,529 million
- a 15.1% increase in revenues from leased circuits to Ptas. 112,938 million

The increase in the average number of lines in service was partly due to the introduction of new products such as the Línea Basica and Línea Duplo services, which add a series of supplemental services to the traditional telephone line, including network-based voice mail services, call waiting, three-way calling and call forwarding. The growth in line usage is attributable to:

- the 100.4% increase in usage of the InfoVía service from 52.4 million hours in 1997 to 105.0 million hours in 1998
- the 56% increase in voicemail services to approximately 7.2 million users as of December 31, 1998 compared to 4.6 million users as of December 31, 1997
- an increase in interconnection with other operators, offset in part by the decrease in use per line per day for domestic long distance

Revenue growth in domestic fixed-link telephone service slowed significantly during 1998 (2.8% in 1998 compared to 9.6% in 1997) primarily due to tariff reductions, the loss of market share for domestic long-distance to Retevisión and the introduction of discount calling plans (particularly, the "Planos Claros", which offered Ptas. 28 billion in discounts during 1998). The revised tariff schedule issued by the Spanish government on July 30, 1998 featured average reductions of 5%, 15% and 12% for provincial long-distance calls, interprovincial
long-distance calls and international long-distance calls, respectively. Tariffs for local calls were reduced by an average of 14%.

Revenues from Telefónica Servicios Móviles (including sales to other members of the group) increased by 29.0% to Ptas. 468.2 billion in 1998 from Ptas. 363.0 billion in 1997. As a percentage of consolidated revenue from operations, revenues from mobile services (including sales to other members of the group) increased to 13.8% in 1998 from 13.5% in 1997. The growth in revenues from Telefónica Servicios Móviles during this period was primarily attributable to:

- a 53.5% increase in the number of Telefónica Servicios Móviles subscribers from approximately 3.19 million at December 31, 1997 to approximately 4.89 million at December 31, 1998
- an increase in roaming agreements with operators in other countries
- an increase in value-added services

These increases were offset in part by a 2% decrease in minutes of usage by cellular customers. Among the principal factors contributing to the increase in the number of new mobile clients was the success of prepaid cards, particularly for the MoviStar service for which active prepaid cards totaled over 1.750,000 at December 31, 1998 and represented approximately 66% of MoviStar’s new customers during 1998.

Telefónica Servicios Móviles’ revenue from operations excluding sales to other members of the group increased 29.5% or Ptas. 76,124 million to Ptas. 334,467 million in 1998 from Ptas. 258,343 million in 1997.

Revenues from Telefónica Internacional (including sales to other members of the group), which represented 26.3% and 16.4% of consolidated revenue from operations in 1998 and 1997, respectively, increased by 101.5% to Ptas. 893.1 billion in 1998 from Ptas. 443.1 billion in 1997. This growth was primarily due to the full effect of the consolidation of Telefónica de Argentina during 1998. Had Telefónica de Argentina been consolidated during 1997, revenues from Telefónica Internacional would have increased by 7.7% in 1998. This 7.7% growth was primarily due to increases in operating revenues at Telefónica de Argentina (14.2%) and Compañía de Telecomunicaciones de Chile (13.2%), offset in part by a 10% decrease in operating revenues at Telefónica del Peru in 1998 compared to 1997.

- The increase at Telefónica de Argentina was a result of increases in the number of cellular customers (33%) and the average number of fixed telephone lines in service (6%).
- In Chile, while operating revenues reflected a growth rate of 20% in terms of Chilean pesos, the combined effect of the depreciation of the Chilean peso against the Spanish peseta and the depreciation of the U.S. dollar against the Spanish peseta reduced this growth to 14% in terms of Spanish pesetas. The increase in Compañía de Telecomunicaciones de Chile’s revenues was a result of the increase in fixed telephone service (10.7%) and the increase in the number of cellular customers (151.8%), offset in part by a decrease in the volume of traffic per fixed line and a decrease in average revenues per cellular customer.
- In Peru, revenues in the local currency increased by 2%. However, because of the combined effect of the depreciation of the Peruvian nuevo sol against the U.S. dollar and the depreciation of the U.S. dollar against the Spanish peseta, this represented a 10.2% decrease in revenues in Spanish pesetas. The 2% increase in revenues in Peru were primarily attributable to a 6.7% increase in the average number of lines in service and a 57% increase in the number of cellular customers, offset by the negative effects of “El Niño” on the Peruvian economy and the tariff reductions implemented in September 1998 in preparation for the liberalization of the Peruvian telecommunications market. In addition, there was a Ptas. 41,304 million write-off for accounts past due at Telefónica del Peru.

Telefónica Internacional’s revenue from operations excluding sales to other members of the group increased 1.9% or Ptas. 8,502 million to Ptas. 450,834 in 1998 from Ptas. 442,332 in 1997. Considering the full effect of
the consolidation of Telefónica de Argentina, revenue from operations increased by 101.6%, or Ps. 449,310 million, to Ps. 891,642 million in 1998.

**Operating expenses**

Operating expenses slowed in growth, with an increase of 14.7% at the consolidated level to Ps. 1,379 billion in 1998, from Ps. 1,201 billion in 1997. This 14.7% increase in operating expenses was largely attributable to the full effect of the consolidation of Telefónica de Argentina during 1998. Had Telefónica de Argentina been consolidated during 1997, operating expenses would have increased by 3.6%, or 2.1 percentage points less than operating revenues, primarily due to an 8.6% increase in goods purchased and a 2.6% increase in external services. The increase in goods purchased was primarily attributable to the increase in payments to Airtel for calls to Airtel subscribers. The increase in external services was due to the significant increase in advertising expenses and sales commissions as a result of the introduction of competition in fixed-link telephone services in Spain.

Had Telefónica de Argentina been consolidated during 1997, personnel costs, which accounted for 47.2% of consolidated operating expenses in 1998, would have increased by 1.5% to Ps. 650.2 billion in 1998. The moderate growth of personnel costs was primarily attributable to reductions in Telefónica’s workforce (5,982 fewer employees at year end 1998 compared to year end 1997) as a result of early and voluntary retirement plans adopted in 1994 and ratified by the 1997/1998 collective bargaining agreement. In addition, the voluntary retirement age was decreased from 55 to 53 years of age in 1998.

**EBITDA**

Our EBITDA increased by 22% or Ps. 277,601 million to Ps. 1,540,712 million during 1998 due to the consolidation of Telefónica de Argentina in 1998 and the strong increase in Telefónica Servicios Móviles revenue.

**Operating profit**

Operating profit grew at the consolidated level to Ps. 815.3 billion in 1998, up 23.4% from Ps. 660.5 billion in 1997, primarily due to the full effect of the consolidation of Telefónica de Argentina by the global integration method for 1998. Had Telefónica de Argentina been consolidated by the global integration method during 1997, operating profit would have grown 3.3%. Trade provisions increased substantially to Ps. 106.1 billion primarily as a result of bad debts incurred by the Latin American subsidiaries as a result of the economic downturn, the restructuring of tariffs in Argentina and the effects of “El Niño” on the Peruvian economy. Provision for depreciation and amortization increased by 20.4% to Ps. 725.4 billion in 1998 from Ps. 602.7 billion in 1997, primarily as a result of the full effect of the consolidation of Telefónica de Argentina by the global integration method for 1998. Had Telefónica de Argentina been consolidated by the global integration method during 1997, provision for depreciation and amortization would have increased by 4.3% primarily due to investments by Telefónica Internacional and Telefónica Servicios Móviles, offset by the decrease in provisions for depreciation and amortization at Telefónica de España to Ps. 463,762 million in 1998 from Ps. 466,461 million in 1997 as a result of a reduction in investments in tangible assets. In September 1998, Telefónica Internacional began to amortize the administrative concessions related to its recent acquisitions in Brazil.

**Profit from ordinary activities**

Profit from ordinary activities increased at the consolidated level to Ps. 576.7 billion in 1998, up 28.3% from Ps. 449.4 billion in 1997. Had Telefónica de Argentina been consolidated by the global integration method during 1997, profit from ordinary activities would have increased 5.3%. Financial expenses increased 27.0% (10.6%, had Telefónica de Argentina been consolidated by the global integration method during 1997), to Ps. 241.2 billion in 1998, primarily as a result of the increase in debt required to finance Telefónica Internacional's investments in Brazil, offset in part by decreases in financial expense at Telefónica de España as a result of the
decrease in its debt and interest rates. Negative exchange differences decreased by 50%, due to positive foreign exchange differences at Telefónica Internacional resulting from the decrease in the value of Telefónica Internacional’s debt in Brazilian reais at the end of 1998, due to the net effect of the depreciation of the real against the dollars and the appreciation of the peseta against the U.S. dollar from August to December. Results from associated companies increased by 22.5% from 1997 to Ptas. 12,199 billion. This increase was due primarily to contributions by the recent Brazilian acquisitions which totaled Ptas. 7,531 million. Goodwill amortization decreased by 36.6% to Ptas. 21.11 billion in 1998 from Ptas. 33.3 billion in 1997, primarily as a result of the increase in the maximum amortization period from 10 to 20 years, offset in part by the 63.3% increase in goodwill from Ptas. 155.035 million in 1997 to Ptas. 253.190 million in 1998, principally as a result of the goodwill recorded by Compañía de Inversiones en Telecomunicaciones.

Income before tax and minority interest

Income before tax and minority interest grew by 19.1% to Ptas. 402.0 billion in 1998 from Ptas. 337.6 billion in 1997. However, had Telefónica de Argentina been consolidated by the global integration method during 1997, income before tax and minority interest would have decreased by 2.9% in 1998 from 1997, primarily as a result of extraordinary expenses of Ptas. 174,696 million due to greater provisions at Telefónica for voluntary preretirement and early retirement plans, payments to Airtel pursuant to a ministerial order and compensation for workforce reductions at Telefónica de Argentina.

Corporate income tax

Provision for corporate income tax at the consolidated level increased by 24.9% to Ptas. 91.9 billion in 1998 from Ptas. 73.5 billion in 1997. Corporate income tax in Spain grew 9.6% to Ptas. 40.1 billion, while foreign income taxes increased 40.0% to Ptas. 51.8 billion, primarily due to the full effect of the consolidation of Telefónica de Argentina by the global integration method for 1998, offset by reductions in operating income at Compañía de Telecomunicaciones de Chile and Telefónica del Perú. Had Telefónica de Argentina been consolidated by the global integration method during 1997, corporate income tax at the consolidated level would have decreased 12.2%. The consolidated effective tax rate increased 1.1% in 1998 from 1997.

Minority interests

Minority interests increased 25% to Ptas. 92.6 billion, primarily due to the full effect of the consolidation of Telefónica de Argentina by the global integration method for 1998. Had Telefónica de Argentina been consolidated by the global integration method during 1997, minority interests would have decreased 22.5%, which is attributable to the fact that until November 1997, the Spanish government held a 23.78% interest in Telefónica Internacional.

Net income

As a result of the factors described above, net income increased by 14.5% to Ptas. 217.6 billion in 1998 from Ptas. 190.0 billion in 1997.
Liquidity and Capital Resources

The table below sets forth our consolidated cash flows for the periods indicated.

<table>
<thead>
<tr>
<th>Year ended December 31,</th>
<th>1997 (billions of pesetas)</th>
<th>1998 (billions of pesetas)</th>
<th>1999 (billions of pesetas)</th>
<th>1999 (billions of dollars)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net cash inflow from operating activities</td>
<td>1,090.4</td>
<td>1,249.3</td>
<td>1,587.5</td>
<td>9.6</td>
</tr>
<tr>
<td>Net cash outflow for interest paid less dividends and interest</td>
<td>(73.5)</td>
<td>(128.6)</td>
<td>(296.4)</td>
<td>(1.8)</td>
</tr>
<tr>
<td>Net cash outflow for capital expenditures</td>
<td>(725.5)</td>
<td>(749.2)</td>
<td>(1,251.8)</td>
<td>(7.6)</td>
</tr>
<tr>
<td>Net cash outflow for investments in affiliates</td>
<td>(376.1)</td>
<td>(1,208.5)</td>
<td>(345.7)</td>
<td>(2.1)</td>
</tr>
<tr>
<td>Net cash inflow before repayment of debt</td>
<td>(84.7)</td>
<td>(837.0)</td>
<td>(306.5)</td>
<td>(1.9)</td>
</tr>
<tr>
<td>Net cash inflow (outflow) used in financing activities</td>
<td>170.9</td>
<td>770.4</td>
<td>388.0</td>
<td>2.3</td>
</tr>
<tr>
<td>Effects of exchange rate changes on cash</td>
<td>2.2</td>
<td>18.8</td>
<td>(18.6)</td>
<td>(0.1)</td>
</tr>
<tr>
<td>Net increase (decrease) in cash and cash equivalents</td>
<td>88.4</td>
<td>(47.8)</td>
<td>63.0</td>
<td>0.4</td>
</tr>
</tbody>
</table>

Positive figures refer to cash inflows and negative figures or those in brackets refer to cash outflows.

Net cash inflow from operating activities increased by 27.07% to Ptas. 1,587.5 billion during 1999 from Ptas. 1,249.3 billion in 1998. This strong growth was principally due to the positive performance of Telefónica Servicios Móviles, whose operating revenues increased by 32.9% in 1999, and the effect of the consolidation of Telesp and Tele Sudeste. Net cash inflow from operating activities increased by 14.6% to Ptas. 1,249.3 billion in 1998 from Ptas. 1,090.4 billion in 1997.

Net cash outflow for interest paid less dividends and interest charged increased by 130% in 1999 to Ptas. 296.4 billion in 1999 from Ptas. 128.6 billion in 1998. Most of the increase in 1999 was due to the consolidation of Telesp and Tele Sudeste. Net interest paid, the main component of net cash outflow, declined at both Telefónica de España and Telefónica Servicios Móviles, and remained relatively steady at Telefónica Internacional, without giving effect to the consolidation of Telesp and Tele Sudeste. Net cash outflow for interest paid less dividends and interest received increased by 75.0% to Ptas. 128.6 billion in 1998 from Ptas. 73.5 billion in 1997. The decrease in 1997 was principally due to a decline in interest rates and the increase in 1998 was due to the increase in debt incurred to finance Telefónica Internacional’s acquisitions in Brazil.

Net cash outflow for capital expenditures increased by 67% during 1999. Tangible capital expenditure payments for 1999 increased 66%, while those related to intangible assets and deferred charges rose 50%. Net cash outflow for capital expenditures amounted to Ptas. 749.2 billion and Ptas. 725.5 billion in 1998 and 1997, respectively. Capital expenditures amounted to 27.7%, 31.7% and 30.7% of revenue from operations in 1999, 1998 and 1997, respectively.

Net cash outflow due to investments in affiliates decreased by 71.4% during 1999 when compared with 1998.

Cash outflow due to investments in affiliates decreased more than 42.5% compared to 1998. The main investments during 1999 were:

- increases in our interest in Telesp and Tele Sudeste through direct market purchases and in the consortium that participated in the privatization of Telesp Participações, which resulted in a cash outflow of Ptas. 99,679 million;
- the acquisition of an additional 5.03% stake in Telefónica del Perú, which resulted in a cash outflow of Ptas. 33,182 million;
- the purchase of additional 19% of Telefónica Larga Distancia de Puerto Rico, which resulted in a cash outflow of Ptas. 7,049 million;

S-87
the acquisition of 100% of the share capital of the Austrian company European Telecom International Gmbh, which resulted in a cash outflow of Ptas. 4,992 million;  
the acquisition of 50% of Alianza Atlántida Holding, which resulted in a cash outflow of Ptas. 3,439 million;  
the acquisition of 5% of the publishing group Pearson, which resulted in a cash outflow of Ptas. 103,391 million;  
the acquisition of additional interests in Vía Digital and Antena 3, which resulted in a cash outflow of Ptas. 112,571 million;  
the subscription to additional Portugal Telecom shares in its capital increase; and  
the acquisition of 72.66% of Centrais Telefónicas de Ribeirão Preto, S.A. which resulted in a cash outflow of Ptas. 30,404 million  

Cash inflow due to investments in affiliates increased 318.5% during 1999 compared to 1998. The principal transactions contributing to this increase were:  
the public offering of 35% of Telefónica Publicidad e Información, which resulted in a cash inflow of Ptas. 99,300 million  
the sale of 12.2% of the stake held in Amper's share capital, which resulted in a cash inflow of Ptas. 6,811 million  
the sale of the total 25% participation held in Sofres Audiencia de Medios, which resulted in a cash inflow of Ptas. 600 million  
the sale of the 100% of Temasa, which resulted in a cash inflow of Ptas. 37,178 million  
the public offering of Infonet Services Corporation Inc. which resulted in a cash inflow of Ptas. 4,664 million  
the public offering of 29.53% of Terra Networks, S.A., which resulted in a cash inflow of Ptas. 111,172 million  
the sale of 20% of our stake in Recoletos Compañía Editorial, S.A.'s share capital, which resulted in a cash inflow of Ptas. 30,000 million  
The increase in cash inflow from operating activities, combined with the sharp drop in net cash outflow due to financial investments, even with the increase in cash outflow for capital expenditures, resulted in a considerable improvement during 1999 in net cash inflow before financing activities, which increased by 63.4%.  

In 1998, net cash outflow for investments in affiliates increased substantially to Ptas. 1,208.5 billion from Ptas. 376.1 billion in 1997. The increase in 1998 was primarily due to:  
the acquisition of interests in Telesp, Telesp Celular, Tele Leste Celular and Tele Sudeste Celular;  
the increase in Telefónica Internacional's stake in Companhia Riograndense de Telecomunicações; and  
the acquisition of INTEL El Salvador, S.A.  

Net cash flow due to financing activities amounted to an inflow of Ptas. 388.0 billion in 1999, compared to an inflow of Ptas. 770.4 billion in 1998 and 170.9 billion in 1997. The principal offerings by us in the Spanish market during 1999 were debenture issues of £500 million, £300 million and £30 million, respectively. The £500 million issue had a 10-year maturity and a 4.5% fixed interest rate. The £300 million issue had an interest rate linked to 12-month Euribor plus 63 basis points with annual interest payments. The final issue of £30 million was a zero coupon with a 30-year maturity and with an implicit interest rate of 6.37%. We also issued floating rate notes totaling £500 million with one year maturity and an interest rate linked to 3-month Euribor outside Spain.
We had positive net cash flow from financing activities in 1998 as a result of a capital increase of Pesos 427,000 million in May 1998 and Pesos 105,000 million in loans received from the European Investment Bank. Telefónica had positive net cash flow from financing activities in 1997 as a result of a $600 million offering of exchangeable bonds by Telefónica Europe (exchangeable for stock of Telefónica), a $500 million (Pesos 76.2 billion) offering of floating rate notes in December 1997 and a 15 billion Portuguese escudo (Pesos 13.0 billion) bond offering in October 1997, both of which were drawn down from the $1.5 billion Euro Medium Term Note Program of Telefónica Europe.

The following table sets forth the amortization schedule for certain of our consolidated debt as of December 31, 1999:

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>Subsequent Years</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Debentures and bonds</td>
<td>207,750</td>
<td>232,076</td>
<td>152,518</td>
<td>88,065</td>
<td>659,390</td>
<td>1,339,799</td>
</tr>
<tr>
<td>Other negotiable</td>
<td>137,176</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>137,176</td>
</tr>
<tr>
<td>instruments</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes payable</td>
<td>1,618</td>
<td>12,286</td>
<td>—</td>
<td>—</td>
<td>—</td>
<td>13,904</td>
</tr>
<tr>
<td>Loans and credits</td>
<td>99,277</td>
<td>58,022</td>
<td>49,702</td>
<td>43,893</td>
<td>463,895</td>
<td>714,789</td>
</tr>
<tr>
<td>Loans in foreign</td>
<td>460,286</td>
<td>227,188</td>
<td>126,772</td>
<td>184,368</td>
<td>352,516</td>
<td>1,351,130</td>
</tr>
<tr>
<td>currency</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>906,107</td>
<td>529,572</td>
<td>328,992</td>
<td>316,326</td>
<td>1,475,801</td>
<td>3,556,798</td>
</tr>
</tbody>
</table>

For details of the composition of, and changes in, our debt, see notes 15 and 16 to Telefónica’s consolidated financial statements.

As the preceding table indicates, Telefónica will be required to repay a significant amount of debt during 2000-2002 with 49.6% of consolidated debt maturing in such period. Notwithstanding these significant cash outlays in the coming years, we believe that we will be able to gradually reduce the level of this consolidated debt. In order to achieve this objective, we expect to:

- make future borrowings on significantly more favorable terms than in the past when much of our debt was at fixed rates substantially above current market rates and
- increase our reliance on self-financing.

Of our Pesos 3,556.8 billion of consolidated debt at December 31, 1999, approximately 6.6% represented zero-coupon obligations and the average interest rate on all of our outstanding debentures and bonds was 8.3%. In November 1996, we established a $1.5 billion Euro Medium Term Note (“EMTN”) program. The maximum aggregate principal amount that may be issued under the EMTN program was increased to $2 billion on June 12, 1998 and to €8 billion in August 2000. Of this amount, $1,201.7 million was issued and outstanding as of June 1, 2000. In addition, we had approximately Pesos 359.9 billion of unused credit lines at the consolidated level at December 31, 1999. In July 1997, Telefónica Europe issued $600 million principal amount of 2% bonds guaranteed by Telefónica and exchangeable for shares of Telefónica. We believe that our EMTN program and available credit lines will provide us with substantial flexibility for our future capital needs as existing debt is retired.

In April 1998, we launched a rights offering, whereby we issued 85,406,438 new shares at a price of Pesos 5,000 each. Existing shareholders had the right to subscribe for one new share for each 11 they held. The aggregate proceeds of the offering (after deducting underwriting fees and other expenses) were approximately Pesos 409 billion.

In July 2000, Telefónica Europe established a euro CP program of up to €2 billion. In August 2000, we established a €8.0 billion syndicated loan facility. This facility is split into a €6.0 billion, one-year term tranche and a €2.0 billion three-year tranche. On September 1, 2000, Telefónica drew approximately €4,900,000,000 from the first tranche, at an interest rate equal to Euribor plus 30 basis points. The proceeds of this loan were used to fund Telefónicas’s capital requirements in connection with the acquisition of UMTS licenses in Germany.

