Telefónica, S.A.

REPORT BY THE BOARD OF DIRECTORS CONCERNING THE PROPOSED INCREASE IN STOCK CAPITAL WITH AN ELIMINATION OF THE PREFERRED SUBSCRIPTION RIGHT WITH A VIEW TO ESTABLISHING AN EMPLOYEE STOCK OPTIONS PLAN (ITEM XII ON THE AGENDA)

1. PURPOSE OF THE REPORT

Item XII of the Agenda for the Annual General Shareholders´Meeting of Telefónica, S.A., scheduled for 14 and 15 June 2001, includes a proposed resolution to increase the stock capital, with an elimination of the preferred subscription right to meet the needs deriving from the establishment of a compensation system pegged to the quotation for the stock shares of Telefónica, S.A., with delivery of stock options, for the employees of ENDEMOL ENTERTAINMENT HOLDING, N.V., a Dutch company, and its subsidiaries (hereinafter called "ENDEMOL," or "ENDEMOL GROUP" when its subsidiaries are included.)

This report has been prepared by the Board of Directors in compliance with the provisions of Articles 144 and 159 of the Corporation Law. It includes the actual text of the resolution that will be submitted for deliberation and resolution by the Annual General Shareholderers´Meeting.

2. JUSTIFICATION FOR THE PROPOSAL

2.1. Employee Stock Option Plans have long been the medium customarily used to establish employee compensation and incentive systems. By giving the employees an opportunity to acquire shares of the company for which they work, under advantageous conditions, these plans promote the motivation and integration of the employees, and enable them to share in any increase in the value of the Company.

Telefónica, S.A., agreed to acquire ENDEMOL by means of an increase in capital with non-cash contribution of ENDEMOL shares. This acquisition was approved by the Annual General Meeting of Shareholders of Telefónica, S.A., on 7 April 2000. The agreements provided that in 2001, 2002, 2003, and 2004 Telefónica, S.A., would give ENDEMOL GROUP employees options each year to acquire Telefónica S.A. stock worth 27,500,000 euros.

In conformance with this provision, Telefónica, S.A., has established an incentive plan (the "EN-SOP Program") under which it will offer Telefónica, S.A., stock options to all GROUP ENDEMOL personnel (the "Beneficiaries") who are permanent employees as of the date of delivery of said options. Employees who participate in other stock or options programs of similar nature are expressly excluded.

The EN-SOP Program consists in delivery each year, in 2001, 2002, 2003, and 2004, of a variable number of options to purchase Telefónica, S.A., stock shares (the “Options") to the Beneficiaries. The total number of Options to be delivered each year will be determined by dividing the agreed amount of 27,500,000 euros by the Annual Refence Value of one share of Telefónica, S.A., stock.

Specifically, the stock capital increase herein represents the first delivery of 1,425,624 Options to be implemented at the first meeting of the Telefónica, S.A., Appointments and Compensations Committee, by the Annual General Meeting of Shareholders of Telefónica, S.A., that approves the resolution discussed in this Report. For all purposes, the first delivery of Options will take effect on 1 January 2001. The Annual Reference Value for one share of Telefónica, S.A., stock for this first delivery has been calculated at 19.2898 euros, taking into account the mathematical average of the average weighted changes per share of Telefónica, S.A., on the continuos market during the five trading days prior to the Telefónica, S.A., Board of Directors meeting that approves the within Directors' Report and resolves to call a Annual General Meeting of Shareholders.

The Annual Reference Value for the remaining years (2002, 2003, and 2004) will be determined by taking into account the mathematical average of the average weighted changes for one share of Telefónica, S.A., stock on the continuos market during the five trading days preceding the Telefónica, S.A., Board of Directors meeting that resolves to call a Annual General Meeting of Shareholders and to propose approval of the pertinent increase in stock capital.