In August 2000, we filed a “shelf” registration statement with the United States Securities and Exchange Commission. Pursuant to this shelf registration, we may sell debt securities in one or more offerings up to a total aggregate offering price of $10.0 billion.
Research and Development

Our research and development policy is aimed at:

- developing new products and services in order to gain market share
- fostering customer loyalty
- increasing revenues
- improving management
- increasing the quality of our infrastructure and services to improve customer service
- reducing costs

Our research and development activities are principally conducted by Telefónica Investigación y Desarrollo, S.A. Telefónica Investigación y Desarrollo conducts experimental and applied research and product development to increase the range of our services and reduce operating costs. It also provides technical assistance to our Latin American operations. Telefónica Investigación y Desarrollo's activities include the following:

- the development of telephone services, particularly the development of new value-added services for the public, corporate, mobile and multimedia sectors, and the automation of customer services
- the development of interactive services, focusing on the development of information services and new infrastructure to provide such services, primarily in the Internet Protocol environment
- the development of management systems designed to strengthen infrastructure and its quality and to develop innovative solutions for the management of Telefónica's networks and services
- the development of business support systems intended to provide innovative solutions for business processes
- innovation in business services intended to reinforce technological skills in the areas of networks, software and information technologies

Approximately 64% in 1999 and 79% in 1998 of Telefónica Investigación y Desarrollo's research and development was for the benefit of Telefónica de España while approximately 36% in 1999 and 21% in 1998 was for the benefit of the Telefónica Group's other subsidiaries, particularly Telefónica Servicios Móviles and Telefónica Data.

Our total research and development expenses (including those of Telefónica Investigación y Desarrollo) totaled Ptas. 19,683 million, Ptas. 21,928 million and Ptas. 15,022 million in 1997, 1998 and 1999, respectively. These expenses represented 0.8%, 0.8% and 0.4% of our consolidated revenues in each of those years, respectively.

Introduction of the Euro

In April 1997, we created the Office for the Euro Project, which was responsible for determining and evaluating the potential impact of the conversion to the euro as well as planning and coordinating the necessary changes.

The majority of our information systems and applications were modified during 1998 in order to offer information in both pesetas and euro as of January 1, 1999. In addition, during 1999 we began developing a plan to modify such systems and applications in order to commence operating exclusively in euro as of January 1, 2002. The mission critical systems are expected to be completely modified by mid-2001 in order to conduct tests throughout the remainder of the year.

Our estimated cost of changes necessary in order to accommodate the conversion to the euro is Ptas. 5,000 million, 70% of which will be applied towards the conversion of IT systems and 30% of which will be used for
training programs. Through December 31, 1999, only 20%, or approximately Ptas. 1,000 million, of the total estimated costs had been expensed.

The above euro discussion contains forward-looking statements that are made pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995. These statements include, without limitation, whether and to what extent the introduction of the euro will affect our business, financial condition and results of operations.

Principal Differences Between U.S. GAAP and Spanish GAAP

The principal differences between U.S. GAAP and Spanish GAAP relevant to us are the revaluation of fixed assets, the recognition of deferred taxes, the capitalization of interest during construction, the capitalization of research and development, the recording of provisions for early retirement, the consolidation of subsidiaries, the recognition of unrealized exchange losses and the recognition of unrealized gains on securities. See note 25 to Telefónica's consolidated financial statements.

Prior to 1988, Spanish GAAP permitted the revaluation of fixed assets. As a result of such revaluation, in years prior to 1988, we stated our property, plant and equipment at the then current replacement cost less accumulated depreciation, and credited the revaluations to the surplus account shown on the balance sheet under "other reserves". Depreciation was calculated each year based on the then current gross replacement cost using estimated remaining useful lives. Between 1988 and 1995, Spanish GAAP did not permit such revaluations, and we used historical cost basis accounting. In 1996, new legislation permitted us to write-up the value of certain of our assets. We took advantage of this legislation on December 31, 1996 and wrote-up the value of certain assets by Ptas. 225.9 billion under Spanish GAAP. This write-up was reversed in the reconciliation to U.S. GAAP of shareholders' equity. In connection with this write-up, we paid a one-time tax of Ptas. 75.8 billion under Spanish GAAP in 1996. Because the asset write-up is not permitted under U.S. GAAP, this tax expense was reversed in the 1996 reconciliation of net income to U.S. GAAP. In addition, the 1996 U.S. GAAP reconciliation included the effect of the tax credit arising from the deductibility of future depreciation generated by the revaluation which, pursuant to SFAS 109, was recorded as Ptas. 55.6 billion of income in 1996.

Under Spanish GAAP tax credit carryforwards are not recognized until they are utilized. Under U.S. GAAP, such credits are generally required to be recognized in the period during which they arise and a valuation allowance is required to be recorded for deferred tax carryforwards when it is determined that it is more likely than not that such assets will not be realized.

In accordance with Spanish GAAP, interest incurred during periods exceeding 12 months in which assets are under construction is capitalized. However, interest incurred during construction is required to be capitalized under U.S. GAAP.

Spanish GAAP requires that research and development expenses be capitalized and amortized over a period not exceeding five years. Such expenses are expensed in current periods under U.S. GAAP.

Under Spanish GAAP, provisions are recorded for early retirement expenses in the period during which management announces the early retirement programs. Under U.S. GAAP, early retirement provisions are recorded in the period during which an agreement is reached with the employee.

Under Spanish GAAP, certain unrealized exchange losses are deferred and recognized only upon realization. Prior to 1996, we deferred exchange losses in accordance with Spanish GAAP, which coincided with the provisions of SFAS 71 (relating to accounting for certain regulated entities). However, we believe that, in light of the ongoing deregulation of the Spanish telecommunications industry, SFAS 71 is no longer applicable. Accordingly, unrealized exchange losses that were previously deferred have been recorded as an extraordinary expense for 1996 for U.S. GAAP purposes and will continue to be treated in this manner in future periods.
Spanish GAAP requires unrealized exchange gains to be deferred. Under U.S. GAAP, deferred exchange gains are included in income on a current basis.

SFAS No. 115 requires certain investments in financial assets to be classified on the basis of the purpose for which they were acquired (held-to-maturity securities, trading securities or available-for-sale securities). The treatment of the unrealized gains and losses differs depending on the classification: unrealized gains and losses (other than permanent diminutions in value) on securities that we consider held-to-maturity are not recorded; unrealized gains and losses on securities considered available-for-sale are not recorded in the income statement but included as a separate equity caption; and unrealized gains or losses on trading securities are recorded in the income statement. These criteria differ from Spanish GAAP.

For additional information concerning significant differences between U.S. GAAP and Spanish GAAP, as well as a reconciliation of net income and shareholders’ equity to U.S. GAAP, please see note 25 to Telefónica’s consolidated financial statements.

Quantitative and Qualitative Disclosures about Market Risk

The principal market risks to which Telefónica was exposed in 1999 were interest rate risk and foreign currency exchange rate risk. These were Telefónica’s principal market risks in 1998 as well. Telefónica actively manages both risks, in part with financial derivatives. All of Telefónica’s financial derivative transactions are entered into for hedging purposes. However, Telefónica is required to classify its exchange rate forward contracts as held for trading purposes if (i) the exchange rate forward contracts are being used to hedge expected foreign income or (ii) the hedges are put in place in Telefónica Internacional, S.A. while the underlying debt is kept in its Latin American subsidiaries. Instruments that are classified as held for trading purposes are carried at market prices, and gains or losses arising therefrom are recorded immediately in the income statement as financial revenue or expense, as appropriate. All other financial derivatives held by Telefónica at December 31, 1999, were classified as hedges under Spanish GAAP. Gains or losses on these instruments are recorded as adjustments to the underlying transactions. In general, Telefónica’s counterparties in its financial derivatives transactions are financial institutions.

Interest rate risk

Telefónica uses swaps and options to manage its exposure to interest rate fluctuations. Giving effect to these derivative transactions, at December 31, 1999 approximately 60.3% of Telefónica’s long-term debt portfolio bore interest at a fixed rate. The corresponding figure was 59.9% at December 31, 1998. Telefónica’s floating rate debt portfolio is principally subject to fluctuations in the London Interbank Offered Rate (particularly for the U.S. dollar Libor) and the Madrid Interbank Offered Rate (Mibor).

The potential loss to Telefónica over one year that would have resulted from a hypothetical, instantaneous and unfavorable 10% change in the interest rates applicable to financial assets and liabilities would have been approximately Ptas. 13,991 million on December 31, 1999, and Ptas. 10,664 million on December 31, 1998. The above sensitivity analyses are based on the assumption of an unfavorable 10% change in the interest rates applicable to each homogenous category of financial assets and liabilities and sustained over a period of one year. A homogenous category is defined according to the currency in which financial assets and liabilities are denominated and assures the same interest rate movement within each homogenous category (e.g. U.S. dollars). As a result, Telefónica’s interest rate sensitivity model may overstate the impact of interest rate fluctuation for such financial instruments since consistently unfavorable movements of all interest rates are unlikely.

Exchange rate risk

The exchange rate risk to which Telefónica is exposed derives principally from both (i) its long-term debt portfolio that is denominated in (or swapped into) currencies other than the peseta or the currencies of those countries that have adopted the euro and (ii) the fact that Telefónica conducts a substantial amount of business
in, and has substantial investments in, countries outside of Spain, principally Latin American countries. Telefónica has incurred foreign currency-denominated debt obligations in order to fund investments outside Spain, primarily in Latin America. Consequently, over 99% of Telefónica's foreign debt obligations (excluding those which are denominated in currencies of countries which have adopted the euro) are denominated in U.S. dollars or Latin American currencies. Telefónica hedges its debt-related exchange rate exposure to the extent that it considers necessary and hedges are commercially available. Telefónica from time to time hedges its exchange rate exposure arising from foreign-currency dividend streams, management fees and attributed net income from its principal non-Spanish subsidiaries. Telefónica uses swaps, options and exchange rate forward contracts to manage its exposure to exchange rate fluctuations. Giving effect to these derivative transactions, Telefónica was exposed to foreign currency fluctuations on approximately 70.4% of its long-term debt at December 31, 1999, and 44.4% as of December 31, 1998.

The potential immediate loss to Telefónica that would have resulted from a hypothetical 10% change in foreign currency exchange rates was approximately Ptas. 106,250 million as of December 31, 1999, and Ptas. 79,079 million as of December 31, 1998. In addition, if such a change were to be sustained, Telefónica's cost of financing would increase in proportion to the change. This sensitivity analysis assumes an unfavorable 10% fluctuation in all of the exchange rates affecting all the foreign currencies in which Telefónica's indebtedness is denominated. Since consistently and simultaneously unfavorable movements in all relevant exchange rates are unlikely, this assumption may overstate the impact of exchange rate fluctuations on Telefónica's results of operations.

Tabular description of market rate sensitive instruments

The tables below describe the financial instruments bearing interest or exchange rate risk for the companies consolidated in the Telefónica group.

The tables below have been prepared as follows:

- The debt obligations are ordered according to their final characteristics and taking into account the effect of the associated derivative instruments. They are classified according to the currency in which they are denominated, within the following categories:
  - Euro
  - European currencies other than the euro
  - U.S. dollar
  - Latin American currencies
  - Asian currencies
- Each such group is further divided into:
  - Floating rate interest
  - Fixed rate interest
  - Interest rate bounded with options
- Each column shows the notional amount of each debt obligation maturing in the year indicated at the top of the column through 2004. The notional amount outstanding after 2004 is shown in the next column. The column "Total" sums all of the notional amounts.
- Notional amounts do not include accrued interest, except for zero coupon bonds, which include accrued interest from inception to December 31, 1999.
- The fair value columns show the value for (i) the underlying debt, (ii) the derivatives linked to the underlying debt and (iii) the total (the sum of the two previous values).
# SENSITIVITY TO INTEREST RATES AND EXCHANGE RATES OF DEBT OBLIGATIONS AT DECEMBER 31, 1999

<table>
<thead>
<tr>
<th>Maturity Dates</th>
<th>Underlying Debt</th>
<th>Associated Derivatives</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2000</td>
<td>2001</td>
<td>2002</td>
</tr>
<tr>
<td>Euro</td>
<td>(276,396)</td>
<td>238,214</td>
<td>170,725</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>(280,375)</td>
<td>40,322</td>
<td>12,849</td>
</tr>
<tr>
<td>Spread—Ref Mibor</td>
<td>0.02%</td>
<td>0.19%</td>
<td>0.25%</td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>3.979</td>
<td>197,893</td>
<td>137,626</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>6.05%</td>
<td>11.52%</td>
<td>5.14%</td>
</tr>
<tr>
<td>Bounded Rate</td>
<td></td>
<td>20,250</td>
<td>20,250</td>
</tr>
<tr>
<td>Less than 3 years</td>
<td></td>
<td></td>
<td>20,250</td>
</tr>
<tr>
<td>More than 3 years</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Other European Countries

| Currencies | 1,110 | 1,110 | 1,110 | 53,569 | 56,889 | 54,225 | 3,316 | 57,542 |
| Instruments in GBP | 32,142 | 32,142 | 30,308 | 1,897 | 32,295 |
| Spread |                |                        |        |        |        |        |        |        |
| Fixed Rate |                |                        |        |        |        |        |        |
| Interest Rate |                |                        |        |        |        |        |        |
| Instruments in CHP | 1,110 | 1,110 | 1,110 | 6.25% | 3,359 | 4,361 |
| Fixed Rate | 1,110 | 1,110 | 1,110 | 3,329 | 4,361 |
| Interest Rate | 2.18% | 2.18% | 2.18% |        | 2.18% |

### America

| Instruments in USD | 647,333 | 221,197 | 69,130 | 162,641 | 138,950 | 567,032 | 1,806,283 | 1,674,728 | 137,753 | 1,812,111 |
| Floating Rate | 515,005 | 151,622 | 25,582 | 4,589 | 49,078 | 9,439 | 155,816 | 755,489 | 25,007 | 750,555 |
| Spread | 0.33% | 1.17% | 0.82% | 2.60% | 0.26% | 4.94% | 0.58% |
| Fixed Rate | 120,828 | 69,753 | 43,548 | 138,052 | 89,871 | 264,623 | 756,497 | 664,299 | 114,760 | 761,059 |
| Interest Rate | 8.45% | 8.10% | 8.30% | 6.31% | 8.93% | 7.52% |
| Bounded rate |                |                        |        |        |        |        |        |
| Less than 3 years | 209,265 | 209,265 | 209,265 |        |        |        |
| More than 3 years | 83,706 | 83,706 | 83,706 |        |        |        |
| Instruments in ARS | 223,305 | 223,305 | 209,769 | 8,923 | 218,692 |
| Interest Rate | 9.37% |        |        |        |        |        |
| Instruments in BRL | 136,228 | 19,272 | 10,589 | 4,586 | 7,569 | 13,812 | 192,056 | 191,313 | 10,814 | 202,128 |
| Floating Rate | 100,859 | 19,272 | 10,589 | 4,586 | 7,569 | 13,812 | 156,723 | 156,742 | 9,714 | 166,455 |
| Spread |                |                        |        |        |        |        |        |
| Fixed Rate | 35,333 |        |        |        |        |        | 35,333 | 34,572 | 1,101 | 35,672 |
| Instruments in CLP | 33,776 |        |        |        |        |        | 33,776 | 33,053 | 411 | 33,464 |
| Interest Rate | 9.08% |        |        |        |        |        | 9.08% |
| Instruments in PEN | 56,825 | 13,032 |        |        | 6,819 | 76,677 | 72,926 | (37) | 72,889 |
| Floating Rate | 5,248 |        |        |        | 12,087 | 12,087 |        |        |
| Spread | 5,600 |        |        |        | 6,960 | 6,378 |
| Fixed Rate | 56,825 | 7,784 |        |        |        |        | 64,610 | 60,919 | (37) | 60,882 |
| Interest Rate | 15.38% | 12.37% |        |        |        |        | 15.19% |
| Instruments in UF | 56,620 | 52,894 | 55,781 | 65,237 | 71,036 | 128,483 | 400,052 | 374,602 | (3,753) | 370,849 |
| Floating Rate | 11,107 | 3,996 | 48,849 | 29,479 | 65,363 |        | 138,728 | 159,513 | (2,336) | 157,178 |
| Spread | 0.85% | 0.85% | 0.85% | 0.85% | 0.85% |        | 0.85% |
| Fixed Rate | 15,513 | 48,988 | 6,932 | 35,758 | 5,674 | 128,483 | 241,258 | 215,089 | (1,417) | 213,672 |
| Interest Rate | 6.36% | 6.36% | 6.36% | 6.36% | 6.36% |        | 6.36% |
| Instruments in VEB | 9,256 |        |        |        |        |        | 9,256 | 8,791 | 144 | 8,935 |
| Fixed Rate | 9,256 |        |        |        |        |        | 9,256 | 8,791 | 144 | 8,935 |
| Interest Rate | 22.28% |        |        |        |        |        | 22.28% |

### Asia

| Instruments in JPY | 11 |        |        |        |        |        |        |        |
| Fixed Rate | 11 |        |        |        |        |        |        |        |
| Interest Rate | 0.73% |        |        |        |        |        |        |        |
| Instruments in MAD | 12,122 |        |        |        |        |        |        |        |
| Fixed Rate | 12,122 |        |        |        |        |        |        |        |
| Interest Rate | 6.96% |        |        |        |        |        |        |        |
| Total | 870,190 | 545,720 | 307,335 | 264,014 | 383,176 | 1,256,304 | 3,626,739 | 3,396,951 | 153,212 | 3,552,162 |
| Exchange Rate Options | 39,511 |        |        |        |        |        |        |        |

S-94
## SENSITIVITY TO INTEREST RATES AND EXCHANGE RATES OF DEBT OBLIGATIONS AT DECEMBER 31, 1998

### Table: Maturity Dates

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>Subsequent</th>
<th>Total</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Euro</strong></td>
<td>107,682</td>
<td>156,412</td>
<td>186,841</td>
<td>125,405</td>
<td>30,385</td>
<td>354,933</td>
<td>961,657</td>
<td>1,043,024</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>5,059</td>
<td>5,054</td>
<td>5,054</td>
<td>37,806</td>
<td>3,815</td>
<td>23,606</td>
<td>80,395</td>
<td>76,631</td>
</tr>
<tr>
<td>Spread—Ref Mibor</td>
<td>0.09%</td>
<td>0.09%</td>
<td>0.09%</td>
<td>0.10%</td>
<td>0.12%</td>
<td>0.05%</td>
<td>0.10%</td>
<td></td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>102,623</td>
<td>143,770</td>
<td>162,449</td>
<td>74,674</td>
<td>25,320</td>
<td>252,177</td>
<td>761,012</td>
<td>847,498</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>6.86%</td>
<td>6.90%</td>
<td>10.24%</td>
<td>5.44%</td>
<td>5.36%</td>
<td>5.14%</td>
<td>6.83%</td>
<td></td>
</tr>
<tr>
<td>Bounded Rate</td>
<td>7,588</td>
<td>19,338</td>
<td>12,925</td>
<td>1,250</td>
<td>79,150</td>
<td>120,250</td>
<td>118,895</td>
<td></td>
</tr>
<tr>
<td>Less than 1 year</td>
<td>7,588</td>
<td>18,088</td>
<td>11,675</td>
<td>52,650</td>
<td>90,000</td>
<td>91,164</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans ESP Mibor</td>
<td>7,588</td>
<td>18,088</td>
<td>11,675</td>
<td>52,650</td>
<td>90,000</td>
<td>91,164</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rest of Europe</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>5,528</td>
<td>5,534</td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>1,106</td>
<td>5,528</td>
<td>5,534</td>
</tr>
<tr>
<td>Interest Rate</td>
<td>2.18%</td>
<td>2.18%</td>
<td>2.18%</td>
<td>2.18%</td>
<td>2.18%</td>
<td>2.18%</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>America</strong></td>
<td>891,137</td>
<td>321,601</td>
<td>0</td>
<td>16,565</td>
<td>105,512</td>
<td>234,170</td>
<td>1,568,984</td>
<td>1,539,764</td>
</tr>
<tr>
<td>Floating Rate</td>
<td>852,500</td>
<td>225,244</td>
<td>0</td>
<td>16,565</td>
<td>34,137</td>
<td>234,170</td>
<td>1,362,617</td>
<td>1,324,217</td>
</tr>
<tr>
<td>Spread</td>
<td>0.11%</td>
<td>0.13%</td>
<td>0.64%</td>
<td>0.07%</td>
<td>0.10%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instruments Issued in USD</td>
<td>159,307</td>
<td>16,565</td>
<td>15,862</td>
<td>104,971</td>
<td>301,106</td>
<td>302,404</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Instruments Synthetically in USD</td>
<td>467,548</td>
<td>14,275</td>
<td>129,199</td>
<td>611,022</td>
<td>661,073</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Loans—USD</td>
<td>232,314</td>
<td>14,275</td>
<td>54,520</td>
<td>301,110</td>
<td>305,840</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed Rate</td>
<td>38,637</td>
<td>96,356</td>
<td>71,375</td>
<td>206,368</td>
<td>215,247</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest Rate</td>
<td>9.87%</td>
<td>6.53%</td>
<td>6.38%</td>
<td>7.10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Loans—USD</td>
<td>21,413</td>
<td>96,356</td>
<td>71,375</td>
<td>189,144</td>
<td>197,822</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Loans—ARS</td>
<td>6,818</td>
<td>6,818</td>
<td>6,897</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Loans—CLP</td>
<td>9,030</td>
<td>9,030</td>
<td>9,154</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Currency Loans—PEN</td>
<td>1,377</td>
<td>1,377</td>
<td>1,394</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asia</td>
<td>1,092</td>
<td>1,092</td>
<td>1,092</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Floating Rate</td>
<td>1,092</td>
<td>1,092</td>
<td>1,092</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Spread</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>1,001,016</td>
<td>479,118</td>
<td>187,946</td>
<td>143,076</td>
<td>137,003</td>
<td>589,102</td>
<td>2,537,261</td>
<td>2,589,414</td>
</tr>
<tr>
<td>Exchange Rate Options</td>
<td>49,820</td>
<td>93,359</td>
<td>143,178</td>
<td>3,201</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

We are managed by our Board of Directors, which consists of 20 members. All members of the Board of Directors are elected to five-year terms by our shareholders during a general meeting of shareholders. Between general meetings, the Board of Directors may appoint directors to fill vacancies on the Board, subject to ratification at the next general meeting. The Board of Directors, which meets monthly, elects from among its own members the chairman and the vice chairmen, and delegates day-to-day management of us to a standing committee of the Board of Directors which meets semi-monthly. The Board of Directors has also constituted an audit and control committee, a hiring and compensation committee, a human resources committee, a regulatory committee and a service quality and customer care committee, each of which is composed of between a minimum of three directors and a maximum of five directors.