The annual deliveries will become possible at the first meeting of the Appointments and Compensations Committee of Telefónica, S.A., by the Annual General Meeting of Shareholders of Telefónica, S.A., that approves the pertinent increase in stock capital. For all purposes, each representative annual delivery of Options will take effect on 1 January 2001, 2002, 2003, and 2004.

The Options delivered each year will remain in effect for four years, and may be exercised in one-half increments on the third and fourth anniversary dates of their delivery.

2.2. The formula chosen to meet the needs deriving from the EN-SOP Program is the formula permitted by Article 159 of the Corporation Law. This article provides that a General Meeting of Shareholders may approve an increase in stock capital with elimination of the preferred subscription right and issue shares at a price higher than the net worth. To meet the requirements of law, on the one hand, and the goals sought by incentive plans, on the other hand, the EN-SOP Program will operate as follows:

The Beneficiaries will be offered an opportunity to enter into a stock options purchase agreement that embodies a commitment by Telefónica, S.A., to deliver to the Beneficiaries a number of Telefónica, S.A., stock shares, subject to the existence of specified conditions, when the employees have been with ENDEMOL GROUP for more than three, four, five, and six years.

The stock shares in the first delivery of Options described above would originate in the increase in capital that the General Meeting of Shareholders is being asked to approve. As stated above, it consists in a 1,425,624 euro increase in the stock capital in the form of issuance and placement of an equal number of common stock shares, represented by accounting entries, that will be issued at their nominal value of 1 euro per share with an issue premium of 18.2898 euros per share. Said price of 19.2898 euros per share complies with the provisions of Article 159.1 c) of the Corporation Law, in that it exceeds the net per-share value of Telefónica, S.A. stock, as will be explained below.

The stock shares composing the subsequent deliveries of Options planned for the years 2002, 2003, and 2004 would originate in stock capital increases that the Board of Directors will ask the General Meetings of Shareholders in those years to approve once the Annual Reference Value for each year has been determined.

The shares to be issued cannot be subscribed to by the Beneficiaries immediately, because the possibility of exercising the options depends, among other requirements, on continuation of their status as permanent employees of ENDEMOL GROUP. It is proposed, therefore, that the new shares to be issued in connection with this stock capital increase be subscribed and distributed by one or more Financial Institutions that will act as Plan Agents, and which will be chosen by the Board of Directors (with power to substitute a Standing Committee or Directors with delegated powers). The Board of Directors will also have the power to determine the conditions that will govern the relations between the Institution(s) and Telefónica, S.A., for the actual performance and implementation of the commitments acquired and the EN-SOP Program.

Lastly, once the EN-SOP Program comes to an end, shares that under the terms of the Program could not be offered to the Beneficiaries, and which are not going to be used to cover another stock options plan for Telefónica Group employees, will be purchased by Telefónica, S.A., for redemption pursuant to a resolution to reduce the capital.

2.3. For the purposes specified in Article 159.1 b) of the Corporation Law, the following statements are made:

a) Interest of the Company: The Board of Directors feels that the resolution being proposed to the General Meeting of Shareholders to increase the stock capital and eliminate the preferred subscription rigth is required in the interests of the Company. It facilitates the achieving of the following goals:

i) to facilitate access by ENDEMOL GROUP employees to the capital of Telefónica, S.A., as parent of the Group of which it forms part, while, at the same time, establishing a competitive compensation formula similar to those of other companies on par with Telefónica, S.A.;

(ii) to create incentives for the Beneficiaries and to enable them to participate in increases in the value of the Company; at the same time, it will permit a beneficial convergence of employee and shareholder interests;

(iii) to recognize the work done and to be done by ENDEMOL GROUP employees as a group during the coming years, and, in this way, to comply with the agreements made for the acquisition of ENDEMOL by Telefónica, S.A.;

(iv) lastly, the Board believes that experience in the establishment of these incentive plans yields results that prove their success, a success that has redounded to the obvious benefit of the interests of the Company and, therefore, of all the shareholders of Telefónica, S.A.