Board of Directors

As of August 31, 2000, the directors of Telefónica, S.A., their respective positions on the Board and the year they were appointed to such positions were as follows:

<table>
<thead>
<tr>
<th>Name</th>
<th>Age</th>
<th>First Appointed</th>
<th>Current Term Ends</th>
<th>Current Position and Present Principal Occupation or Employment Material Positions Held During Past Five Years*</th>
</tr>
</thead>
<tbody>
<tr>
<td>César Alierta Izuel(1)(3)</td>
<td>55</td>
<td>1997</td>
<td>2002</td>
<td>Chairman and Chief Executive Officer, Telefónica, S.A.; Director, Telefónica Internacional, S.A.; President, Altadis, S.A.</td>
</tr>
<tr>
<td>Fernando Abril-Martorell Hernández</td>
<td>38</td>
<td>2000</td>
<td>(14)</td>
<td>Chief Operating Officer, Telefónica, S.A.</td>
</tr>
<tr>
<td>Isidro Fainé Casas(1)(2)(8)</td>
<td>57</td>
<td>1994</td>
<td>2001</td>
<td>Vice Chairman, Telefónica, S.A.; General Manager, Caja de Ahorros y Pensiones de Barcelona; Director, Telefónica Internacional, S.A.</td>
</tr>
<tr>
<td>Pedro Luis Uriarte Santamarina(7)</td>
<td>57</td>
<td>2000</td>
<td>2005</td>
<td>Director, Telefónica, S.A.; Vice President and Managing Director, Banco Bilbao Vizcaya Argentaria</td>
</tr>
<tr>
<td>José Ignacio Goirigolzarri Tellaeche(7)</td>
<td>46</td>
<td>2000</td>
<td>2005</td>
<td>Director, Telefónica, S.A.; General Manager, Banco Bilbao Vizcaya Argentaria</td>
</tr>
<tr>
<td>Gaspar Añito Ortiz(5)</td>
<td>64</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A.; Manager, Banco Portugués de Inversiones; Alternate Director, Telefónica de Argentina, S.A.; Alternate Director COINTEL, S.A.; General Manager, Aror, S.L.</td>
</tr>
<tr>
<td>Pedro Ballvé Lantero(3)(4)</td>
<td>46</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A.; President Campofrio; Director, Banco Santander Central Hispano, S.A.; President, Telepizza; Director, Telefónica Data, S.A.; Director Telefónica de Espauna, S.A.; Director, Atento Holding Telecomunicaciones, S.A.</td>
</tr>
<tr>
<td>Maximino Carpio García(2)</td>
<td>55</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A.; Director, Economic and Social Council of Spain</td>
</tr>
<tr>
<td>Name</td>
<td>Age</td>
<td>First Appointed</td>
<td>Current Term Ends</td>
<td>Current Position and Present Principal Occupation or Employment; Material Positions Held During Past Five Years</td>
</tr>
<tr>
<td>--------------------------------------------------------------------</td>
<td>-----</td>
<td>-----------------</td>
<td>-------------------</td>
<td>-----------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Alberto Cortina de Alcocer(1)(3)</td>
<td>54</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A.; Alternate Director, Telefónica Internacional, S.A.; Alternate Director, Cointel, S.A.; Alternate Director, Telefónica de Argentina, S.A.; Director Telefónica Publicidad e Información, S.A.; President, Banco Zaragozano, S.A.; Manager, Cartera Zaragozano, S.A.; Director, A.C. Hoteles; Director, Autopista Vasco-Aragonesa CEPSA; Vice President, Instalaciones y Montajes Eléctricos, S.A.; President, Vendedores de Residuos, S.A.; Director, Parzara, S.A.</td>
</tr>
<tr>
<td>José Javier Echenique Landiribar(1)(3)(5)(7)</td>
<td>48</td>
<td>1995</td>
<td>2000</td>
<td>Director, Telefónica, S.A.; Director, Autopista Concesionaria Española, S.A. (ACESA); Director, Corporacion IBV Servicios y Tecnologías, S.A.; Vice President and Director, Sociedad de Proyectos Industriales Conjuntos, S.A.; General Manager, Banco Bilbao Vizcaya Argentaria</td>
</tr>
<tr>
<td>Miguel Horta e Costa(9)(13)</td>
<td>52</td>
<td>1998</td>
<td>2003</td>
<td>Director, Telefónica, S.A.; Vice Chairman, Portugal Telecom; Director, Telesp, S.A.; Vice President, Telesp Celular, S.A.; Director, Telesp Celular Participaciones, S.A.</td>
</tr>
<tr>
<td>Ignacio Larracoechea Jausoro(6)</td>
<td>46</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A. and Managing Director, Johnson &amp; Johnson, LTD.</td>
</tr>
<tr>
<td>José Maldonado Ramos(5)(6)(7)</td>
<td>48</td>
<td>1999</td>
<td>2004</td>
<td>Director, Telefónica, S.A.; Director, Secretary, Banco Bilbao Vizcaya Argentaria</td>
</tr>
<tr>
<td>Antonio Massanell Lavilla(4)(6)(8)</td>
<td>45</td>
<td>1995</td>
<td>2000</td>
<td>Director, Telefónica, S.A.; Director, Inmobiliaria Colonial Sociedad Anónima; Director, Autema, S.A.; Director, Eltec, S.A.; Director, Port Vetura, S.A.; Director, Baquiera Beret; President, Prominmo; President, Building Center; Assistant General Manager, Caja de Ahorros y Pensiones de Barcelona</td>
</tr>
<tr>
<td>Name</td>
<td>Age</td>
<td>First Appointed</td>
<td>Current Term Ends</td>
<td>Current Position and Present Principal Occupations or Employment: Material Positions Held During Past Five Years*</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>-----</td>
<td>-----------------</td>
<td>-------------------</td>
<td>-------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Antonio Viana-Baptista</td>
<td>42</td>
<td>2000</td>
<td>2005</td>
<td>Managing Director, Telefónica Internacional, S.A.; Director, Telefónica, S.A.; Director, Telefónica Servicios Móviles, S.A.; Chairman and Chief Executive Officer, Telefónica Data Corp., S.A.; Director, Telefónica de España, S.A.; President COINTEL, S.A.; Director, Telefónica de Argentina, S.A.; Alternate Director, Cablevisión, S.A.; President, Telesp, S.A.; Director, Tele Leste Celular Part, S.A.; Director, Telegipe Celular, S.A.; Director Telebahía Celular, S.A.; Director, Portelcom Participações, S.A.; Director, Telesp Celular Participações, S.A.; President, Tele Sudeste Celular Participações, S.A.; President, Teletel Celular, S.A.; President, Teletel Celular, S.A.; Director, Sudetelcel Participações, S.A.; Director, Iberoeste Participações, S.A.; President, Telefónica del Peru Holding, S.A.; Director, Telefónica Internacional de Chile, S.A.; Director, Compañía Telecomunicaciones de Chile, S.A.; Alternative Director, CTC Comunicaciones Móviles, S.A.; Director, Telefónica del Perú, S.A.A.; President, Telefónica Larga Distancia de Puerto Rico, Inc.; Director, Telefónica de Centroamérica, S.L.</td>
</tr>
<tr>
<td>Bert C. Roberts, Jr.</td>
<td>57</td>
<td>1998</td>
<td>2003</td>
<td>Director, Telefónica, S.A.; President, WorldCom</td>
</tr>
<tr>
<td>Martín Velasco Gómez</td>
<td>46</td>
<td>1997</td>
<td>2002</td>
<td>Director, Telefónica, S.A.</td>
</tr>
<tr>
<td>Carles Vilarrubi Carrió</td>
<td>46</td>
<td>1996</td>
<td>2002</td>
<td>Director, Telefónica, S.A.; Director, Telefónica del Perú, S.A.; Director, Antena 3 Televisión, S.A.; Director, Telefónica Multimedia, S.A.C.</td>
</tr>
<tr>
<td>Luis Lada Díaz</td>
<td>50</td>
<td>2000</td>
<td>(14)</td>
<td>Director, Telefónica, S.A.; Chairman and Chief Executive Officer, Telefónica, Móviles S.A.</td>
</tr>
<tr>
<td>José María Mas Millet</td>
<td>46</td>
<td>1997</td>
<td>2005</td>
<td>Director, Telefónica, S.A.; Secretary of the Board, Telefónica, S.A.; Director, Telefónica del Perú, S.A.; Director, Antena 3 Televisión, S.A.; Director, Caja de Ahorros de Valencia, Castellón y Alicante, BANCAJA</td>
</tr>
<tr>
<td>Diego L. Lozano Romeral</td>
<td>40</td>
<td>1997</td>
<td>—</td>
<td>Vice Secretary, Telefónica, S.A.</td>
</tr>
</tbody>
</table>

(1) Member of the Standing Committee of the Board of Directors.
(2) Member of the Audit and Control Committee of the Board of Directors.
(3) Member of the Hiring and Compensation Committee of the Board of Directors.
(4) Member of the Human Resources Committee of the Board of Directors.
(5) Member of the Regulatory Committee of the Board of Directors.
(6) Member of the Service Quality and Customer Care Committee of the Board of Directors.
(7) Representative of Banco Bilbao Vizcaya Argentaria, S.A.
(8) Representative of Caja de Ahorros y Pensiones de Barcelona.
(9) Representative of Portugal Telecom.
(10) Representative of MCI/WorldCom.
(11) Non-director.
(12) Citizen of the United States.
(13) Citizen of Portugal.
(14) Interim appointment subject to approval at Telefónica's next shareholders' meeting.

* Where no position is shown, principal occupation for past five years was as director of Telefónica.

Spanish law permits limited liability companies to serve as members of the Board of Directors. A company serving in such a capacity must appoint a natural person to represent it at the meetings of the Board.

The Standing Committee is a body empowered to make decisions on general matters on behalf of the Board of Directors and has the delegated authority to carry out our Board of Directors' powers as permitted by our by-laws and Spanish corporate law. The members of the Standing Committee are Isidro Fainé Casas, César Alierta Izuel, Alberto Cortina de Alcocer, José Javier Echenique Landiribar, Luis Martín de Bustamante Vega, Antonio Viana-Baptista and José María Mas Millet.

The Audit and Control Committee is responsible for providing support to the Board of Directors in supervising the correct application of generally accepted accounting principles, reviewing compliance with internal control systems and maintaining the integrity of the preparation of individual and consolidated audits. The members of the Audit and Control Committee are Isidro Fainé Casas and Maximino Carpio García.

The Hiring and Compensation Committee is responsible for informing the Board of Directors of the proposals for naming Board of Directors members, members of Board of Directors committees and top members of management. The members of the Hiring and Compensation Committee are Pedro Ballvé Lanteroa, José Javier Echenique Landiribar, César Alierta Izuel and Alberto Cortina de Alcocer.

The Human Resources Committee is responsible for making proposals to the Board of Directors regarding the adoption of agreements with personnel. The members of the Human Resources Committee are Pedro Ballvé Lanteroa and Antonio Massanell Lavilla.

The Regulatory Committee is responsible for keeping the Board informed of personnel matters and making proposals to the Board of Directors for adopting policies in connection with regulatory matters. The members of the Regulatory Committee are Gaspar Arisña Ortiz, José Javier Echenique Landiribar, Martín Velasco Gómez and José Maldonado Ramos.

The Service Quality and Customer Care Committee is responsible for assuring and monitoring the standards of quality of all services provided by the Telefónica group and is committed to focusing on the customer satisfaction of all of its clients. The members of the Service Quality and Customer Care Committee are Ignacio Larracoechea Jausoro, José Maldonado Ramos, Antonio Massanell Lavilla and Martín Velasco Gómez.
Executive Committee

The members of our executive management committee at August 31, 2000, and the years of their appointments to their respective positions were as follows:

<table>
<thead>
<tr>
<th>Name</th>
<th>Position</th>
<th>Appointed</th>
<th>Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>César Alierta Izuel</td>
<td>Chairman and CEO, Telefónica, S.A.</td>
<td>2000</td>
<td>55</td>
</tr>
<tr>
<td>Fernando Abril-Martorell Hernández</td>
<td>COO, Telefónica, S.A.</td>
<td>2000</td>
<td>38</td>
</tr>
<tr>
<td>Joaquim Agut Bonsfills</td>
<td>Chairman, Terra Networks</td>
<td>2000</td>
<td>46</td>
</tr>
<tr>
<td>José María Álvarez-Pallec Lópeze</td>
<td>CFO and CAO (Chief Accounting Officer), Telefónica S.A.</td>
<td>1999</td>
<td>36</td>
</tr>
<tr>
<td>Guillermo Fernández Vidal</td>
<td>COO, Telefónica Datacorp</td>
<td>1998</td>
<td>54</td>
</tr>
<tr>
<td>Luis Lada Díaz</td>
<td>Chairman and CEO, Telefónica Móviles</td>
<td>2000</td>
<td>50</td>
</tr>
<tr>
<td>Julio Linares López</td>
<td>Chairman and CEO, Telefónica de España, S.A.</td>
<td>1999</td>
<td>54</td>
</tr>
<tr>
<td>Juan José Nieto Bueso</td>
<td>Chairman and CEO, Telefónica Media, S.A.</td>
<td>2000</td>
<td>35</td>
</tr>
<tr>
<td>Antonio Viana-Baptista</td>
<td>Chairman and CEO, Telefónica Datacorp</td>
<td>1999</td>
<td>42</td>
</tr>
<tr>
<td>Ángel Vilá Boix</td>
<td>General Manager of Corporate Development, Telefónica, S.A.</td>
<td>2000</td>
<td>36</td>
</tr>
<tr>
<td>José María Mas Millet</td>
<td>Director Secretary, Telefónica, S.A.</td>
<td>1998</td>
<td>46</td>
</tr>
</tbody>
</table>

In addition to the above, the senior management of Telefónica, S.A. is comprised of six general managers, four deputy general managers and 17 assistant general managers from Telefónica, S.A.

Compensation of Directors and Executive Officers

In 1999 the compensation paid to the members of our Board of Directors and our executive officers amounted to Ptas. 2,972 million.

We provide pension, retirement or similar benefits to our directors with executive functions and to our executive officers. We set aside or accrued Ptas. 23 million during 1999 for these benefits.

The cost to the Telefónica group of the compensation plans linked to the share market price in which directors participate as executives amounted to Ptas. 146 million in 1999.

In January 1998, Telefónica Internacional granted certain Telefónica Internacional executives options to purchase approximately 0.65% of Telefónica Internacional's capital stock (which Telefónica Internacional will acquire from Telefónica). These options are exercisable on a staggered basis over a three year period beginning in 1998, at an exercise price equal to the per-share price paid by us to the Spanish government in connection with the purchase of the Spanish government's minority interest in Telefónica Internacional.

Share Ownership

As of May 31, 2000, members of our Board of Directors and our executive officers owned an aggregate of 557,833 shares, representing less than 0.017% of the shares issued and outstanding at such date.

Incentive Plans

We have established two incentive compensation plans to retain and motivate our officers. These plans, called RISE and TIES, require that eligible officers purchase shares of the company in the open market at market prices and hold these shares for specified periods in order to receive additional cash compensation calculated on the basis of any increase in the value of our shares. We expect to establish an additional plan, called TIES, in 2000. Each of these plans is described below.
RISE

In February 1997, we established a compensation plan called RISE to retain and motivate the 100 most significant officers of the company. Under the plan, these officers were required to purchase in the open market at market prices and retain a specified number of Telefónica shares, depending on their management level, for the entire plan period, which ran from February 26, 1997, to February 25, 2000. The total number of shares initially acquired by eligible officers and assigned to the program was 307,339 shares, or 922,017 shares giving effect to stock splits and anti-dilution provisions of the plan. The plan provided that plan members would receive financial compensation following expiration of the plan to be based on the increase in value, if any, of our shares during the life of the plan. As adjusted for all stock splits and stock dividends, the amount to be received by plan participants for each share deposited and assigned to the program was the sum of:

- 12.2518 multiplied by the difference between Ptas. 962.75, the market price of our shares when the plan was initiated, and Ptas. 4,945.66, the average price of our shares on the Madrid stock exchange during the 10 business days prior to the expiration of the plan on February 25, 2000; and

- 12.2518 multiplied by the difference between Ptas. 1,476.47, 150% of the above market price when the plan was initiated, and Ptas. 4,945.66, the average price

All rights to compensation under this plan were expressly contingent on the officer not ending, unilaterally and voluntarily, his or her employment status with us prior to the expiration of the plan. Finally, the plan contained anti-dilution and other general and customary provisions for this type of transaction. This compensation plan granted the right to cash compensation and did not grant any shares, an option to purchase any shares or any other rights with respect to shares.

In order to cover the economic exposure derived from implementation of the RISE plan, we engaged two financial institutions to cover our payment obligations arising from the plan as a result of an increase in the price of our shares. This hedge was obtained through purchases of options on the total shares included in the plan. The total initial cost of these options was Ptas. 2,800 million, which has been allocated to the years that the plan has been in effect, resulting in an allocation of Ptas. 700 million in 1997, Ptas. 969 million in 1998, Ptas. 969 million in 1999 and Ptas. 162 million in 2000. Given these option arrangements, the sole cost to us of the plan was the cost of such options.

Our shareholders approved this plan at our annual general shareholders’ meeting in April 2000.

TOP

On May 26, 1999, our Board of Directors approved a stock option plan called TOP proposed by its Hiring and Compensation Committee. This stock option plan is effective for a period of four years and three months from its June 28, 1999 commencement date and is open to up to 500 officers throughout the Telefónica group.

As in the RISE compensation plan described above, all beneficiaries are required to acquire in the open market at market prices and hold, during the entire effective period, a specified number of shares in an amount corresponding to the beneficiary’s management responsibility. If all eligible officers elect to participate in the plan, the total number of shares acquired by them would be 270,237 shares, or 830,711 shares after giving effect to stock splits and anti-dilution provisions of the plan.

Under this management incentive plan, participating officers will receive the following number of options on our shares for each share acquired by such person and deposited under the plan:

- 10 type A options, with an exercise price equal to the market price of the shares on the date that the plan was initiated, €46.18 or €15.09 after giving effect to stock splits and anti-dilution provisions; and

- 10 type B options, with an exercise price equal to the market price described above plus 50% of the market price
Participants in the plan may exercise these options:

- beginning in its second year following effectiveness in an amount equal to one-third of the total options granted; and
- again in each of the third and fourth years following effectiveness in an amount equal to one-third of the total options granted

As adjusted for all stock splits and stock dividends, a plan participant will, upon exercise of an option, receive, at our election, either:

- cash in an amount based on the difference between the average price of our shares on the Madrid stock exchange during the 10 business days prior to July 28, 2001, August 28, 2002 and September 28, 2003, depending on when the option was exercised, and the strike price of such option, which is €15.09 for type A options and €22.63 for type B options; or
- one of our shares

Options granted under this plan are neither listed nor transferable. This incentive plan is subject to anti-dilution and other provisions customary for transactions of this type and to the condition that the participant not terminate his employment with the Telefónica group voluntarily and unilaterally prior to the exercise date.

In order to cover the economic exposure derived from the implementation of the TOP plan we have entered into hedging contracts with two financial institutions. The maximum total cost to us of the plan, assuming all eligible participants fully participate in the plan, will be approximately Ptas. 12,000 million. As adjusted for all stock splits, beneficiaries of the TOP plan have deposited an aggregate of 641,532 shares under the plan, for which they have received an aggregate of 6,415,320 type A options and 6,415,320 type B options. Mr. Villalonga has deposited 23,388 shares under the plan, for which he has received 233,880 type A options and 233,880 type B options. Messrs. Bustamante, Viana-Baptista and Mas have each deposited 7,797 shares under the plan, for which each of them has received 77,920 type A and 77,920 type B options.

Our shareholders approved the TOP plan at our annual general shareholders’ meeting in April 2000.

The computing period for the RISE plans consists of the 10 business days prior to the expiration date, February 25, 2000. The computing period for the TOP plans consists of the 10 business days prior to the following expiration dates: July 28, 2001, August 28, 2002 and September 28, 2003. Up to one-third of the options under the TOP plan may be redeemed at each of these three expiration dates.

At our April 2000 general shareholders’ meeting our shareholders approved a new stock option plan called TIES. We currently expect:

- to launch the TIES program in mid-2000
- that the TIES program will have a duration of four years
- that the TIES program will be open to approximately 90,000 employees of the group
- that program participants will be able to subscribe for our shares at below market prices and
- that program participants will be granted options, based on the number of shares subscribed by them, whose value will depend upon the appreciation, if any, of our share price over an initial reference value
MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

General

At June 14, 2000, we had outstanding 3,302,439,045 shares, each having a nominal value of 1 euro per share.

The following table shows certain information regarding beneficial ownership of Telefónica’s shares:

<table>
<thead>
<tr>
<th>Name of Beneficial Owner</th>
<th>Shares</th>
<th>Percent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banco Bilbao Vizcaya Argentaria, S.A.</td>
<td>297,281,710</td>
<td>9.1%</td>
</tr>
<tr>
<td>Caja de Ahorros y Pensiones de Barcelona (La Caixa)</td>
<td>163,467,628</td>
<td>5.0%</td>
</tr>
</tbody>
</table>

In May 1995, three Spanish banks, Banco Bilbao Vizcaya, S.A., Caja Postal y Banco Hipotecario, S.A., and Caja de Ahorros y Pensiones de Barcelona (La Caixa) signed an agreement to vote a portion of their shares as a block at our shareholders’ meetings. This agreement applied to an aggregate of 7.5% of our issued and outstanding shares. On October 19, 1999, the boards of directors of each of Banco Bilbao Vizcaya and Argentaria, Caja Postal y Banco Hipotecario approved a plan to merge such companies. Such merger plan was approved by the shareholders’ meetings of each company on December 18, 1999, and the companies have merged to form Banco Bilbao Vizcaya Argentaria, S.A. The voting agreement referred to above expired on May 25, 2000.

On February 11, 2000, we and Banco Bilbao Vizcaya Argentaria announced a strategic alliance under which Banco Bilbao Vizcaya Argentaria will increase its interest in us from approximately 9.2% at January 28, 2000, to up to 10% less one share through open market purchases of additional Telefónica shares, and we will purchase in the open market a 3% interest in Banco Bilbao Vizcaya Argentaria.

The ownership percentages in the last three years have been the following:

<table>
<thead>
<tr>
<th>Title of Class</th>
<th>Percent of Class</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
</tr>
<tr>
<td>Ordinary</td>
<td>5.03</td>
</tr>
<tr>
<td>Ordinary</td>
<td>5.21</td>
</tr>
<tr>
<td>Ordinary</td>
<td>5.01</td>
</tr>
</tbody>
</table>

All outstanding shares have the same rights.

Related Party Transactions

In February 2000, we entered into separate strategic alliances with our significant shareholders, Banco Bilbao Vizcaya Argentaria and Caja de Ahorros y Pensiones de Barcelona. These transaction are described in “Business—Other Activities—Our Strategic Alliance with Banco Bilbao Vizcaya Argentaria” and “—Our Joint Venture with Caja de Ahorros y Pensiones de Barcelona”.

Limitations on Certain Transactions

In January 1997, in connection with the final phase of our privatization, the Spanish government adopted a requirement of prior government approval with respect to a limited number of fundamental corporate and control transactions affecting us, including the acquisition of 10% or more of our capital stock or the capital stock of Telefónica Servicios Móviles and the sale of assets material to the provision of fixed telephone services. The approval requirement applied in connection with the transfer of certain assets of Telefónica, S.A. to its wholly owned subsidiary Telefónica de España in November 1998 and will apply to subsequent transfers by Telefónica de España.
FINANCIAL INFORMATION

Dividend Information

At the extraordinary general meeting of shareholders held on June 24, 1998, we announced our new dividend policy aimed at providing an alternative to cash dividend payments. The objective of this policy is to strengthen our capacity to finance value-creating projects while enabling our shareholders to obtain liquidity by trading their shares. In connection with this new policy, throughout fiscal 1999, we carried out three capital increases charged to freely disposable reserves. These capital increases were approved by our extraordinary shareholders' meeting of June 24, 1998, and the annual general shareholders' meeting of March 26, 1999. At the general shareholders' meeting of April 7, 2000, two new capital increases were approved.

The table below sets forth the annual cash dividends per share paid by us with respect to the past five years.

<table>
<thead>
<tr>
<th>Fiscal Year Ended December 31</th>
<th>Cash Dividends per Share</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pesetas(1)</td>
</tr>
<tr>
<td>1999</td>
<td>—</td>
</tr>
<tr>
<td>1998</td>
<td>—</td>
</tr>
<tr>
<td>1997(3)</td>
<td>102</td>
</tr>
<tr>
<td>1996(5)</td>
<td>89</td>
</tr>
<tr>
<td>1995(6)</td>
<td>76</td>
</tr>
</tbody>
</table>

(1) Peseta amounts reflect nominal amounts at date of payment.
(2) Translated to dollars at the Noon Buying Rate on the date of payment, unless otherwise indicated. See "Exchange Rates."
(3) An interim dividend was paid in January 1998 and a final dividend was paid in May 1998.
(4) The interim dividend payment has been translated into dollars at the Noon Buying Rate for the day following the interest payment date because the interest payment date was a national holiday in the United States as a result of which a Noon Buying Rate was not available on such date.
(5) An interim dividend was paid in January 1997 and a final dividend was paid in June 1997.
(6) An interim dividend was paid in January 1996 and a final dividend was paid in June 1996.
UNDERWRITING

Telefónica Europe, Telefónica and the underwriters for the offering named below have entered into an underwriting agreement and a pricing agreement relating to the notes. Subject to certain conditions, each underwriter has severally agreed to purchase the principal amounts of the notes indicated in the following table.

### U.S. Dollar Notes

<table>
<thead>
<tr>
<th>Underwriter</th>
<th>Principal Amount of U.S. Dollar Notes due 2005</th>
<th>Principal Amount of U.S. Dollar Notes due 2010</th>
<th>Principal Amount of U.S. Dollar Notes due 2030</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman, Sachs &amp; Co.</td>
<td>354,166,667</td>
<td>708,333,333</td>
<td>354,166,667</td>
</tr>
<tr>
<td>J.P. Morgan Securities Inc.</td>
<td>354,166,667</td>
<td>708,333,333</td>
<td>354,166,667</td>
</tr>
<tr>
<td>Morgan Stanley &amp; Co. Incorporated</td>
<td>354,166,666</td>
<td>708,333,334</td>
<td>354,166,667</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Banque Brussels Lambert S.A.</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Barclays Bank PLC</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Deutsche Bank AG London</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Société Générale</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>UBS AG, acting through its business group UBS Warburg</td>
<td>25,000,000</td>
<td>50,000,000</td>
<td>25,000,000</td>
</tr>
<tr>
<td>Banco Bilbao Vizcaya Argentaria, S.A.</td>
<td>15,858,000</td>
<td>18,750,000</td>
<td>9,375,000</td>
</tr>
<tr>
<td>ABN AMRO Incorporated</td>
<td>7,214,000</td>
<td>18,750,000</td>
<td>9,375,000</td>
</tr>
<tr>
<td>Chase Securities Inc.</td>
<td>7,214,000</td>
<td>18,750,000</td>
<td>9,375,000</td>
</tr>
<tr>
<td>Dresdner Kleinwort Benson North America LLC</td>
<td>7,214,000</td>
<td>18,750,000</td>
<td>9,375,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>US$1,250,000,000</strong></td>
<td><strong>US$2,500,000,000</strong></td>
<td><strong>US$1,250,000,000</strong></td>
</tr>
</tbody>
</table>

### Euro Notes

<table>
<thead>
<tr>
<th>Underwriter</th>
<th>Principal Amount of Euro Notes due 2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goldman, Sachs &amp; Co.</td>
<td>170,000,000</td>
</tr>
<tr>
<td>J.P. Morgan Securities Inc.</td>
<td>170,000,000</td>
</tr>
<tr>
<td>Morgan Stanley &amp; Co. International Limited</td>
<td>170,000,000</td>
</tr>
<tr>
<td>Banco Bilbao Vizcaya Argentaria, S.A.</td>
<td>170,000,000</td>
</tr>
<tr>
<td>InverCaixa Valores, SVB, S.A.</td>
<td>170,000,000</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Banque Brussels Lambert S.A.</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Barclays Bank PLC</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Deutsche Bank AG London</td>
<td>20,000,000</td>
</tr>
<tr>
<td>Société Générale</td>
<td>20,000,000</td>
</tr>
<tr>
<td>UBS AG, acting through its business group UBS Warburg</td>
<td>20,000,000</td>
</tr>
<tr>
<td>ABN AMRO Bank N.V.</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Chase Manhattan International Limited</td>
<td>10,000,000</td>
</tr>
<tr>
<td>Dresdner Bank AG London Branch</td>
<td>10,000,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>€1,000,000,000</strong></td>
</tr>
</tbody>
</table>

Goldman, Sachs & Co., J.P. Morgan Securities Inc. and Morgan Stanley & Co. Incorporated are acting as joint book-runners for the U.S. dollar notes. Goldman, Sachs & Co., J.P. Morgan Securities Inc., Morgan Stanley & Co. International Limited, Banco Bilbao Vizcaya Argentaria, S.A. and InverCaixa Valores, SVB, S.A. are acting as joint book-runners for the euro notes. The underwriters will initially offer to sell the notes to the public at the initial public offering price indicated on the cover of this prospectus supplement. The underwriters may sell the notes to securities dealers at a discount from the initial public offering price of the principal amount of the notes of 0.2% in the case of the U.S. dollar notes due 2005, 0.3% in the case of the U.S. dollar notes due 2010, 0.5% in the case of the U.S. dollar notes due 2030 and 0.2% in the case of the euro notes due 2005. These securities dealers may resell any U.S. dollar notes purchased from the underwriters to other brokers or dealers at
a discount from the initial public offering price of the principal amount of the notes of 0.1% in the case of the
U.S. dollar notes due 2005, 0.25% in the case of the U.S. dollar notes due 2010 and 0.25% in the case of the
U.S. dollar notes due 2030. If the underwriters cannot sell all the notes at the initial offering price, they may
change the offering price and the other selling terms.

The notes are a new issue of securities with no established trading market. The underwriters have advised
us that they intend to make a market in the notes but are not obligated to do so and may discontinue market
making at any time without notice. Therefore the liquidity of the trading market of the notes may be low.

Furthermore, the underwriters may purchase and sell notes in the open market. These transactions may
include short sales, stabilizing transactions and purchases to cover positions that any short sales have created.
Short sales are the sale by the underwriters of a greater number of notes than they are required to purchase in the
offering. Stabilizing transactions are bids or purchases made for the purpose of preventing or retarding a decline
in the market price of the notes while the offering is in progress.

The underwriters also may impose a penalty bid. This occurs when a particular underwriter repays to the
underwriters a portion of the underwriting discount received by it because the representatives have repurchased
notes sold by or for the account of such underwriter in stabilizing or short covering transactions.

These activities by the underwriters may stabilize, maintain or otherwise affect the market price of the notes.
As a result, the price of the notes may be higher than the price that otherwise might exist in the open market. If
the underwriters commence these activities, they may discontinue the activities at any time. These transactions
may be effected in the over-the-counter market or otherwise.

Telefónica Europe estimates that its share of the total expenses of the offering, excluding underwriting
discouts and commissions, will be approximately U.S. $1,000,000, including the following:

<table>
<thead>
<tr>
<th>Item</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting fees and expenses</td>
<td>U.S.$100,000</td>
</tr>
<tr>
<td>Trustee fees</td>
<td>U.S.$ 30,000</td>
</tr>
<tr>
<td>Rating agency fees</td>
<td>U.S.$ 50,000</td>
</tr>
<tr>
<td>Legal fees and expenses</td>
<td>U.S.$275,000</td>
</tr>
<tr>
<td>Printing and other expenses</td>
<td>U.S.$450,000</td>
</tr>
<tr>
<td>Listing fees</td>
<td>U.S.$ 15,000</td>
</tr>
</tbody>
</table>

In the ordinary course of their businesses, some of the underwriters and their respective affiliates may have
engaged in commercial banking and/or investment banking transactions with Telefónica and its affiliates,
including the syndicated loan facility described under “Capitalization”. These underwriters may also engage in
similar transactions with us in the future. See “Use of Proceeds” and “Capitalization”.

Because more than ten percent of the net proceeds of the offering may be paid to members or affiliates of
members of the National Association of Securities Dealers, Inc. participating in the offering, this offering will be
conducted in accordance with NASD Conduct Rule 2710(c)(8).

Affiliates of Banco Bilbao Vizcaya Argentaria, S.A. and InverCaixa Valores, S.V.B., S.A. are among
Telefónica’s major shareholders. See “Major Shareholders and Related Party Transactions”.

Each of the underwriters has severally represented and agreed that (i) it has not offered or sold and prior to
the date six months after the date of issue of the notes will not offer or sell any notes to persons in the United
Kingdom except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing
of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which
have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the
Public Offers of Securities Regulations 1995 (as amended), (ii) it has complied and will comply with all
applicable provisions of the Financial Services Act 1986 with respect to anything done by it in relation to the
notes in, from or otherwise involving the United Kingdom, and (iii) it has only issued or passed on and will only
issue or pass on in the United Kingdom any document received by it in connection with the issue of the notes to
a person who is of a kind described in Article 11(3) of the Financial Services Act 1986 (Investment
Advertisements) (Exemptions) Order 1996 (as amended) or is a person to whom such document may otherwise
lawfully be issued or passed on.

S-106
Each of the underwriters has agreed not to offer or sell the notes within the Kingdom of Spain by any means which might infringe in any way the regulations currently in place on public offerings and issues of securities, and in this regard, the notes will only be offered in the Kingdom of Spain to a maximum of 100 institutional investors referred to in article 7.1a) of Royal Decree 291/1992, of March 27, on Issuance and Public Offers of Securities ("RD 291/1992"), that will have to make a minimum disbursement of €150,255. The institutional investors will be subject to the restrictions on the transferability set forth in article 7.1a) of RD 291/1992.

The notes (including rights representing an interest in a note in global form) may not be offered, transferred or sold as part of their initial distribution or at any time thereafter, to or for the benefit of any persons (including legal entities) established, domiciled, incorporated or resident in The Netherlands ("Dutch Residents").

The notes are securities (effecten) within the meaning of article 1 of The Netherlands' Securities Market Supervision Act 1995 (Wet toezicht effectenverkeer 1995). The notes may be offered in certain countries excluding The Netherlands. Any offer of these notes, any announcement thereof and all offer notices, publications, advertisements and other documents in which an offer of the notes is made, or a forthcoming offer is announced, will comply with all applicable laws and regulations of the jurisdictions in which such an offer is made from time to time. A statement to the effect that the offering of the notes, will comply with all applicable rules in the countries in which such offering takes place will be submitted to the Securities Board of The Netherlands (Stichting Toezicht Effectenverkeer) pursuant to article 3, paragraph 2 of the Exemption Regulation pursuant to The Netherlands' Securities Market Supervision Act, before any notes are offered.

These restrictions shall cease to apply from the date on which the Securities Board of The Netherlands (Stichting Toezicht Effectenverkeer) shall have granted a dispensation on the offering of the notes pursuant to the prospectus.

The notes have not been and will not be registered under the Securities and Exchange Law of Japan (Law No. 25 of 1948) (as amended) (the "Securities and Exchange Law"). Each of the underwriters has represented and agreed that it has not, directly or indirectly, offered or sold and will not, directly or indirectly, offer or sell, notes in Japan or to any person resident in Japan for Japanese securities law purposes (including any corporation or other entity organized under the laws of Japan), except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the Securities and Exchange Law of Japan.

Telefónica Europe and Telefónica have agreed in the underwriting agreement that during the period starting the date of the pricing agreement until the later of

- the end of trading restrictions for the notes as indicated to Telefónica Europe and Telefónica by the representatives, and
- time of delivery of the notes,

neither of them will, without the prior written consent of the representatives, offer, sell, contract to sell or otherwise dispose of any debt securities of Telefónica or Telefónica Europe that

- mature more than one year after the delivery of the notes,
- are substantially similar to the notes and
- are offered primarily in the same market as the notes.

Telefónica Europe and Telefónica have jointly agreed to indemnify the several underwriters against various liabilities, including liabilities under the Securities Act of 1933.

**VALIDITY OF THE NOTES AND THE GUARANTEE**

The validity of the notes and the guarantee will be passed upon for us by our United States counsel, Clifford Chance Rogers & Wells LLP, and for the underwriters by their United States counsel, Davis Polk & Wardwell, as to matters of United States federal and New York State law. The validity of the notes under Dutch law will be passed upon by our Dutch counsel, Clifford Chance Limited Liability Partnership. The validity of the guarantee under Spanish law will be passed upon by our Spanish counsel, Clifford Chance S.C., and for the underwriters by their Spanish counsel Uría & Menéndez.
GENERAL INFORMATION

Telefónica Europe was incorporated on October 31, 1996 under the laws of the Netherlands as a private company with limited liability for an unlimited duration. Telefónica Europe is a wholly-owned subsidiary of Telefónica. Telefónica Europe has its corporate seat in Rotterdam and is registered with the Commercial Register of the Chamber of Commerce of Rotterdam under the number 24269798. Its address is Aert van Nesstraat 45, 3012 CA Rotterdam, The Netherlands.

The objects of Telefónica Europe according to its Articles of Association are:

- to borrow money and raise funds through the issuance and sale of debt securities;
- to invest and/or on lend those funds;
- to acquire, dispose and utilize property; and
- to perform any act related to any of the above objectives.

The authorized share capital of Telefónica Europe amounts to NLG 100,000 and is divided into 100 ordinary shares with a nominal value of NLG 1,000 each, all of which are issued and fully paid in.

The business address of the director of Telefónica Europe is Aert van Nesstraat 45, 3012 CA Rotterdam.

We have obtained all necessary internal corporate consents, approvals and authorizations in connection with the issuance and performance of the notes. Resolutions of the Board of Managing Directors of Telefónica Europe, dated August 14, 2000 authorize the issuance of the notes. Resolutions of the Board of Directors of Telefónica, dated August 26, 2000 authorize the guarantees.

We have applied to list the notes on the Luxembourg Stock Exchange in accordance with rules of the Luxembourg Stock Exchange. In connection with such listing application, the legal notice relating to the issuance of the notes and the constitutional documents of Telefónica Europe and Telefónica have been deposited with the Greffier en Chef du Tribunal d’Arrondissement de et à Luxembourg, where such documents may be examined and copies thereof may be obtained upon request. Additionally, copies of Telefónica’s Articles of Association and all reports prepared and filed are available at the office of Banque Internationale à Luxembourg, the paying agent in Luxembourg.

So long as the notes remain outstanding and listed on the Luxembourg Stock Exchange, copies (and English translations for documents not in English) of the following items will be available free of charge from our listing agent at its offices at 69 route d’Esch, L-1470 Luxembourg:

- all documents incorporated by reference that are considered part of this prospectus supplement;
- the audited annual consolidated financial statements of Telefónica;
- unaudited interim consolidated financial statements of Telefónica;
- future annual and interim financial filings of Telefónica including, without limitation, all annual reports on Form 20-F and all reports on Form 6-K which contain interim financial statements of Telefónica;
- any related notes to these items; and
- the audited financial statements of Telefónica Europe (if required under Dutch law).

During the same period, the indenture will be available for inspection at the office of Banque Internationale à Luxembourg, the paying agent in Luxembourg. Telefónica publishes its unaudited financial information on a

S-108
quarterly basis. Telefónica does not publish unconsolidated accounts. Telefónica Europe has not published interim reports to date and does not publish consolidated financial statements. Telefónica Europe will maintain, until the repayment of the notes, a paying agent in New York City, as well as in Luxembourg.

Except as disclosed in this prospectus supplement, we are not involved in any litigation or arbitration proceeding relating to claims or amounts which are material in the context of the issuance of the notes nor, so far as we are aware, is any such litigation or arbitration pending or threatened. Except as disclosed in this prospectus supplement, there has not been any material adverse change in the financial position or prospects of Telefónica or Telefónica Europe since December 31, 1999.
Issuer
Telefónica Europe B.V.
Aert van Nesstraat 45
3012 CA Rotterdam

Guarantor
Telefónica, S.A.
Gran Vía 28
28013 Madrid

Joint Book-runners
Goldman, Sachs & Co.
85 Broad Street
New York, NY 10004

J.P. Morgan & Co.
60 Wall Street
New York, NY 10260

Morgan Stanley & Co.
Incorporated
1585 Broadway
New York, NY 10036

Trustee
The Bank of New York
One Canada Square
London E14 5AL

Agents
Principal Paying Agent
The Bank of New York
One Canada Square
London E14 5AL

Listing Agent and Luxembourg Paying Agent
Banque Internationale à Luxembourg S.A.
69 route d’Esch
L-1470 Luxembourg

Further Paying Agent
The Bank of New York
101 Barclay St.
New York, NY 10286

Legal Advisors
To the Issuer and Guarantor

As to U.S. Law:
Clifford Chance
Rogers & Wells LLP
200 Park Avenue
New York, NY 10166

As to Dutch Law:
Clifford Chance Limited
Liability Partnership
Droogbak 1a
1013 GE Amsterdam

As to Spanish Law:
Clifford Chance S.C.
Paseo de la Castellana, 110
28046 Madrid

As to U.S. Law:
Davis Polk & Wardwell
450 Lexington Avenue
New York, NY 10017

To the Underwriters

As to Spanish Law:
Uría & Menéndez
Jorge Juan, 6
28001 Madrid

Auditors of
Telefónica, S.A.
Arthur Andersen y Cía., S. Com.
Raimundo Fdez. Villaverde, 65
Madrid 28003

Telefónica Europe B.V.
Arthur Andersen
Oostmaaslaan 71
P.O. Box 4506
3006 AM Rotterdam
Telefónica Europe B.V.

(Incorporated with limited liability under the laws of The Netherlands with corporate seat in Rotterdam)

U.S.$10,000,000,000

Debt Securities

fully and unconditionally guaranteed by

Telefónica, S.A.

Telefónica

Telefónica Europe B.V. ("Telefónica Europe") is offering for sale through this prospectus and the accompanying prospectus supplement debt securities fully and unconditionally guaranteed by Telefónica, S.A. ("Telefónica").

Investing in these securities involves some risks. See “Risk Factors” beginning on page 7 of Telefónica’s annual report on Form 20-F for the fiscal year ended December 31, 1999, which is incorporated by reference in this prospectus.

The specific terms of the debt securities appear in the accompanying prospectus supplement. The prospectus supplement also contains the names of the underwriters, dealers or agents involved in the sale of the securities, together with any applicable commissions or discounts. You should carefully read this prospectus and the accompanying prospectus supplement before making a decision to invest.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.

This prospectus may not be used to sell securities unless accompanied by a prospectus supplement.

The date of this prospectus is September 1, 2000.
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABOUT THIS PROSPECTUS</td>
<td>3</td>
</tr>
<tr>
<td>WHERE YOU CAN FIND MORE INFORMATION—INCORPORATION BY REFERENCE</td>
<td>4</td>
</tr>
<tr>
<td>Telefónica</td>
<td>4</td>
</tr>
<tr>
<td>Telefónica Europe</td>
<td>4</td>
</tr>
<tr>
<td>FORWARD-LOOKING STATEMENTS</td>
<td>5</td>
</tr>
<tr>
<td>TELEFÓNICA</td>
<td>6</td>
</tr>
<tr>
<td>TELEFÓNICA EUROPE</td>
<td>6</td>
</tr>
<tr>
<td>USE OF PROCEEDS</td>
<td>6</td>
</tr>
<tr>
<td>RATIO OF EARNINGS TO FIXED CHARGES</td>
<td>7</td>
</tr>
<tr>
<td>Calculation of Ratios</td>
<td>7</td>
</tr>
<tr>
<td>DESCRIPTION OF THE DEBT SECURITIES AND THE GUARANTEE</td>
<td>8</td>
</tr>
<tr>
<td>Ranking</td>
<td>8</td>
</tr>
<tr>
<td>Debt Securities</td>
<td>8</td>
</tr>
<tr>
<td>Guarantee</td>
<td>10</td>
</tr>
<tr>
<td>Legal Ownership</td>
<td>10</td>
</tr>
<tr>
<td>Overview of Remainder of This Description</td>
<td>12</td>
</tr>
<tr>
<td>Payment of Additional Amounts</td>
<td>17</td>
</tr>
<tr>
<td>Covenants</td>
<td>18</td>
</tr>
<tr>
<td>Default And Related Matters</td>
<td>20</td>
</tr>
<tr>
<td>Regarding the Trustee</td>
<td>22</td>
</tr>
<tr>
<td>Clearance and Settlement</td>
<td>22</td>
</tr>
<tr>
<td>The Clearing Systems</td>
<td>23</td>
</tr>
<tr>
<td>Primary Distribution</td>
<td>24</td>
</tr>
<tr>
<td>Secondary Market Trading</td>
<td>25</td>
</tr>
<tr>
<td>Special Timing Considerations</td>
<td>26</td>
</tr>
<tr>
<td>PLAN OF DISTRIBUTION</td>
<td>26</td>
</tr>
<tr>
<td>Underwriters</td>
<td>27</td>
</tr>
<tr>
<td>Direct Sales; Agents</td>
<td>27</td>
</tr>
<tr>
<td>Indemnification; Other Transactions with Agents and Underwriters</td>
<td>27</td>
</tr>
<tr>
<td>Market for the Debt Securities</td>
<td>27</td>
</tr>
<tr>
<td>Dutch Regulation</td>
<td>27</td>
</tr>
<tr>
<td>Spanish Regulation</td>
<td>28</td>
</tr>
<tr>
<td>Registration Fee and Other Expenses</td>
<td>28</td>
</tr>
<tr>
<td>TAXATION</td>
<td>28</td>
</tr>
<tr>
<td>Spanish Tax Considerations</td>
<td>28</td>
</tr>
<tr>
<td>Dutch Tax Considerations</td>
<td>29</td>
</tr>
<tr>
<td>Proposed European Union Withholding Tax Directive</td>
<td>30</td>
</tr>
<tr>
<td>United States Federal Income Tax Considerations</td>
<td>30</td>
</tr>
<tr>
<td>LEGAL MATTERS</td>
<td>36</td>
</tr>
<tr>
<td>EXPERTS</td>
<td>36</td>
</tr>
<tr>
<td>ENFORCEABILITY OF CIVIL LIABILITIES</td>
<td>36</td>
</tr>
</tbody>
</table>
ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement filed with the United States Securities and Exchange Commission using the "shelf" registration process. Under the shelf registration process, we may sell the debt securities described in this prospectus in one or more offerings up to a total aggregate offering price of U.S.$10,000,000,000.

This prospectus contains a general description of the debt securities that we can offer. Each time we offer to sell debt securities, we provide prospective investors with a prospectus supplement containing detailed information about the specific terms of the debt securities that we are offering. The prospectus supplement contains, for example, the specific information regarding the aggregate amount of the debt securities that we are offering, their maturity and interest rate (if any). The prospectus supplement may also add to, update or change some of the information contained in this prospectus. If there is any inconsistency between the information in this prospectus and the prospectus supplement, you should rely on the information in the prospectus supplement. You should read both this prospectus and the prospectus supplement together with the additional information described under the heading "Where You Can Find More Information—Incorporation by Reference".

The registration statement containing this prospectus and the exhibits to the registration statement provide additional information about us and the debt securities that may be offered through this prospectus and an accompanying prospectus supplement. The registration statement can be read at the SEC offices mentioned under the heading "Where You Can Find More Information—Incorporation by Reference".

When you decide whether to purchase any debt securities described in this prospectus and the prospectus supplement, you should rely only on the information contained or incorporated by reference in this prospectus and the prospectus supplement (see the discussion under the heading "Where You Can Find More Information—Incorporation by Reference"). Neither we, nor any underwriters, dealers or agents participating in offerings of our debt securities, have authorized anyone to provide you with different or additional information. The information in this prospectus, in any prospectus supplement, or in any document incorporated by reference in this prospectus or the prospectus supplement, is truthful and complete on the date of the prospectus, prospectus supplement or document that is so incorporated. You should not assume the continued truthfulness or completeness of that information at any later date.

We may sell the debt securities to underwriters who will sell the debt securities to the public on terms fixed at the time of sale. In addition, we may sell the debt securities directly or through dealers or agents designated from time to time. If we, directly or through agents, solicit offers to purchase the debt securities, we reserve the right to accept or reject, in whole or in part, any of those offers. The underwriters, dealers and agents may also reject any offer to purchase debt securities in whole or in part.

The prospectus supplement contains the names of any underwriters, dealers or agents participating in the offering, together with the terms of the offering, the compensation of those underwriters, dealers or agents, and the net proceeds to us. Any underwriters, dealers or agents participating in the offering may be considered "underwriters" within the meaning of the Securities Act of 1933.

Unless otherwise mentioned or unless the context requires otherwise, all references in this prospectus to "we", "us", "our", or similar references mean Telefónica and Telefónica Europe.

Unless otherwise specified, all references to "U.S. dollars," "dollars," "U.S.$" or "$" are to United States dollars. References to "EUR", "euro" or "€" are to the single currency of the European Union member states, including The Netherlands and Spain, participating in the Third Stage of the European Economic and Monetary Union pursuant to the treaty establishing the European Community, as amended from time to time. Telefónica has historically published its financial statements in Spanish pesetas ("pesetas" or "Pts"). In 1999, Telefónica began publishing its financial statements in both pesetas and euros. Telefónica Europe has historically published its financial statements in Dutch guilders ("guilders" or "NLG"). In 1999, Telefónica Europe began publishing its financial statements in both guilders and euros.
WHERE YOU CAN FIND MORE INFORMATION—INCORPORATION BY REFERENCE

Telefónica

Telefónica files with the SEC annual reports on Form 20-F, and furnishes to the SEC periodic reports on Form 6-K and other information from time to time. You may read and copy any document filed by Telefónica at the SEC’s public reference room at 450 Fifth Street, N.W., Washington, D.C., and at the public reference rooms in New York, New York, and Chicago, Illinois. Please call the SEC at 1-800-SEC-0330 for further information on the public reference rooms. You may also inspect certain reports and other information concerning Telefónica at the offices of the New York Stock Exchange, 11 Wall Street, New York, New York 10005. As a foreign private issuer, Telefónica is not subject to the proxy rules in Section 14 or the insider disclosure and short-swing profit rules of Section 16 of the Securities Exchange Act of 1934.

The SEC allows us to “incorporate by reference” in this prospectus the information contained in other documents filed with the SEC. Incorporation by reference means that:

- incorporated documents are considered part of this prospectus;
- Telefónica will meet its obligation to disclose important information to you by referring you to those other documents filed with the SEC; and
- information in this prospectus automatically updates and supersedes any inconsistent information contained in earlier documents that are incorporated by reference in this prospectus, and information that Telefónica files with the SEC after the date of this prospectus automatically updates and supersedes any inconsistent information contained in this prospectus.

Telefónica incorporates by reference in this prospectus its Annual Report on Form 20-F for the fiscal year ended December 31, 1999, which was filed with the SEC on June 30, 2000, as well as Telefónica’s unaudited consolidated balance sheet as of March 31, 2000 and Telefónica’s unaudited consolidated income statement for the three-month period ended March 31, 2000 included with the report on Form 6-K submitted to the SEC on May 16, 2000, and the reports on Form 6-K submitted to the SEC on July 26, 2000, August 22, 2000 and August 23, 2000. Telefónica also incorporates by reference in this prospectus each of the following documents that it will file with the SEC after the date of this prospectus until it terminates the offering of the debt securities:

- all future Annual Reports filed on Form 20-F; and
- any future reports filed on Form 6-K that indicate that they are incorporated by reference in this prospectus.

Telefónica will provide to each person, including any beneficial owner, to whom a prospectus is delivered, without charge, upon written or oral request, a copy of any document that is incorporated by reference in this prospectus, other than exhibits that are not specifically incorporated by reference. These requests should be directed to Telefónica’s Director of Investor Relations, at Gran Vía 28, 28013, Madrid, Spain, telephone number +34 91 584-0306.

The annual reports filed with the SEC by Telefónica will include the audited annual consolidated financial statements of Telefónica prepared under Spanish generally accepted accounting principles, or Spanish GAAP, as well as a reconciliation of certain amounts to U.S. generally accepted accounting principles, or U.S. GAAP.

For a discussion of the principal differences between Spanish GAAP and U.S. GAAP that are relevant to Telefónica, see note 25 of Telefónica’s audited consolidated financial statements included in Telefónica’s Annual Report on Form 20-F for the fiscal year ended December 31, 1999, which is incorporated by reference in this prospectus.

Telefónica Europe

Telefónica Europe is a wholly owned, consolidated subsidiary of Telefónica. Telefónica Europe does not, and will not, file separate reports with the SEC.
FORWARD-LOOKING STATEMENTS

This prospectus and the documents incorporated by reference in this prospectus contain statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements appear in a number of places in this prospectus and such documents, and include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effects on our results of the introduction of competition in the several telecommunications markets in which Telefónica operates;
- trends affecting our financial condition or results of operations;
- acquisitions or investments which we may make in the future;
- our capital expenditures plan;
- supervision and regulation of the telecommunications sector;
- our strategic partnerships; and
- the potential for growth and competition in current and anticipated areas of our business.

Forward-looking statements involve risks and uncertainties and are not guarantees of future performance. Actual results may differ materially from those in the forward-looking statements as a result of circumstances such as:

- changes in the economic, political or regulatory framework in the different countries in which Telefónica operates;
- the occurrence of events described as risk factors in Telefónica’s Annual Report on Form 20-F for the fiscal year ended December 31, 1999; or
- other factors described in this prospectus, the prospectus supplement or a document incorporated by reference in this prospectus or the prospectus supplement. Some of those factors appear in Telefónica’s Annual Report on Form 20-F for the fiscal year ended December 31, 1999, under the headings “Information on the Company”, “Operating and Financial Review and Prospects” and “Quantitative and Qualitative Disclosures About Market Risk”.

Accordingly, readers are cautioned not to place undue reliance on those forward-looking statements, which speak only as of their respective dates.

We undertake no obligation to update any of these forward-looking statements to reflect subsequent events or circumstances, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.
TELEFÓNICA

Telefónica is a diversified telecommunications and multimedia group that provides a comprehensive range of services primarily in Spain and Latin America through one of the world’s largest and most modern telecommunications networks.

Telefónica is the leading provider of fixed-line telephone services, mobile services and data transmission services in Spain, and the largest telecommunications operator in Latin America with operations in Argentina, Brazil, Chile, El Salvador, Guatemala, Peru and Puerto Rico. Telefónica considers its principal lines of business to be:

- fixed-line telephone services;
- wireless or cellular telephone services;
- data transmissions;
- Internet services;
- media communications; and
- yellow pages or directory services.

On January 12, 2000, Telefónica announced a reorganization of its business along global business lines to enhance its strategic and competitive position globally and in each of these business lines. As part of the reorganization, Telefónica’s Board of Directors created two new global business divisions, Telefónica Móviles and Telefónica DataCorp, for its wireless telephone services and its data transmission business, respectively. Some of Telefónica’s current subsidiaries, such as Telefónica Internacional and Telefónica Intercontinental, may be combined with other subsidiaries as a result of the reorganization. In addition, Telefónica may create new business lines in the future, or transfer from a current subsidiary to an existing or newly created subsidiary, specific lines of business.

Telefónica’s principal executive offices are located at Gran Vía 28, 28013 Madrid, Spain. Telefónica’s telephone number is +34 91 584-0306. Telefónica’s website address is http://www.telefonica.es. Information contained in Telefónica’s website is not part of this prospectus.

TELEFÓNICA EUROPE

Telefónica created Telefónica Europe in The Netherlands in 1996 as its direct, wholly owned subsidiary whose principal purpose is raising funds for its parent company and other companies of the Telefónica group.

Telefónica Europe’s corporate seat is at Rotterdam, The Netherlands; its office address is Aerz van Nesstraat 45, 3012 CA Rotterdam, The Netherlands, and its postal address is P.O. Box 548, 3000 AM Rotterdam, The Netherlands. Telefónica Europe’s telephone number is +31 10 414-7230. Telefónica Europe is registered with the trade register of the Chamber of Commerce of Rotterdam under the number 24269798.

USE OF PROCEEDS

Unless otherwise stated in the accompanying prospectus supplement, net proceeds received by Telefónica Europe from the sale of securities offered through this prospectus will be on-lent to Telefónica or other companies of the Telefónica group for general corporate purposes.
RATIO OF EARNINGS TO FIXED CHARGES


<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Spanish GAAP</td>
<td>2.93</td>
<td>3.34</td>
<td>3.32</td>
<td>3.11</td>
<td>2.57</td>
</tr>
<tr>
<td>U.S. GAAP</td>
<td>3.39</td>
<td>3.03</td>
<td>3.20</td>
<td>3.02</td>
<td>2.72</td>
</tr>
</tbody>
</table>

Calculation of Ratios

For purposes of calculating the ratio of earnings to fixed charges, earnings consist of income from operations before income tax, minority interest, extraordinary items and fixed charges. Fixed charges consist of interest expense (including amortization of deferred interest expenses) plus one third of the rental expense.
DESCRIPTION OF THE DEBT SECURITIES AND THE GUARANTEE

This prospectus relates to debt securities issued by Telefónica Europe which are fully and unconditionally guaranteed by Telefónica. United States federal law requires that debt securities of companies that are publicly offered be governed by a contract called an indenture. The indenture relating to the debt securities designates The Bank of New York as trustee. The trustee has two main roles:

- first, it can enforce your rights against us if we default. There are some limitations on the extent to which the trustee is obligated to act on your behalf, described later beginning on page 21 under "Default and Related Matters—Remedies if an Event of Default Occurs"; and
- second, the trustee performs administrative duties for us, such as sending you interest payments and notices and registering transfers of the debt securities.

Telefónica is the guarantor of the debt securities issued by Telefónica Europe. The guarantee is described later on page 11 under "Guarantee".

The indenture and associated documents contain the full legal text of the matters described in this section. The indenture, the debt securities and the guarantee are governed by New York law. The indenture is an exhibit to our registration statement. See "Where You Can Find More Information—Incorporation by Reference" on page 5 for information on how to obtain a copy.

Telefónica Europe may issue as many distinct series of debt securities under its indenture as it wishes. This section discusses all material terms of the debt securities issued by Telefónica Europe and the guarantee of Telefónica, that are common to all series, unless otherwise indicated in the prospectus supplement relating to a particular series.

This section may not include every provision of the indenture that may be of interest to you and is subject to and qualified in its entirety by reference to all the provisions of the indenture. In this section, we include references in parentheses to some sections of the indenture. Whenever we refer to particular sections of the indenture in this prospectus or in the prospectus supplement, those sections are incorporated by reference here or in the prospectus supplement.

Ranking

The debt securities constitute direct, unsecured and unsubordinated obligations of Telefónica Europe, and rank equally without any preference among themselves and with all other outstanding unsecured and unsubordinated indebtedness of Telefónica Europe, present and future, except as may be preferred by law.

The guarantee constitutes the direct, unconditional and unsecured obligation of Telefónica, and ranks equally and without any preference with all other outstanding unsecured and unsubordinated indebtedness of Telefónica, present and future, except for indebtedness that:

- has been notarized or intervened by a Spanish notary or a Corredor Colegiado de Comercio in compliance with Spanish law, or
- is preferred by law.

Debt Securities

The specific financial, legal and other terms particular to a series of debt securities are described in the prospectus supplement relating to the series. Those terms may vary from the terms described here. Accordingly, with respect to each particular series of debt securities, this section is subject to, and qualified by reference to, the description of the particular terms of that series as described in the corresponding prospectus supplement.
The prospectus supplement relating to a series of debt securities describes the following terms of that series:

- the title of the series of debt securities;
- any limit on the aggregate principal amount of debt securities of that series which we may issue;
- any stock exchange on which the series of debt securities may be listed;
- information regarding the persons entitled to receive any payments of interest on the series of debt securities;
- the date or dates on which we will pay the principal of the series of debt securities;
- the rate or rates, which may be fixed or variable, at which the series of debt securities will bear interest, if any, and the date or dates from which that interest, if any, will accrue;
- the dates on which interest, if any, on the series of debt securities will be payable and the regular record dates for the interest payment dates;
- the date, if any, after which and the price or prices at which the series of debt securities may, in accordance with any optional or mandatory redemption provisions that are not described in this prospectus, be redeemed and the other detailed terms and provisions of those optional or mandatory redemption provisions, if any;
- any mandatory or optional sinking funds or analogous provisions or provisions for redemption at the option of the holder;
- the denominations in which the series of debt securities will be issuable, if other than $1,000 and any integral multiple of $1,000;
- the currency of payment of principal, premium, if any, and interest, if any, on the series of debt securities, if other than the currency of the United States of America;
- any index used to determine the amount of payment of principal of, premium, if any, and interest on the series of debt securities;
- if any payment on the debt securities of that series will be made, at our option or your option, in any currency other than the currency in which the debt securities state that they will be payable, the terms and conditions regarding how that election shall be made;
- if other than the principal amount, the portion of the principal amount of the series of debt securities that shall be payable upon acceleration of maturity following an event of default;
- the applicability of the provisions described later beginning on page 17 under “Optional Tax Redemption” and on page 19 under “Covenants—Defeasance and Discharge”;
- whether the provisions described later beginning on page 17 under “Payment of Additional Amounts” will not apply to that series;
- whether we may from time to time without the consent of the holders create and issue further debt securities having the same terms and conditions as the debt securities so that such further issue is consolidated and forms a single series with the series of outstanding debt securities;
- if the series of debt securities is redeemable at our option, whether the adjusted comparable yield, which is defined later in this prospectus, is different from the adjusted comparable yield described in this prospectus;
- if the principal amount of the debt securities that will be due on maturity is not determinable on the date of issuance, the manner how the principal amount of the debt securities will be computed for all purposes under the indenture;
- whether the series of debt securities will be issuable in whole or part in the form of a global security as described beginning on page 11 under “Global Securities”, and, if that is the case, the identity of
the depositary or its nominee with respect to the series of debt securities, as well as any special circumstances under which the global security may be registered for transfer or exchange in the name of a person other than the depositary or its nominee:

- any addition to or change in the events of default that applies to the series of debt securities and any change in the rights of the trustee or holders to declare the principal amount due and payable following an event of default;
- any addition to or change in the covenants contained in the indenture applicable to the series of debt securities; and
- any other special features of the series of debt securities.

Guarantee

Telefónica fully, unconditionally and irrevocably guarantees the payment of the principal of, premium, if any, and interest on the debt securities issued by Telefónica Europe, including any additional amounts which may be payable in respect of those debt securities, as described under “Payment of Additional Amounts”. Telefónica guarantees the payment of such amounts when such amounts become due and payable, whether at the stated maturity of the debt securities, by declaration of acceleration, call for redemption or otherwise.

Telefónica is a holding company. Therefore, in the distribution of the assets of any subsidiary of Telefónica upon the subsidiary’s liquidation or reorganization, any creditor of the subsidiary will have a right to participate in the distribution before the creditors of Telefónica, including claimants under the guarantee. In addition, since it is a holding company, Telefónica depends for its cash on dividends and repayment of intercompany loans from its subsidiaries. The guarantee is an unsecured obligation of Telefónica.

Legal Ownership

Street Name and Other Indirect Holders

Investors who hold debt securities in accounts at banks or brokers will generally not be recognized by us as legal holders of debt securities. This is called holding in street name. Instead, we would recognize only the bank or broker, or the financial institution the bank or broker uses to hold its debt securities. These intermediary banks, brokers and other financial institutions pass along principal, interest and other payments on the debt securities, either because they agree to do so in their customer agreements or because they are legally required to do so. If you hold debt securities in street name, you should check with your own institution to find out:

- how it handles debt securities payments and notices;
- whether it imposes fees or charges;
- how it would handle voting if it were ever required;
- whether and how you can instruct it to send you debt securities registered in your own name so you can be a direct holder as described below; and
- how it would pursue rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests.

Direct Holders

Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, under the debt securities run only to persons who are registered as holders of debt securities. As noted above, we do not have obligations to you if you hold in street name or by other indirect means, either because you choose to hold debt securities in that manner or because the debt securities are issued in the form of global securities as described below. For example, once we make payment to the registered holder we have no
further responsibility for the payment even if that holder is legally required to pass the payment along to you as a street name customer but does not do so.

**Global Securities**

**What is a Global Security?**

A global security is a special type of indirectly held security, as described above under "Street Name and Other Indirect Holders". If Telefónica Europe chooses to issue debt securities in the form of global securities, the ultimate beneficial owners of global securities can only be indirect holders. We require that the global security be registered in the name of a financial institution we select.

We also require that the debt securities included in the global security not be transferred to the name of any other direct holder unless the special circumstances described below occur. The financial institution that acts as the sole direct holder of the global security is called the depositary. Any person wishing to own a security must do so indirectly by virtue of an account with a broker, bank or other financial institution that in turn has an account with the depositary. The prospectus supplement indicates whether your series of debt securities will be issued only in the form of global securities.

**Special Investor Considerations for Global Securities**

As an indirect holder, an investor’s rights relating to a global security will be governed by the account rules of the investor’s financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a holder of debt securities and instead deal only with the depositary that holds the global security.

If you are an investor in debt securities that are issued only in the form of global debt securities, you should be aware that:

- you cannot get debt securities registered in your own name;
- you cannot receive physical certificates for your interest in the debt securities;
- you will be a street name holder and must look to your own bank or broker for payments on the debt securities and protection of your legal rights relating to the debt securities, as explained earlier under "Street Name and Other Indirect Holders" on page 10;
- you may not be able to sell interests in the debt securities to some insurance companies and other institutions that are required by law to own their debt securities in the form of physical certificates;
- the depositary’s policies will govern payments, transfers, exchange and other matters relating to your interest in the global security; we and the trustee have no responsibility for any aspect of the depositary’s actions or for its records of ownership interests in the global security; we and the trustee also do not supervise the depositary in any way; and
- the depositary will require that interest in a global security be purchased or sold within its system using same-day funds.

**Special Situations When Global Security Will Be Terminated**

In a few special situations described later, the global security will terminate and interests in it will be exchanged for physical certificates representing debt securities. After that exchange, the choice of whether to hold debt securities directly or in street name will be up to the investor. Investors must consult their own bank or brokers to find out how to have their interests in debt securities transferred to their own name so that they will be direct holders. The rights of street name investors and direct holders in the debt securities have been
previously described in the subsections entitled “Street Name and Other Indirect Holders” on page 10 and “Direct Holders” on page 10.

The special situations for termination of a global security are:

- when the depositary notifies us that it is unwilling, unable or no longer qualified to continue as depositary and we do not appoint a successor within 120 days; and
- when an event of default on the debt securities has occurred and has not been cured (defaults are discussed later under “Default and Related Matters—Events of Default” beginning on page 20).

The prospectus supplement may also list additional situations for terminating a global security that would apply only to the particular series of debt securities covered by the prospectus supplement. When a global security terminates, the depositary (and not us or the trustee) is responsible for deciding the names of the institutions that will be the initial direct holders. (Sections 203, 204 and 305)

In the remainder of this description “you” means direct holders and not street name or other indirect holders of debt securities. Indirect holders should read the subsection on page 11 entitled “Street Name and Other Indirect Holders”.

Overview of Remainder of This Description

The remainder of this description summarizes:

- additional mechanics relevant to the debt securities under normal circumstances, such as how you transfer ownership and where we make payments;
- your rights under several special situations, such as if we merge with another company, if we want to change a term of the debt securities or redeem the debt securities;
- your rights to receive payment of additional amounts due to changes in the tax withholding requirements of the jurisdiction in which Telefónica or Telefónica Europe is incorporated;
- covenants contained in the indenture or a prospectus supplement that require us to perform or refrain from performing various acts;
- your rights if we default or experience other financial difficulties; and
- our relationship with the trustee.

Exchange and Transfer

You may have your debt securities broken into more debt securities of smaller denominations or combined into fewer debt securities of larger denominations, as long as the total principal amount is not changed. (Section 305) This is called an exchange.

You may exchange or transfer your debt securities at the office of the trustee. The trustee acts as our agent for registering debt securities in the names of holders and transferring debt securities. We may change this appointment to another entity or perform the service ourselves. The entity performing the role of maintaining the list of registered holders is called the security registrar. It will also register transfers of the debt securities. (Section 305)

You will not be required to pay a service charge to transfer or exchange debt securities, but you may be required to pay for any tax or other governmental charge associated with the exchange or transfer. The transfer or exchange of a debt security will only be made if the security registrar is satisfied with your proof of ownership.
If we have designated additional transfer agents, they are named in the prospectus supplement. We may cancel the designation of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts. (Section 1002)

If the debt securities are redeemable and we redeem less than all of the debt securities of a particular series, we may block the transfer or exchange of debt securities during a specified period of time in order to freeze the list of holders to prepare the mailing. The period begins 15 days before the day we mail the notice of redemption and ends on the day of that mailing. We may also refuse to register transfers or exchanges of debt securities selected for redemption.

However, we will continue to permit transfers and exchanges of the unredeemed portion of any security being partially redeemed. (Section 303)

Payment and Paying Agents

We will pay interest to you if you are a direct holder listed in the trustee's records at the close of business on a particular day in advance of each due date for interest, even if you no longer own the security on the interest due date. That particular day, usually about two weeks in advance of the interest due date, is called the regular record date and is stated in the prospectus supplement. (Section 307)

We will pay interest, principal and any other money due on the debt securities at the corporate trust office of the trustee in New York City. That office is currently located at The Bank of New York, 101 Barclay Street, New York, New York 10286. You must make arrangements to have your payments picked up at or wired from that office. We may also choose to pay interest by mailing checks.

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee's corporate trust office. These offices are called paying agents. We may also choose to act as our own paying agent. We must notify you of changes in the paying agents for any particular series of debt securities. (Sections 1002)

Interest on global securities will be paid to the depositary of the global security by wire transfer of same-day funds.

Holders buying and selling debt securities must work out between them how to compensate for the fact that we will pay all the interest for an interest period to the registered holder on the regular record date. The most common manner is to adjust the sales price of the debt securities to take into account accrued interest.

Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments.

Notices

We and the trustee will send notices only to direct holders, using their addresses as listed in the trustee’s records. (Sections 101 and 106)

Regardless of who acts as paying agent, all money that we pay to a paying agent that remains unclaimed at the end of two years after the amount is due to direct holders will be repaid to us. After that two-year period, you may look only to us for payment and not to the trustee, any other paying agent or anyone else. (Section 1003)

Consolidation, Merger and Sale of Assets

Each of Telefónica and Telefónica Europe generally may enter into a merger or consolidation with another company or firm, sell or lease substantially all of their assets to another firm, or buy or lease substantially all of
the assets of another firm. However, Telefónica and Telefónica Europe may not take any of these actions unless all of the following conditions are met (Section 801):

- Where Telefónica or Telefónica Europe merges out of existence or sells or leases substantially all of its assets, the other firm must assume its obligations under the debt securities or the guarantee. The other firm’s assumption of these obligations must include the obligation to pay the additional amounts described later beginning on page 17 under “Payment of Additional Amounts”. If the other firm is organized under the laws of a country other than Spain, in the case of Telefónica, or the Netherlands, in the case of Telefónica Europe, it must indemnify you against any governmental charge or other cost resulting from the transaction.

- Immediately prior to the consummation of the transaction, neither Telefónica nor Telefónica Europe is in default on any obligations under the debt securities or the guarantee. In addition, the consummation of the transaction must not cause a default under the debt securities or the guarantee that Telefónica or Telefónica Europe does not reasonably believe can be remedied within 90 days. For purposes of these no-default tests, a default would include an event of default that has occurred and not been cured, as described later on page 20 under “Default and Related Matters—Events of Default”. A default for these purposes also would include any event that would be an event of default if the requirements for giving Telefónica or Telefónica Europe notice of its default, or of their default having to exist for a specified period of time, were disregarded.

It is possible that a merger or other similar transaction may cause the holders of the debt securities to be treated for U.S. federal income tax purposes as though they exchanged the debt securities for new securities. This could result in the recognition of taxable gain or loss for U.S. federal income tax purposes and other possible adverse tax consequences.

**Modification and Waiver**

There are three types of changes we can make to the indenture and the debt securities.

**Changes Requiring Your Approval**

First, there are changes that cannot be made to your debt securities without your specific approval. Following is a list of those types of changes:

- change the stated maturity of the principal or interest on a debt security;
- reduce any amounts due on a debt security;
- change any obligation to pay the additional amounts described later beginning on page 16 under “Payment of Additional Amounts”;
- reduce the amount of principal payable upon acceleration of the maturity of a debt security following a default;
- change the place or currency of payment on a debt security;
- impair your right to sue for payment;
- reduce the percentage of holders of debt securities whose consent is needed to modify or amend the indenture;
- reduce the percentage of holders of debt securities whose consent is needed to waive compliance with various provisions of the indenture or to waive various defaults;
- modify any other aspect of the provisions dealing with modification and waiver of the indenture; and
- change the obligations of Telefónica as guarantor with respect to payment of principal, premium, if any, and interest or sinking fund payments. (Section 902)
Changes Requiring a Majority Vote

The second type of change to the indenture and the debt securities is the kind that requires a vote in favor by holders of debt securities owning a majority of the outstanding principal amount of the particular series affected. Most changes fall into this category, except for clarifying changes and other changes that would not adversely affect holders of the debt securities in any material respect. The same vote would be required for us to obtain a waiver of all or part of the covenants described later beginning on page 18, or a waiver of a past default. However, we cannot obtain a waiver of a payment default or any other provision of the indenture or the debt securities listed in the first category described previously beginning on page 14 under “Changes Requiring Your Approval” unless we obtain your individual consent to the waiver. (Section 513)

Changes Not Requiring Approval

The third type of change does not require any vote by holders of debt securities. This type is limited to clarifications and other changes that would not adversely affect holders of the debt securities in any material respect. (Section 901)

Further Details Concerning Voting

When taking a vote, we will use the following five rules to decide how much principal amount to attribute to a security:

- For original issue discount securities, we will use the principal amount that would be due and payable on the voting date if the maturity of the debt securities were accelerated to that date because of a default.
- For debt securities whose principal amount is not known (for example, because it is based on an index), we will use a special rule for that security described in the prospectus supplement.
- For debt securities denominated in one or more foreign currencies or currency units, we will use the U.S. dollar equivalent determined as of the date of original issuance.
- Debt securities will not be considered outstanding, and therefore not eligible to vote, if we have deposited or set aside in trust money for their payment or redemption. Debt securities will also not be eligible to vote if they have been fully defeased as described later beginning on page 20 under “Covenants—Defeasance and Discharge”. (Sections 403 and 1008)
- We will generally be entitled to set any day as a record date for the purpose of determining the holders of outstanding debt securities that are entitled to vote or take other action under the indenture. In limited circumstances, the trustee will be entitled to set a record date for action by holders. If we or the trustee set a record date for a vote or other action to be taken by holders of a particular series, that vote or action may be taken only by persons who are holders of outstanding debt securities of that series on the record date and must be taken within 180 days following the record date or another period that we may specify (or as the trustee may specify if it set the record date). We may shorten or lengthen (but not beyond 180 days) this period from time to time. (Section 104)

Street name and other indirect holders should consult their banks or brokers for information on how to provide such banks or brokers with voting instructions if we seek to make changes to the indenture or any debt securities or request a waiver.

Redemption at Our Option

If the debt securities are redeemable, in whole or in part, at our option then, unless otherwise specified in the prospectus supplement, upon redemption we will pay a redemption price equal to the greater of (1) 100% of the principal amount of the debt securities plus accrued interest to the date of redemption or (2) as determined
by the trustee, the sum of the present values of the remaining scheduled payments of principal and interest on
the debt securities (not including any portion of such payments of interest accrued as of the date of redemption).
The present values will be determined by discounting the remaining principal and interest payments to the
redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months), using
the adjusted comparable yield.

The definitions of terms used in the paragraph above are as follows:

"Adjusted comparable yield" means, with respect to any redemption date, the rate per annum equal to
the semi-annual equivalent yield to maturity of the comparable issue, assuming a price for the comparable
issue (expressed as a percentage of its principal amount) equal to the comparable issue price for such
redemption date with such adjustments as are described in the prospectus supplement for the debt securities
to be redeemed.

"Comparable issue" means either (1) the U.S. Treasury security selected by the quotation agents as
having a maturity comparable to the remaining term of the series of debt securities to be redeemed that
would be utilized, at the time of selection and in accordance with customary financial practice, in pricing
new issues of corporate debt securities of comparable maturity to the remaining term of the debt securities,
or, (2) if no U.S. Treasury security meeting the requirements described above exists at the time, the alternate
comparable issue specified in the prospectus supplement for the debt securities to be redeemed.

"Comparable issue price" means, with respect to any redemption date, the average of the quotation
agents' quotations for the redemption date.

"Quotation agents" means a group of reference dealers that are primary dealers in the comparable issue
in New York City. The trustee will appoint the quotation agents after first consulting with us.

"Quotation agents' quotations" means with respect to any redemption date, the average, as determined
by the trustee, of the bid and asked prices for the comparable issue (expressed in each case as a percentage
of its principal amount) quoted in writing to the trustee by the quotation agents at 3:00 p.m. on the third
business day before the redemption date.

From and after the redemption date, if money for the redemption of the series of debt securities called for
redemption is made available as provided in the indenture and the debt securities are called for redemption on
the redemption date, the debt securities will cease to bear interest, and the only right of the holders of the debt
securities will be to receive payment of the redemption price and all unpaid interest accrued to the date of
redemption.

We will give notice to the trustee of any redemption we propose to make at least 30 days, but not more than
60 days, before the redemption date. Notice by any depositary of global securities to participating institutions
and by these participants to street name holders of indirect interests in the series of debt securities will be made
according to arrangements among them and may be subject to statutory or regulatory requirements.

We or our affiliates may purchase debt securities from investors who are willing to sell from time to time,
either in the open market at prevailing prices or in private transactions at negotiated prices. Debt securities that
we or they purchase may, in our discretion, be held, resold or cancelled.
Optional Tax Redemption

Other than as described above under “Redemption at our Option”, unless the prospectus supplement specifies otherwise, we will have the option to redeem the debt securities in two situations described below:

- The first situation is where, as a result of a change in, execution of or amendment to any laws or treaties or the official application or interpretation of any laws or treaties, either:
  - Telefónica or Telefónica Europe would be required to pay additional amounts as described later under “Payment of Additional Amounts”; or
  - Telefónica or any of its subsidiaries would have to deduct or withhold tax on any payment to Telefónica Europe to enable it to make a payment of principal or interest on a debt security.

This applies in the case of changes, executions, amendments, applications or interpretations that occur on or after the date specified in the prospectus supplement for the applicable series of debt securities and in the jurisdiction where Telefónica or Telefónica Europe is incorporated. If Telefónica or Telefónica Europe is succeeded by another entity, the applicable jurisdiction will be the jurisdiction in which the successor entity is organized, and the applicable date will be the date the entity became a successor.

We would not have the option to redeem in this case if we could have avoided the payment of additional amounts or the deduction or withholding by using reasonable measures available to us.

- The second situation is where a person located outside of Spain or The Netherlands into which Telefónica or Telefónica Europe is merged or to whom it has conveyed, transferred or leased its property is required to pay additional amounts. We would have the option to redeem the debt securities even if we are required to pay an additional amount immediately after the merger, conveyance, transfer or lease. We are not required to use reasonable measures to avoid the obligation to pay additional amounts in this situation.

In the situations described above, the redemption price for the debt securities, other than original issue discount debt securities, will be equal to the principal amount of the debt securities being redeemed plus accrued interest and any additional amounts due on the date fixed for redemption. The redemption price for original issue discount debt securities will be specified in the prospectus supplement for such securities. Furthermore, we must give between 30 and 60 days’ notice before redeeming the debt securities.

Payment of Additional Amounts

The Netherlands or Spain may require Telefónica Europe or Telefónica to withhold amounts from payments on the principal or interest on a debt security or any amounts to be paid under the guarantee, as the case may be, for taxes or any other governmental charges. If the relevant jurisdiction requires a withholding of this type, Telefónica Europe or Telefónica, as the case may be, may be required to pay you an additional amount so that the net amount you receive will be the amount specified in the debt security to which you are entitled.

Telefónica Europe or Telefónica, as the case may be, will not have to pay additional amounts in respect of taxes or other governmental charges that are to be deducted or withheld by any paying agent from a payment on a debt security or a guarantee, if such payment can be made without such deduction or withholding by any other paying agent, or in respect of taxes or other governmental charges that would not have been imposed but for:

- the existence of any present or former connection between you and The Netherlands or Spain, as the case may be, other than the mere holding of the debt security and the receipt of payments thereon;
- your status as an individual resident of a member state of the European Union;
- a failure to comply with any reasonable certification, documentation, request for information or other reporting requirements concerning your nationality, residence, identity or connection with The
Netherlands or Spain, as the case may be, if such compliance is required as a precondition to relief or exemption from such taxes or other governmental charges (including, without limitation, a certification that you are not resident in The Netherlands or Spain or are not an individual resident of a member state of the European Union);

- a change in law that becomes effective more than 30 days after payment on the debt security becomes due and payable or on which payment thereof is duly provided for, whichever occurs later;
- the imposition of an estate, inheritance, gift, sale, transfer, personal property or similar tax or other governmental charge; or
- the imposition of a tax or government charge that is payable in a manner that does not involve withholding.

These provisions will also apply to any taxes or governmental charges imposed by any jurisdiction in which a successor to Telefónica Europe or Telefónica is organized. The prospectus supplement relating to the debt securities may describe other circumstances in which Telefónica Europe or Telefónica would not be required to pay additional amounts.

Covenants

Restrictive Covenants

Restrictions on Liens

Some of our property may be subject to a mortgage or other legal mechanism that gives our lenders preferential rights in that property over other lenders, including you and the other direct holders of the debt securities, or over our general creditors if we fail to pay them back. These preferential rights are called liens. Except to the extent described below, we promise that we will not become obligated on any present or future capital market indebtedness, which is described further below, that is secured by a lien on the whole or any part of our present or future assets, unless an equivalent or higher-ranking lien on the same property is granted to you and the other direct holders of the debt securities. (Section 1007)

We are, however, allowed to secure capital market indebtedness in the following circumstances:

- if the indebtedness was originally offered primarily to the residents of Spain, in the case of indebtedness of Telefónica, or to the residents of The Netherlands, in the case of indebtedness of Telefónica Europe;
- if the capital market indebtedness matures within one year of its date of issue;
- if the lien affects assets of an entity which, when the lien was first created, was unrelated to Telefónica or Telefónica Europe and which was subsequently acquired by Telefónica or Telefónica Europe; or
- if the capital market indebtedness that is secured and is issued or guaranteed by either Telefónica or Telefónica Europe does not exceed 5% of the consolidated net tangible assets of Telefónica.

As used here:

"Capital market indebtedness" means any obligation to repay money that is borrowed through the issuance of bonds, notes or other debt securities which are capable of being listed or traded on a stock exchange or other recognized securities market. It does not include any off-balance sheet obligations.

"Consolidated net tangible assets" means the total amount of assets of Telefónica and its consolidated subsidiaries, including investments in unconsolidated subsidiaries, after deduction of (1) deferred charges, (2) goodwill in consolidation, (3) intangible assets, and (4) amounts due from stockholders for uncalled capital.
The indenture does not contain any covenants restricting Telefónica’s or Telefónica Europe’s ability to make payments, incur indebtedness, dispose of assets, enter into sale and leaseback transactions, issue and sell capital stock, enter into transactions with affiliates or engage in business other than its existing businesses. A particular series of debt securities, however, may contain restrictive covenants of this type, which we will describe in the applicable prospectus supplement.

Notarized Debt

Telefónica promises not to notarize or have intervened by a Spanish notary or a Corredor Colegiado de Comercio any capital market indebtedness issued by Telefónica, or any guarantee or surety of any capital market indebtedness given by Telefónica, unless Telefónica also notarizes or intervenes the guarantee at least one day before notarizing or intervening the capital market indebtedness, guarantee or surety. However, Telefónica will not have to notarize or have intervened the guarantee if the capital market indebtedness which it notarizes or has so intervened is convertible into equity of Telefónica or if Telefónica had to notarize or intervene the capital market indebtedness in order to comply with mandatory provisions of Spanish law.

Defeasance and Discharge

The following discussion of full defeasance and discharge and covenant defeasance and discharge is applicable to your series of debt securities unless otherwise stated in the prospectus supplement. (Sections 403 and 1008)

Full Defeasance

We can legally release ourselves from any payment or other obligations on the debt securities, except for various obligations described below (called “full defeasance”), if we, in addition to other actions, put in place the following arrangements:

• we deposit in trust for your benefit and the benefit of all other direct holders of the debt securities a combination of money and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates;
• we deliver to the trustee a legal opinion of our counsel, based upon a ruling by the U.S. Internal Revenue Service or upon a change in applicable U.S. federal income tax law, confirming that under then current U.S. federal income tax law we may make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit and just repaid the debt securities ourselves; and
• if the debt securities are listed on any securities exchange, we deliver to the trustee a legal opinion of our counsel confirming that the deposit, defeasance and discharge will not cause the debt securities to be delisted.

If we were able to satisfy the condition for full defeasance as described above, you would have to rely solely on the deposited funds for repayment on the debt securities. You could not look to us for repayment on the debt securities. You could not look to us for repayment in the event of any shortfall. Conversely, the trust deposit would most likely be protected from claims of our lenders and other creditors if we ever became bankrupt or insolvent. However, even if we take these actions, a number of our obligations relating to the debt securities will remain. These include the following obligations:

• to register the transfer and exchange of debt securities;
• to replace mutilated, destroyed, lost or stolen debt securities;
• to maintain paying agencies; and
• to hold money for payment in trust.
Covenant Defeasance

We can make the same deposit described above and be released from all or some of the covenants or other provisions that apply to the debt securities of any particular series. This is called "covenant defeasance". In that event, you would lose the protection of those covenants or provisions but would gain the protection of having money and securities set aside in trust to repay the debt securities. In order to achieve covenant defeasance, we must do the following:

- we must deposit in trust for your benefit and the benefit of all other direct holders of the debt securities a combination of money and U.S. government or U.S. government agency notes or bonds that will generate enough cash to make interest, principal and any other payments on the debt securities on their various due dates; and
- we must deliver to the trustee a legal opinion of our counsel confirming that under then current U.S. federal income tax law we may make the above deposit without causing you to be taxed on the debt securities any differently than if we did not make the deposit and just made payments on the debt securities ourselves.

If we accomplish covenant defeasance with respect to all restrictive covenants (if any) that apply to a series of debt securities, the following provisions of the indenture and/or the debt securities would no longer apply:

- any covenants applicable to the series of debt securities and described in this prospectus or in the applicable prospectus supplement; and
- the events of default relating to breach of covenants and acceleration of the maturity of other debt, described under "Default and Related Matters".

If we accomplish covenant defeasance, you can still look to us for repayment of the debt securities if there were a shortfall in the trust deposit. In fact, if any other event of default occurred (such as our bankruptcy) and debt securities became immediately due and payable, there may be such a shortfall. Depending on the event causing the default, you may not be able to obtain payment of the shortfall. (Section 1008)

Default And Related Matters

Events of Default

You will have special rights if an event of default occurs and is not cured, as described later in this subsection.

There will be an event of default with respect to the debt securities of a particular series if any of the following occurs:

- Telefónica Europe fails to pay, and Telefónica fails to honor the guarantee with respect to payments of, principal or interest due on the debt securities of that series within 21 days from the relevant due date;
- Telefónica Europe or Telefónica fails to perform any other obligation under the debt securities of that series or the guarantee and such failure continues for more than 60 days (90 days, if the failure to perform is the result of the consummation of a transaction described under "Consolidation, Merger and Sale of Assets") after we receive written notice of the failure from the trustee, or each one of us and the trustee receive written notice of the failure from holders of at least 25% in principal amount of the outstanding debt securities of that series;
- Telefónica Europe or Telefónica does not deposit any sinking fund payment with respect to that series of debt securities within 21 days of the date when such deposit is due;
- Telefónica's guarantee relating to any of the debt securities of that series ceases to be valid or legally binding for any reason;
Telefónica Europe or Telefónica fails to fulfill any payment obligation in excess of €50,000,000 or its equivalent in any other currency under any capital market indebtedness or under any guarantee or suretyship provided for any capital market indebtedness of others, and this failure remains uncured for 30 days;

the holders of any other capital market indebtedness of Telefónica Europe or Telefónica accelerate payment of all amounts owed to them as a result of Telefónica Europe or Telefónica entering into a transaction described under “Consolidation, Merger and Sale of Assets” which results in an event of default with respect of such capital market indebtedness;

Telefónica Europe or Telefónica announces its inability to meet its financial obligations or files a petition before a court for a suspension of payments (surséance van betaling in the Netherlands, or suspensión de pagos in Spain);

a court opens insolvency proceedings against Telefónica Europe or Telefónica;

Telefónica Europe or Telefónica makes a filing seeking relief under any applicable bankruptcy, or insolvency laws;

Telefónica Europe or Telefónica goes into liquidation unless it is done in connection with a merger or other form of business combination with another company and that company assumes all the obligations of Telefónica Europe or Telefónica, as the case may be, in connection with the debt securities;

the passage of any governmental order, decree or enactment which makes Telefónica Europe or Telefónica unable to perform its obligations under the debt securities of the particular series and this situation remains uncured for 90 days; or

any other event of default described in the prospectus supplement occurs. (Section 501)

Remedies If an Event of Default Occurs.

If an event of default has occurred and has not been cured, the trustee or the holders of at least 25% in principal amount of the debt securities of the affected series may declare the entire principal amount of all the debt securities of that series to be due and immediately payable. This is called a declaration of acceleration of maturity and may be cancelled by the holders of a majority in principal amount of the debt securities of the affected series. (Section 502)

Except in cases of default, where the trustee has some special duties, the trustee is not required to take any action under the indenture at the request of any holders unless the holders offer the trustee reasonable protection from expenses and liability. This protection is called an indemnity. (Section 603) If reasonable indemnity is provided, the holders of a majority in principal amount of the outstanding debt securities of the relevant series may direct the time, method and place of conducting any lawsuit or other formal legal action seeking any remedy available to the trustee. These majority holders may also direct the trustee in performing any other action under the indenture. (Section 512)

Before you bypass the trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the debt securities, the following must occur:

- you must give the trustee written notice that an event of default has occurred and remains uncured;
- the holders of at least 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee take action because of the default, and must offer reasonable indemnity to the trustee against the cost and other liabilities of taking that action;
- the trustee must have not taken action for 60 days after receipt of the above notice and offer of indemnity; and
• the holders of 50% or more of all outstanding debt securities of the relevant series must not have given
the trustee a direction that is inconsistent with the above notice. (Section 507)

However, you are entitled at any time to bring a lawsuit for the payment of money due on your debt security
on or after its due date. (Section 508)

Street name and other indirect holders should consult their banks or brokers for information on how
to give notice or direction to or make a request of the trustee and to make or cancel a declaration of
acceleration.

We will furnish to the trustee every year a written statement from some of our designated officers certifying
that, to their knowledge, we are in compliance with the indenture and the debt securities, or else specifying any
default. (Section 1005)

Regarding the Trustee

We and several of our subsidiaries maintain banking relations with the trustee in the ordinary course of their
business.

If an event of default occurs, or an event, that would be an event of default if the requirements for giving us
default notice or our default having to exist for a specific period of time were disregarded, occurs, the trustee
may be considered to have a conflicting interest with respect to the debt securities for purposes of the Trust
Indenture Act of 1939. In that case, the trustee may be required to resign as trustee under the applicable indenture
and we would be required to appoint a successor trustee.

Clearance and Settlement

Debt securities issued by Telefónica Europe may be held through one or more international and domestic
clearing systems. The principal clearing systems we will use are the book-entry systems operated by DTC in the
United States, Clearstream Banking in Luxembourg and Euroclear in Brussels, Belgium. These systems have
established electronic securities and payment transfer, processing, depositary and custodial links among
themselves and others, either directly or through custodians and depositaries. These links allow securities to be
issued, held and transferred among the clearing systems without the physical transfer of certificates.

Special procedures to facilitate clearance and settlement have been established among these clearing systems
to trade securities across borders in the secondary market. Where payments for U.S. debt securities in global
form will be made in U.S. dollars, these procedures can be used for cross-market transfers and the securities will
be cleared and settled on a delivery against payment basis.

Cross-market transfers of debt securities that are not in global form may be cleared and settled in accordance
with other procedures that may be established among the clearing systems for these securities. Investors in debt
securities that are issued outside of the United States, its territories and possessions must initially hold their
interests through Clearstream, Euroclear or the clearance system that is described in the applicable prospectus
supplement.

Clearstream and Euroclear hold interests on behalf of their participants through customers’ securities
accounts in Clearstream’s and Euroclear’s names on the books of their respective depositaries, which in turn hold
such interests in customers’ securities accounts in the depositaries’ names on the books of DTC.

The policies of DTC, Clearstream and Euroclear will govern payments, transfers, exchange and other
matters relating to the investor’s interest in securities held by them. This is also true for any other clearance
system that may be named in a prospectus supplement.
We have no responsibility for any aspect of the actions of DTC, Clearstream or Euroclear or any of their direct or indirect participants. We have no responsibility for any aspect of the records kept by DTC, Clearstream or Euroclear or any of their direct or indirect participants. We also do not supervise these systems in any way. This is also true for any other clearing system indicated in a prospectus supplement.

DTC, Clearstream, Euroclear and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. You should be aware that they are not obligated to perform or continue to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Clearstream and Euroclear as they are currently in effect. These systems could change their rules and procedures at any time.

The Clearing Systems

**DTC**

DTC has advised us as follows:

- DTC is:
  - a limited purpose trust company organized under the laws of the State of New York;
  - a member of the Federal Reserve System;
  - a "clearing corporation" within the meaning of the Uniform Commercial Code; and
  - a "clearing agency" registered pursuant to the provisions of Section 17A of the Securities Exchange Act of 1934.

- DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to accounts of its participants. This eliminates the need for physical movement of certificates.

- Participants in DTC include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives.

- Indirect access to the DTC system is also available to banks, brokers, dealers and trust companies that have relationships with participants.

- The rules applicable to DTC and DTC participants are on file with the SEC.

**Clearstream**

Clearstream has advised us as follows:

- Clearstream is incorporated under the laws of Luxembourg as a bank and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (*Commission de Surveillance du Secteur Financier*).

- Clearstream holds securities for its customers and facilitates the clearance and settlement of securities transactions among them through electronic book-entry transfers between their accounts, thereby eliminating the need for physical movement of securities.

- Clearstream provides other services to its customers, including safekeeping, administration, clearance and settlement of internationally traded securities and securities lending and borrowing.
• Clearstream interfaces with domestic securities markets in over 30 countries through established depositary and custodial relationships.

• Clearstream’s customers are worldwide financial institutions, including underwriters, securities brokers and dealers, banks, trust companies and clearing corporations. Clearstream’s U.S. customers are limited to securities brokers and dealers and banks.

• Indirect access to Clearstream is available to other institutions such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a Clearstream customer.

• Clearstream has established an electronic bridge with Euroclear to facilitate settlement of trades between Clearstream and Euroclear.

**Euroclear**

Euroclear has advised us as follows:

• Euroclear is operated by the Brussels office of Morgan Guaranty Trust Company of New York, which is known as the Euroclear Operator, under contract with Euroclear Clearance Systems, S.C., which is a Belgian cooperative corporation.

• Euroclear holds securities for its participants and facilitates the clearance and settlement of securities transactions among them through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates and any risk from lack of simultaneous transfers of securities and cash.

• Euroclear provides various other services, including securities lending and borrowing and interfaces with domestic markets in several countries.

• All operations are conducted by the Euroclear Operator, and all Euroclear securities clearance accounts and Euroclear cash accounts are accounts with the Euroclear Operator and not the cooperative.

The cooperative establishes policy for the Euroclear system on behalf of Euroclear participants.

• Euroclear participants include banks, including central banks, securities brokers and dealers and other professional financial intermediaries.

• Indirect access to the Euroclear system is also available to other firms that clear through or maintain a custodial relationship with a Euroclear participant, either directly or indirectly.

• All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

• The Euroclear Operator is the Belgian branch of a New York banking corporation, which is a member bank of the Federal Reserve System. As a member of this system, it is regulated and determined by the Board of Governors of the Federal Reserve System and the New York State Banking Department. It is also regulated by the Belgian Banking Commission.

**Other Clearing Systems**

We may choose any other clearing system for a particular series of debt securities. The clearance and settlement procedures for the clearing system we choose will be described in the applicable prospectus supplement.

**Primary Distribution**

The distribution of the debt securities will be cleared through one or more of the clearing systems that we have described above or any other clearing system that is specified in the applicable prospectus supplement.
Payment for debt securities will be made on a delivery versus payment or free delivery basis. These payment procedures will be more fully described in the applicable prospectus supplement.

Clearance and settlement procedures may vary from one series of debt securities to another according to the currency that is chosen for the specific series of debt securities. Customary clearance and settlement procedures are described below.

We will submit applications to the relevant system or systems for the debt securities to be accepted for clearance. The clearance numbers that are applicable to each clearance system will be specified in the prospectus supplement.

**Clearance and Settlement Procedures—DTC**

DTC participants that hold debt securities through DTC on behalf of investors will follow the settlement practices applicable to United States corporate debt obligations in DTC’s Same-Day Funds Settlement System.

Debt securities will be credited to the securities custody accounts of these DTC participants against payment in same-day funds, for payments in U.S. dollars, on the settlement date. For payments in a currency other than U.S. dollars, debt securities will be credited free of payment on the settlement date.

**Clearance and Settlement Procedures—Clearstream and Euroclear**

We understand that investors that hold their debt securities through Clearstream or Euroclear accounts will follow the settlement procedures that are applicable to conventional Eurobonds in registered form.

Debt securities will be credited to the securities custody accounts of Clearstream and Euroclear participants on the business day following the settlement date, for value on the settlement date. They will be credited either free of payment or against payment for value on the settlement date.

**Secondary Market Trading**

**Trading Between DTC Participants**

Secondary market trading between DTC participants will occur in the ordinary way in accordance with DTC’s rules. Secondary market trading will be settled using procedures applicable to United States corporate debt obligations in DTC’s Same-Day Funds Settlement System.

If payment is made in U.S. dollars, settlement will be in same-day funds. If payment is made in a currency other than U.S. dollars, settlement will be free of payment. If payment is made other than in U.S. dollars, separate payment management outside of the DTC system must be made between the DTC participants involved.

**Trading Between Clearstream and/or Euroclear Participants**

We understand that secondary market trading between Clearstream and/or Euroclear participants will occur in the ordinary way following the applicable rules and operating procedures of Clearstream and Euroclear. Secondary market trading will be settled using procedures applicable to conventional Eurobonds in registered form.

**Trading between a DTC Seller and a Clearstream or Euroclear Purchaser**

A purchaser of debt securities that are held in the account of a DTC participant must send instructions to Clearstream or Euroclear at least one business day prior to settlement. The instructions will provide for the transfer of the debt securities from the selling DTC participant’s account to the account of the purchasing
Clearstream or Euroclear participant. Clearstream or Euroclear, as the case may be, will then instruct the common depositary for Clearstream and Euroclear to receive the debt securities either against payment or free of payment.

The interests in the debt securities will be credited to the respective clearing system. The clearing system will then credit the account of the participant, following its usual procedures. Credit for the debt securities will appear on the next day, European time.

Cash debit will be back-valued to, and the interest on the debt securities will accrue from the value date, which would be the preceding day, when settlement occurs in New York. If the trade fails and settlement is not completed on the intended date, the Clearstream or Euroclear cash debit will be valued as of the actual settlement date instead.

Clearstream participants or Euroclear participants will need the funds necessary to process same-day funds settlement. The most direct means of doing this is to preposition funds for settlement, either from cash or from existing lines of credit, as for any settlement occurring within Clearstream or Euroclear. Under this approach, participants may take on credit exposure to Clearstream or Euroclear until the debt securities are credited to their accounts one business day later.

As an alternative, if Clearstream or Euroclear has extended a line of credit to them, participants can choose not to preposition funds and will instead allow that credit line to be drawn upon to finance settlement. Under this procedure, Clearstream participants or Euroclear participants purchasing debt securities would incur overdraft charges for one business day (assuming they clear the overdraft as soon as the debt securities were credited to their accounts). However, interest on the debt securities would accrue from the value date. Therefore, in many cases, the investment income on securities that is earned during that one business day period may substantially reduce or offset the amount of the overdraft charges. This result will, however, depend on each participant’s particular cost of funds.

Because the settlement will take place during New York business hours, DTC participants will use their usual procedures to deliver debt securities to the depositary on behalf of Clearstream participants or Euroclear participants. The sale proceeds will be available to the DTC seller on the settlement date. For the DTC participants, then, a cross-market transaction will settle no differently than a trade between two DTC participants.

**Special Timing Considerations**

You should be aware that investors will only be able to make and receive deliveries, payments and other communications involving the debt securities through Clearstream and Euroclear on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Clearstream and Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the debt securities, or to receive or make a payment or delivery of the debt securities, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg or Brussels, depending on whether Clearstream or Euroclear is used.

**PLAN OF DISTRIBUTION**

Telefónica Europe may sell the debt securities offered by this prospectus through underwriters or dealers, through agents, or directly to one or more purchasers. The applicable prospectus supplement will describe the terms of the offering of the securities, including:

- the name or names of any underwriters, dealers or agents;
- the purchase price of the debt securities and the proceeds we will receive from the sale.
• any underwriting discounts and other items constituting underwriters’ compensation;
• any initial public offering price;
• any discounts or concessions allowed or reallowed or paid to dealers or agents; and
• any securities exchange or market on which the securities may be listed.

Underwriters

We may offer the debt securities to the public through underwriting syndicates represented by managing underwriters or by underwriters without a syndicate. Subject to certain closing conditions, the underwriters will generally be obligated to purchase all the securities of the series offered by the prospectus supplement. Any initial public offering price and any discounts or concessions allowed or reallowed or paid to dealers may change from time to time.

Only underwriters named in the prospectus supplement are underwriters of the debt securities offered by the prospectus supplement. If underwriters are used in the sale, they will acquire the debt securities for their own account and may resell them from time to time in one or more transactions at a fixed public offering price or at varying prices determined at the time of sale.

Direct Sales: Agents

We may sell securities directly or through agents we designate from time to time. We will name any agent involved in the offering and sale of securities and we will describe any commissions we will pay the agent in the prospectus supplement. Unless the prospectus supplement states otherwise, an agent will act on a best efforts basis for the period of its appointment.

We may authorize agents or underwriters to solicit offers by certain types of institutional investors to purchase securities from us at the public offering price set forth in the prospectus supplement pursuant to delayed delivery contracts providing for payment and delivery on a specified date in the future. We will describe the conditions to these contracts and the commissions we must pay for solicitation of these contracts in the prospectus supplement.

Indemnification; Other Transactions with Agents and Underwriters

We may provide agents and underwriters with indemnification against certain civil liabilities, including liabilities under the Securities Act of 1933, or contribution with respect to payments that the agents or underwriters may make with respect to such liabilities.

Agents and underwriters may engage in transactions with, or perform services for, us in the ordinary course of business.

Market for the Debt Securities

Unless otherwise stated in the accompanying prospectus supplement, all debt securities we offer pursuant to this prospectus will be new issues of debt securities with no established trading market.

Any underwriters may make a market in these debt securities, but will not be obligated to do so and may discontinue any market making at any time without notice. We cannot guarantee the liquidity of the trading markets for any securities.

Dutch Regulation

The debt securities may not be offered or sold anywhere except in compliance with the requirements of the Dutch Securities Market Supervision Act 1995 (Wet toezicht effectenverkeer 1995).
Spanish Regulation

The debt securities may not be offered or sold in Spain except in compliance with the requirements of the Spanish Securities Market Law of July 28, 1988 and the Royal Decree 291 dated March 27, 1992 on issues and public offers for the sale of securities as amended by Law 37/1998.

Registration Fee and Other Expenses

We have paid a registration fee of U.S.$2,640,000 to the Securities and Exchange Commission to register these debt securities, and have incurred accounting, legal and trustee fees in an aggregate of approximately U.S.$700,000 in connection with the preparation of the filing of the registration statement that includes this prospectus. In addition, the prospectus supplement contains an itemized estimate of the accounting fees and expenses, trustee fees, rating agency fees, legal fees and expenses, and printing and other expenses incurred in connection with the offering of the debt securities described in the prospectus supplement.

TAXATION

The following is a summary of certain Spanish, Dutch and U.S. federal income tax consequences of the ownership of debt securities that Telefónica Europe may issue. This summary represents the opinion of Clifford Chance S.C. as to matters of Spanish tax law, Clifford Chance Limited Liability Partnership as to matters of Dutch tax law and of Clifford Chance Rogers & Wells LLP as to matters of U.S. federal income tax law.

Spanish Tax Considerations

The following is a summary of the Spanish tax consequences regarding your investment in the debt securities if you are neither a resident of Spain nor operating in Spain through a permanent establishment. This summary is based upon Spanish law as it stands on the date of this prospectus and may be subject to change. You should consult your own advisers regarding the tax consequences of the purchase, ownership and disposition of debt securities in light of your particular circumstances, including the effect of any state, local or other Spanish tax laws. Any special Spanish tax consequences relevant to a particular issue of debt securities will be discussed in the prospectus supplement.

Payments on the Debt Securities

Under ordinary circumstances, payments under the debt securities as well as gains realized on the disposal of the debt securities will not give rise to Spanish source income because they are issued by an entity resident for tax purposes in The Netherlands.

Payments under the Guarantee

Payments made to non-Spanish holders under the guarantee will not generally be subject to taxation in Spain.

It is however possible that the Spanish tax authorities will take the view that payments corresponding to interest under the guarantee to non-Spanish holders should be subject to withholding tax at a rate of 25%, subject to possible reduction or elimination by the application of the relevant double taxation treaty. Non-Spanish holders of the debt securities who are resident in the United States may be protected by the tax treaty between the United States and Spain which would reduce the withholding tax to a rate of 10%. In the case of non-Spanish holders of debt securities who are resident for tax purposes in a member state of the European Union, other than those operating through a territory regarded as a tax haven territory pursuant to Spanish law (currently set at Royal Decree 1080/1991, of 5 of July), such a withholding tax would not be imposed if any such holder submitted to Telefónica or its paying agent a tax residence certificate issued by the competent tax authorities of the holder’s country of residence demonstrating that the holder is a tax resident in that jurisdiction when the payment under
the guarantee is due. Such a certificate, which would also have to be submitted in case of reduction or elimination of the withholding tax under a double taxation treaty, will be valid for a period of one year from issuance.

Dutch Tax Considerations

The following is a summary of certain Dutch tax consequences regarding your investment in the debt securities if you are not resident in The Netherlands for Dutch tax purposes. The summary does not purport to be a comprehensive description of all of the tax considerations that may be relevant to any particular investor, including tax considerations that arise from rules of general application or that are generally assumed to be known investors. This summary is based on Dutch law as it stands on the date of this prospectus and may be subject to change. You should consult your own adviser regarding the tax consequences of the purchase, ownership and disposition of debt securities in light of your particular circumstances, including the effect of any state, local or other Dutch tax laws. Any special Dutch tax consequences relevant to a particular issue of debt securities will be discussed in the prospectus supplement.

Withholding Tax

All payments by Telefónica Europe under the debt securities may be made free of withholding or deduction for or on account of any taxes of whatsoever nature imposed, levied, withheld or assessed by The Netherlands or any political subdivision or taxing authority thereof or therein.

Taxes on Income and Capital Gains

If you derive income from a debt security or you realize a gain on the disposal or redemption of a debt security, you will not be subject to Dutch taxation on income or capital gains unless:

- you are, or are deemed to be, resident in The Netherlands;
- such income or gain is attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative in The Netherlands;
- you have, directly or indirectly, a substantial interest or a deemed substantial interest in Telefónica Europe or Telefónica, and such interest or the debt securities do not form part of the assets of an enterprise;
- you are an individual and you do not have a substantial interest or a deemed substantial interest in Telefónica Europe or Telefónica and any of certain persons connected to you has a substantial interest or a deemed substantial interest in Telefónica Europe or Telefónica, and such interest or the debt securities do not form part of the assets of an enterprise; or
- you carry out, on or after January 1, 2001, when new tax legislation becomes effective, investment management activities that exceed “normal investment activities” in The Netherlands.

Net Wealth Tax

You will not be subject to Dutch net wealth tax in respect of the debt securities unless you are an individual and:

- you are, or are deemed to be, resident in The Netherlands; or
- such debt security is attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative in The Netherlands.

Gift and Estate Taxes

Dutch gift, estate or inheritance taxes will not be levied on the occasion of the transfer of a debt security by way of gift by, or on the death of, a holder unless:

- the holder is, or is deemed to be, resident in The Netherlands;
• the transfer is construed as an inheritance or as a gift made by or on behalf of a person who, at the
time of the gift or death, is, or is deemed to be, resident in The Netherlands; or

• such debt security is attributable to an enterprise or part thereof which is carried on through a
permanent establishment or a permanent representative in The Netherlands.

Other Taxes and Duties

No Dutch registration tax, custom duty, stamp duty, capital tax or any other similar tax or duty, other
than court fees in The Netherlands, is payable by you in respect of, or in connection with, the execution, delivery
and enforcement by legal proceedings (including the enforcement of any foreign judgment in the Courts of The
Netherlands) of the indenture or its related agreements or the performance of Telefónica Europe’s or Telefónica’s
obligations under the debt securities.

Proposed European Union Withholding Tax Directive

In May 1998, the European Commission presented to the Council of Ministers of the European Union a
proposal for a directive on the taxation of savings which would oblige EU member states to either (1) require a
“paying agent” established in the EU member state to withhold tax on the payment of interest, discount or
premium to an individual beneficial owner who is a tax resident in another EU member state, unless the recipient
establishes that it has reported the payment in its state of residence (a “withholding tax system”) or (2) require a
paying agent established in the EU member state to supply information concerning the payment to the EU
member state where such recipient is a tax resident (an “information reporting system”). For these purposes, the
term “paying agent” is widely defined to include an agent who collects interest, discounts or premiums on behalf
of an individual who is entitled to them.

In June 2000 the Council of Ministers of Finance and Economics (ECOFIN) agreed that the proposal for
the directive should be amended on a number of points, including the requirement that discussions be held with
non-EU member states to promote the adoption of an equivalent savings withholding tax in their countries.
Subject to these discussions being successful, ECOFIN will decide whether or not to implement the directive no
later than December 31, 2002. Pending agreement on the scope and precise text of the directive, it is not possible
to say what effect, if any, the adoption of the proposed directive would have on the debt securities or payments
in respect thereof.

United States Federal Income Tax Considerations

The following is a summary of the material U.S. tax consequences regarding your investment in the debt
securities if you are a U.S. holder. You will be a U.S. holder if you are an individual who is a citizen or resident
of the United States, a U.S. domestic corporation, or any other person that is subject to U.S. federal income tax
on a net income basis in respect of an investment in the debt securities. This discussion does not purport to be a
comprehensive description of all of the tax considerations that may be relevant to any particular investor,
including tax considerations that arise from rules of general application or that are generally assumed to be
known investors. This discussion deals only with U.S. holders that hold debt securities as capital assets. It does
not address considerations that may be relevant to you if you are an investor that is subject to special tax rules,
such as a bank, thrift, real estate investment trust, regulated investment company, insurance company, dealer in
securities or currencies, trader in securities or commodities that elects to mark to market treatment, person that
will hold debt securities as a hedge against currency risk or as a position in a “straddle” or conversion
transaction, tax-exempt organization or a person whose “functional currency” is not the U.S. dollar. Any special
U.S. federal income tax consequences relevant to a particular issue of debt securities will be discussed in the
prospectus supplement.
This summary is based on laws, regulations, rulings and decisions now in effect, all of which may change. Any change could apply retroactively and could affect the continued validity of this summary.

You should consult your tax adviser about the tax consequences of holding debt securities, including the relevance to your particular situation of the considerations discussed below, as well as the relevance to your particular situation of state, local or other tax laws.

Payments and Accruals of Interest

Payments or accruals of "qualified stated interest" (as defined below) on a debt security will be taxable to you as ordinary interest income at the time that you receive or accrue such amounts (in accordance with your regular method of tax accounting). If you use the cash method of tax accounting and you receive payments of interest pursuant to the terms of a debt security in a currency other than U.S. dollars (a "foreign currency"), the amount of interest income you will realize will be the U.S. dollar value of the foreign currency payment based on the exchange rate in effect on the date you receive the payment, regardless of whether you convert the payment into U.S. dollars. If you are an accrual-basis U.S. holder, the amount of interest income you will realize will be based on the average exchange rate in effect during the interest accrual period (or with respect to an interest accrual period that spans two taxable years, at the average exchange rate for the partial period within the taxable year). Alternatively, as an accrual-basis U.S. holder, you may elect to translate all interest income on foreign currency-denominated debt securities at the spot rate on the last day of the accrual period (or the last day of the taxable year, in the case of an accrual period that spans more than one taxable year) or on the date that you receive the interest payment if that date is within five business days of the end of the accrual period. If you make this election, you must apply it consistently to all debt instruments from year to year and you cannot change the election without the consent of the Internal Revenue Service. If you use the accrual method of accounting for tax purposes, you will recognize foreign currency gain or loss on the receipt of a foreign currency interest payment if the exchange rate in effect on the date the payment is received differs from the rate that applies to a previous accrual of that interest income. This foreign currency gain or loss will be treated as ordinary income or loss, but generally will not be treated as an adjustment to interest income received on the debt security.

Purchase, Sale and Retirement of Debt Securities

Initially, your tax basis in a debt security generally will equal the cost of the debt security to you. Your basis will increase by any amounts that you are required to include in income under the rules governing original issue discount and market discount, and will decrease by the amount of any amortized premium and any payments other than qualified stated interest made on the debt security. (The rules for determining these amounts are discussed below.) If you purchase a debt security that is denominated in a foreign currency, the cost to you (and therefore generally your initial tax basis) will be the U.S. dollar value of the foreign currency purchase price on the date of purchase calculated at the exchange rate in effect on that date. If the foreign currency debt security is traded on an established securities market and you are a cash-basis taxpayer (or if you are an accrual-basis taxpayer that makes a special election), you will determine the U.S. dollar value of the cost of the debt security by translating the amount of the foreign currency that you paid for the debt security at the spot rate of exchange on the settlement date of your purchase. The amount of any subsequent adjustments to your tax basis in a debt security in respect of foreign currency-denominated original issue discount market discount and premium will be determined in the manner described below. If you convert U.S. dollars into a foreign currency and then immediately use that foreign currency to purchase a debt security, you generally will not have any taxable gain or loss as a result of the conversion or purchase.

When you sell or exchange a debt security, or if a debt security that you hold is retired, you generally will recognize gain or loss equal to the difference between the amount you realize on the transaction (less any accrued interest, which will be subject to tax in the manner described above under "Payments or Accruals of Interest") and your tax basis in the debt security. If you sell or exchange a debt security for a foreign currency, or receive foreign currency on the retirement of a debt security, the amount you will realize for U.S. tax purposes generally will be the dollar value of the foreign currency that you receive calculated at the exchange rate in effect on the
date the foreign currency debt security is disposed of or retired. If you dispose of a foreign currency debt security that is traded on an established securities market and you are a cash-basis U.S. holder (or if you are an accrual-basis holder that makes a special election), you will determine the U.S. dollar value of the amount realized by translating the amount at the spot rate of exchange on the settlement date of the sale, exchange or retirement.

The special election available to you if you are an accrual-basis taxpayer in respect of the purchase and sale of foreign currency debt securities traded on an established securities market, which is discussed in the two preceding paragraphs, must be applied consistently to all debt instruments from year to year and cannot be changed without the consent of the Internal Revenue Service.

Except as discussed below with respect to market discount and foreign currency gain or loss, the gain or loss that you recognize on the sale, exchange or retirement of a debt security generally will be capital gain or loss. The gain or loss on the sale, exchange or retirement of a debt security will be long-term capital gain or loss if you have held the debt security for more than one year on the date of disposition. Net long-term capital gain recognized by an individual U.S. holder generally will be subject to a maximum tax rate of 20%. The ability of U.S. holders to offset capital losses against ordinary income is limited.

Despite the foregoing, the gain or loss that you recognize on the sale, exchange or retirement of a foreign currency debt security will be treated as ordinary income or loss to the extent that the gain or loss is attributable to changes in exchange rates during the period in which you held the debt security. This foreign currency gain or loss will not be treated as an adjustment to interest income that you receive on the debt security.

**Original Issue Discount**

If Telefónica Europe issues debt securities at a discount from their stated redemption price at maturity, and the discount is equal to or more than the product of one-fourth of one percent (0.25%) of the stated redemption price at maturity of the debt securities multiplied by the number of full years to their maturity, the debt securities will be “Original Issue Discount Debt Securities”. The difference between the issue price and the stated redemption price at maturity of the debt securities will be the “original issue discount”. The “issue price” of the debt securities will be the first price at which a substantial amount of the debt securities are sold to the public (i.e., excluding sales of debt securities to underwriters, placement agents, wholesalers, or similar persons). The “stated redemption price at maturity” will include all payments under the debt securities other than payments of qualified stated interest. The term “qualified stated interest” generally means stated interest that is unconditionally payable in cash or property (other than debt instruments issued by the relevant issuer) at least annually during the entire term of a debt security at a single fixed interest rate or, subject to certain conditions, based on one or more interest indices.

If you invest in an Original Issue Discount Debt Security, you generally will be subject to the special tax accounting rules for original issue discount obligations provided by the Internal Revenue code and certain U.S. Treasury regulations. You should be aware that, as described in greater detail below, if you invest in an Original Discount Debt Security, you generally will be required to include original issue discount in ordinary gross income for U.S. federal income tax purposes as it accrues, although you may not yet have received the cash attributable to that income.

Second, regardless of whether you are a cash-basis or accrual-basis holder, if you are the holder of a short-term debt security you may elect to accrue any “acquisition discount” with respect to the debt security on a current basis. Acquisition discount is the excess of the remaining redemption amount of the debt security at the time of acquisition over the purchase price. Acquisition discount will be treated as accruing ratably or, at the election of the holder, under a constant yield method based on daily compounding. If you elect to accrue acquisition discount, the original issue discount rules will not apply.

Finally, the market discount rules described below will not apply to short-term debt securities.
As discussed above, certain of the debt securities may be subject to special redemption features. These features may affect the determination of whether a debt security has a maturity of one year or less an thus whether the debt security is a short-term debt security. If you purchase debt securities with these features, you should carefully examine the prospectus supplement and consult your tax adviser about these features.

**Premium**

If you purchase a debt security at a cost greater than the debt security’s remaining stated redemption price at maturity, you will be considered to have purchased the debt security at a premium, and you may elect to amortize the premium as an offset to interest income, using a constant yield method, over the remaining term of the debt security. If you make this election, it generally will apply to all debt instruments that you hold at the time of the election, as well as any debt instruments that you subsequently acquire. In addition, you may not revoke the election without the consent of the Internal Revenue Service. If you elect to amortize the premium, you will be required to reduce your tax basis in the debt security by the amount of the premium amortized during your holding period. Original Issue Discount Debt Securities purchased at a premium will not be subject to the original issue discount rules described above. In the case of premium on a foreign currency debt security, you should calculate the amortization of the premium in the foreign currency. Premium amortization deductions attributable to a period reduce interest income in respect of that period, and therefore are translated into U.S. dollars at the rate that you use for interest payments in respect of that period. Exchange gain or loss will be realized with respect to amortized premium on a foreign currency debt security based on the difference between the exchange rate computed on the date or dates the premium is amortized against interest payments on the debt security and the exchange rate on the date the holder acquired the debt security. If you do not elect to amortize premium and you hold the debt security to maturity, the amount of premium will be included in your tax basis in the debt security and you generally will be required to treat the premium as capital loss when the debt security matures.

In general, regardless of whether you use the cash or the accrual method of tax accounting, if you are the holder of an Original Issue Discount Debt Security with a maturity greater than one year, you will be required to include in ordinary gross income the sum of the “daily portions” of original issue discount on that debt security for all days during the taxable year that you own the debt security. The daily portions of original issue discount on an Original Issue Discount Debt Security are determined by allocating to each day in any accrual period a ratable portion of the original issue discount allocable to that period. Accrual periods may be any length and may vary in length over the term of an Original Issue Discount Debt Security, so long as no accrual period is longer than one year and each scheduled payment of principal or interest occurs on the first or last day of an accrual period. If you are the initial holder of the debt security who purchased at the issue price (as described above), the amount of original issue discount on an Original Issue Discount Debt Security allocable to each accrual period is determined by:

- multiplying the “adjusted issue price” (as defined below) of the debt security at the beginning of the accrual period by a fraction, the numerator of which is the annual yield to maturity (defined below) of the debt security and the denominator of which is the number of accrual periods in a year; and

- subtracting from that product the amount (if any) payable as qualified stated interest allocable to that accrual period.

In the case of an Original Issue Discount Debt Security that is a floating rate debt security, both the “annual yield to maturity” and the qualified stated interest will be determined for these purposes as though the debt security will bear interest in all periods at a fixed rate generally equal to the rate that would be applicable to interest payments on the debt security on its date of issue or, in the case of some floating rate debt securities, the rate that reflects the yield that is reasonably expected for the debt security. (Additional rules may apply if interest on a floating rate debt security is based on more than one interest index.) The “adjusted issue price” of an Original Issue Discount Debt Security at the beginning of any accrual period will generally be the sum of its issue price (including any pre-issuance accrued interest) and the amount of original issue discount allocable to
all prior accrual periods, reduced by the amount of all payments other than any qualified stated interest payments on the debt security in all prior accrual periods. All payments on an Original Issue Discount Debt Security (other than qualified stated interest) will generally be viewed first as payments of previously accrued original issue discount (to the extent of the previously accrued discount), with payments considered made from the earliest accrual periods first, and then as a payment of principal. The “annual yield to maturity” of a debt security is the discount rate that causes the present value of all payments on the debt security to equal the issue price. As a result of this “constant yield” method of including original issue discount income, the amounts you will be required to include in your gross income if you invest in an Original Issue Discount debt Security denominated in U.S. dollars generally will be lesser in the early years and greater in the later years than amounts that would be includable on a straight-line basis.

You generally may make an irrevocable election to include in income your entire return on a debt security (i.e., the excess of all remaining payments to be received on the debt security, including payments of qualified stated interest, over the amount you paid for the debt security) under the constant yield method described above. If you purchase debt securities at a premium or at a market discount and you make such an election, you will also be deemed to have made the election (discussed below under “Premium” and “Market Discount”) to amortize premium or to accrete market discount currently on a constant yield basis in respect of all other premium or market discount bonds that you hold.

In the case of an Original Issue Discount Debt Security that is also a foreign currency debt security, you should determine the U.S. dollar amount includable as original issue discount for each accrual period by (i) calculating the amount of original issue discount allocable to each accrual period in the foreign currency using the constant yield method described above and (ii) translating that foreign currency amount at the average exchange rate in effect during that accrual period (or, with respect to an interest accrual period that spans two taxable years, at the average exchange rate for each partial period). Alternatively, you may translate the foreign currency amount at the spot rate of exchange on the last day of the accrual period (or the last day of the taxable year, for an accrual period that spans two taxable years) or at the spot rate of exchange on the date of receipt, if that date is within five business days of the last day of the accrual period, provided that you have made the election described above under “Payments or Accruals of Interest”. Because exchange rates may fluctuate, if you are the holder of an Original Issue Discount Debt Security that is also a foreign currency debt security, you may recognize a different amount of original issue discount income in each accrual period than would be the case if you were the holder of an otherwise similar Original Issue Discount Debt Security denominated in U.S. dollars. Upon the receipt of an amount attributable to original issue discount (whether in connection with a payment of an amount that is not qualified stated interest or the sale or retirement of the Original Issue Discount Debt Security), you will recognize ordinary income or loss measured by the difference between the amount received (translated into U.S. dollars at the exchange rate in effect on the date of receipt or on the date of disposition of the Original Issue Discount Debt Security, as the case may be) and the amount accrued as qualified stated interest (using the exchange rate applicable to such previous accrual).

If you purchase an Original Issue Discount Debt Security outside of the initial offering at a cost less than its remaining redemption amount (i.e., the total of all future payments to be made on the debt security other than payments of qualified stated interest), or if you purchase an Original Issue Discount Debt Security in the initial offering at a price other than the debt security’s issue price, you generally will also be required to include in gross income the daily portions of original issue discount, calculated as described above. However, if you acquire an Original Issue Discount Debt Security at a price greater than its adjusted issue price, you will be entitled to reduce your periodic inclusions of original issue discount to reflect the premium paid over the adjusted issue price.

Floating rate debt securities generally will be treated as “variable rate debt instruments” under the OID Regulations. Accordingly, the stated interest on a Floating Rate Debt Security generally will be treated as “qualified stated interest” and such a Debt Security will not have OID solely as a result of the fact that it provides for interest at a variable rate. If a floating rate debt security does not qualify as a “variable rate debt instrument,” the debt security will be subject to special rules that govern the tax treatment of debt obligations.
that provide for contingent payments. We will provide a detailed description of the tax considerations relevant to U.S. holders of any such Debt Securities in the prospectus supplement.

Certain debt securities may be redeemed prior to maturity, either at the option of Telefónica Europe or at the option of the holder, or may have special repayment or interest rate reset features as indicated in the prospectus supplement. Debt securities containing these features may be subject to rules that differ from the general rules discussed above. If you purchase debt securities with these features, you should carefully examine the prospectus supplement and consult your tax adviser about their treatment since the tax consequences of original issue discount will depend, in part, on the particular terms and features of the debt securities.

**Short-Term Securities**

The rules described above will also generally apply to Original Issue Discount Debt Securities with maturities of one year or less ("short-term debt securities"), but with some modifications.

First, the original issue discount rules treat none of the interest on a short-term debt security as qualified stated interest, but treat a short-term debt security as having original issue discount. Thus, all short-term debt securities will be Original Issue Discount Debt Securities. Except as described below, if you are a cash-basis holder of a short-term debt security and you do not identify the short-term debt security as part of a hedging transaction you will generally not be required to accrue original issue discount currently, but you will be required to treat any gain realized on a sale, exchange or retirement of the debt security as ordinary income to the extent such gain does not exceed the original issue discount accrued with respect to the debt security during the period you held the debt security. You may not be allowed to deduct all of the interest paid or accrued on any indebtedness incurred or maintained to purchase or carry a short-term debt security until the maturity of the debt security or its earlier disposition in a taxable transaction. Notwithstanding the foregoing, if you are a cash-basis U.S. holder of a short-term debt security, you may elect to accrue original issue discount on a current basis (in which case the limitation on the deductibility of interest described above will not apply). A U.S. holder using the accrual method of tax accounting and some cash method holders (including banks, securities dealers, regulated investment companies and certain trust funds) generally will be required to include original issue discount on a short-term debt security in gross income on a current basis. Original issue discount will be treated as accruing for these purposes on a ratable basis or, at the election of the holder, on a constant yield basis based on daily compounding.

**Market Discount**

If you purchase a debt security at a price that is lower than the debt security’s remaining redemption amount (or in the case of an Original Issue Discount Debt Security, the debt security’s adjusted issue price), by 0.25% or more of the remaining redemption amount (or adjusted issue price), multiplied by the number of remaining whole years to maturity, the debt security will be considered to bear “market discount” in your hands. In this case, any gain that you realize on the disposition of the debt security generally will be treated as ordinary interest income to the extent of the market discount that accrued on the debt security during your holding period. In addition, you may be required to defer the deduction of a portion of the interest paid on any indebtedness that you incurred or continued to purchase or carry the debt security. In general, market discount will be treated as accruing ratably over the term of the debt security, or, at your election, under a constant yield method. You must accrue market discount on a foreign currency debt security in the specified currency. The amount that you will be required to include in income in respect of accrued market discount will be the U.S. dollar value of the accrued amount, generally calculated at the exchange rate in effect on the date that you dispose of the debt security.

You may elect to include market discount in gross income currently as it accrues (on either a ratable or constant yield basis), in lieu of treating a portion of any gain realized on a sale of the debt security as ordinary income. If you elect to include market discount on a current basis, the interest deduction deferral rule described above will not apply. If you make such an election, it will apply to all market discount debt instruments that you acquire or hold on or after the first day of the first taxable year to which the election applies. The election
may not be revoked without the consent of the Internal Revenue Service. Any accrued market discount on a foreign currency debt security that is currently includible in income will be translated into U.S. dollars at the average exchange rate for the accrual period (or portion thereof within the holder's taxable year).

Indexed Debt Securities and Other Debt Securities Providing for Contingent Payments

Special rules govern the tax treatment of debt obligations that provide for contingent payments ("contingent debt obligations"). These rules generally require accrual of interest income on a constant yield basis in respect of contingent debt obligations at a yield determined at the time of issuance of the obligation, and may require adjustments to these accruals when any contingent payments are made. We will provide a detailed description of the tax considerations relevant to U.S. holders of any contingent debt obligations in the prospectus supplement.

Information Reporting and Backup Withholding

The paying agent must file information returns with the United States Internal Revenue Service in connection with debt security payments made to certain United States persons. If you are a United States person, you generally will not be subject to a 31% United States backup withholding tax on such payments if you provide your taxpayer identification number to the paying agent. You may also be subject to information reporting and backup withholding tax requirements with respect to the proceeds from a sale of the debt securities. If you are not a United States person, you may have to comply with certification procedures to establish that you are not a United States person in order to avoid information reporting and backup withholding tax requirements.

LEGAL MATTERS

The legality of the securities will be passed upon by Clifford Chance Rogers & Wells LLP, New York, New York, United States counsel to Telefónica and Telefónica Europe with respect to matters of New York law and United States federal law, Clifford Chance S.C., Madrid, Spain, special Spanish counsel to Telefónica with respect to matters of Spanish law and Clifford Chance Limited Liability Partnership, Dutch counsel to Telefónica Europe with respect to Dutch law. Certain legal matters as to United States law relating to the securities will be passed upon for the underwriters by Davis Polk & Wardwell or any other law firm named in the applicable prospectus supplement. Certain legal matters as to Spanish law will be passed upon for the underwriters by Uria y Menéndez or any other law firm named in the applicable prospectus supplement. Certain legal matters as to Dutch law may be passed upon for the underwriters by a law firm named in the applicable prospectus supplement.

EXPERTS

The financial statements and schedules as of December 31, 1999 and 1998, and for each of the three years in the period ended December 31, 1999, incorporated by reference in this prospectus and elsewhere in the registration statement from Telefónica’s annual report on Form 20-F, have been audited by Arthur Andersen, independent auditors, as indicated in their reports with respect thereto, and are included herein in reliance upon the authority of said firm as experts in giving said reports.

ENFORCEABILITY OF CIVIL LIABILITIES

Telefónica is a corporation (sociedad anónima) in the Kingdom of Spain, and Telefónica Europe is a company with limited liability with an unlimited duration, established under the laws of The Netherlands. Most of the members of the Board of Directors or officers of Telefónica and the managing director of Telefónica Europe are residents outside the United States. All or substantially all of the assets of those individuals and of Telefónica and Telefónica Europe are located outside the United States. As a result, it may not be possible for
investors to effect service of process upon such persons within the United States or to enforce against such persons or upon Telefónica or Telefónica Europe judgments obtained in the courts of the United States, including without limitation, judgments predicated upon the civil liability provisions of the federal securities laws of the United States.

Telefónica has been advised by its Spanish legal counsel, Clifford Chance S.C., that any judgment obtained against Telefónica in the United States would be recognized and enforced by the courts of Spain in accordance with and subject to the Law of Civil Procedures ("Ley de Enjuiciamiento Civil"), the substantive provisions of which provide, inter alia, that any judgment rendered outside Spain will be enforced in Spain if the appropriate order (exequatur) would be obtainable (i) according to the provisions of any applicable treaty (there is none currently in existence with the United States), (ii) in the absence of any such treaty, if it could be proved that the jurisdiction where the foreign judgment was rendered recognizes Spanish judgments on a reciprocal basis, or (iii) if reciprocity could not be proved, subject to the satisfaction of certain conditions, such as the plaintiff having pursued a personal action before the foreign court. If the United States case law were not to show that reciprocity existed, unless the condition referred to in (iii) above were satisfied, the requisite order (exequatur) would not be granted.

Telefónica Europe has been advised by its Dutch counsel, Clifford Chance Limited Liability Partnership, that because there is no treaty between the United States and The Netherlands providing for the reciprocal recognition and enforcement of judgments, judgments of United States federal and state courts are not enforceable in The Netherlands. A judgment rendered in the United States will not be recognized and enforced by the courts of The Netherlands. However, if a person has obtained a final and conclusive judgment for the payment of money rendered by a court in the United States which is enforceable in the United States and brings suit in a court of competent jurisdiction in The Netherlands, such person may submit to such court the final judgment which has been rendered in the United States. If the Dutch court finds that the jurisdiction of the rendering U.S. court has been based on grounds which are internationally acceptable, that legal proceedings have been conducted in accordance with generally accepted principles of fair trial and that the U.S. judgment is final and definite, the Dutch court would in all probability give binding effect to and render a judgment in accordance with the final U.S. judgment unless such judgment contravened principles of public policy in The Netherlands or an existing Dutch judgment. Nevertheless, there is doubt as to whether a court in The Netherlands would impose civil liability on Telefónica, Telefónica Europe, their directors or officers or controlling persons or the experts named in this registration statement, in an original action based solely upon the federal securities laws of the United States brought in a court of competent jurisdiction in The Netherlands or to enforce a judgment based solely upon such laws.
No dealer, salesperson or other person is authorized to give any information or represent anything not contained in this prospectus. You must not rely on any unauthorized information or representations. This prospectus is an offer to sell only the notes offered hereby, but only under circumstances and in jurisdictions where it is lawful to do so. The information contained in this prospectus is current only as of its date.

TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Prospectus Supplement</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>About This Prospectus Supplement</td>
<td>S-3</td>
</tr>
<tr>
<td>Forward-Looking Statements</td>
<td>S-4</td>
</tr>
<tr>
<td>Summary</td>
<td>S-5</td>
</tr>
<tr>
<td>The Offering</td>
<td>S-6</td>
</tr>
<tr>
<td>Selected Financial Data</td>
<td>S-10</td>
</tr>
<tr>
<td>Risk Factors</td>
<td>S-14</td>
</tr>
<tr>
<td>Use of Proceeds</td>
<td>S-17</td>
</tr>
<tr>
<td>Capitalization</td>
<td>S-18</td>
</tr>
<tr>
<td>Business</td>
<td>S-20</td>
</tr>
<tr>
<td>Operating and Financial Review and Prospects</td>
<td>S-71</td>
</tr>
<tr>
<td>Directors, Senior Management and Employees</td>
<td>S-96</td>
</tr>
<tr>
<td>Major Shareholders and Related Party</td>
<td></td>
</tr>
<tr>
<td>Transactions</td>
<td>S-103</td>
</tr>
<tr>
<td>Financial Information</td>
<td>S-104</td>
</tr>
<tr>
<td>Underwriting</td>
<td>S-105</td>
</tr>
<tr>
<td>Validity of the Notes and the Guarantee</td>
<td>S-107</td>
</tr>
<tr>
<td>General Information</td>
<td>S-108</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Prospectus</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>About This Prospectus</td>
<td>3</td>
</tr>
<tr>
<td>Where You Can Find More Information</td>
<td>4</td>
</tr>
<tr>
<td>— Incorporation by Reference</td>
<td></td>
</tr>
<tr>
<td>Forward-Looking Statements</td>
<td>5</td>
</tr>
<tr>
<td>Telefónica</td>
<td>6</td>
</tr>
<tr>
<td>Telefónica Europe</td>
<td>6</td>
</tr>
<tr>
<td>Use of Proceeds</td>
<td>6</td>
</tr>
<tr>
<td>Ratio of Earnings to Fixed Charges</td>
<td>7</td>
</tr>
<tr>
<td>Description of the Debt Securities and the Guarantee</td>
<td>8</td>
</tr>
<tr>
<td>Plan of Distribution</td>
<td>26</td>
</tr>
<tr>
<td>Taxation</td>
<td>28</td>
</tr>
<tr>
<td>Legal Matters</td>
<td>36</td>
</tr>
<tr>
<td>Experts</td>
<td>36</td>
</tr>
<tr>
<td>Enforceability of Civil Liabilities</td>
<td>36</td>
</tr>
</tbody>
</table>

Guaranteed as to Payment of Principal and Interest by

Telefónica, S.A.

Telefónica Europe B.V.

$1,250,000,000 7.35% Notes due 2005
$2,500,000,000 7.75% Notes due 2010
$1,250,000,000 8.25% Notes due 2030
€1,000,000,000 6.125% Notes due 2005

Goldman, Sachs & Co.
J.P. Morgan & Co.
Morgan Stanley Dean Witter