b) With respect to the justification of the proposal, we call attention to the considerations set forth in earlier sections of this report. In view of the identity of the ultimate beneficiaries of the increase in capital, it is obvious that the granting of a preferred subscription right would make this goal unachievable.

c) The price of 19.2898 euros per share established for the increase in capital is higher than the net per-share worth of Telefónica, S.A. stock, as will be evidenced in the report by the Company's Auditors that will be made available to the shareholders when the General Meeting notices are sent out, in conformance with Article 159 of the Corporation Law. The said per-share price of 19.2898 euros is felt to be adequate in view of the goals sought with said increase.

d) With respect to the parties to whom the shares will be offered, we repeat: the shares will be offered to ENDEMOL GROUP employees, who were permanent employees as of 1 January 2001, 2002, 2003, and 2004.

All employees who participate in other stock or options programs of similar nature are specifically excluded.

The shares to be issued in connection with the increase in stock capital, ultimately, will be allocated to Beneficiaries, who exercise their options after meeting the conditions of the EN-SOP Program.

As has been stated, however, to facilitate this distribution on the terms and conditions specified in said Program, all the shares issued at this time, initially, will be subscribed to and distributed by one or more Financial Institutions to be designated by the Board of Directors, which is also authorized (with power of substitution by a Standing Committee or by Directors with delegated powers) to establish the conditions that will govern the relations between said Financial Institutions and Telefónica, S.A., for the actual performance and implementation of the commitments made to the Beneficiaries.

Without prejudice to the foregoing, the Beneficiaries may exercise the Options in the form of liquidation in installments. For this purpose, the Financial Institutions subscribing the issue would sell the appropriate shares on the market on behalf of the Beneficiaries.

3. PROPOSED RESOLUTION TO BE SUBMITTED FOR APPROVAL BY THE GENERAL MEETING OF SHAREHOLDERS

For the purpose of providing adequate coverage for an options plan of “Telefonica, S.A.,” as a compensation system for employees of the companies of the Endemol Group, that “Telefonica, S.A.” is obligated to establish under the commitments assumed at the time of the acquisition by the latter of the company “Endemol Entertainment Holding, N.V.,” and that was approved by the Standing Committee of “Telefonica, S.A.” on the date of April 25, 2001, it is resolved that:

1. Capital increase by means of monetary contributions

It is resolved to increase the share capital of “Telefonica, S.A.” by a nominal amount of 1,425,624 euros, through the issuance of an equal number of ordinary shares with a nominal value of one euro each, of the same class and series as the existing ones, represented by account entries and with an issue premium of 18.2898 euros each. This will result in an issue price of 19.2898 euros per share.

The number of shares to be issued has been calculated by dividing the quantity agreed upon with ENDEMOL of 27,500,000 annual euros by the Annual Reference Value of Telefonica, S.A. shares that has been calculated at 19.2898 euros, taking into account the arithmetic mean of the weighted average exchanges of Telefonica, S.A. shares in the continuous market over the five preceding stock exchange days prior to the Telefonica, S.A. Board of Directors session that approved the submission of the present capital increase resolution to the Annual General Shareholders´Meeting.

2. Subscriptions of the shares

The capital increase to which this resolution refers has the exclusive purpose of providing coverage so as to be able to satisfy the exercise of options on Telefonica, S.A. shares corresponding to the year 2001 to be granted to employees of the ENDEMOL GROUP under the so-called "EN-SOP Program."

In order to serve this purpose, all the shares will be subscribed to and disbursed initially by one or various financial entities that will act and agent entities of the Plan and that will be determined by the Board of Directors, which will likewise be empowered (all this entailing the power of substitution of its Standing Committee and/or any board members with delegate powers) to fix the conditions that will govern the relations between said financial entities and Telefonica, S.A. for the effective execution and introduction of the EN-SOP Program for the execution of which this resolution is adopted. For such purpose, among these conditions, the exercise by said entities of the rights inherent in the shares to which they subscribe shall expressly be governed, in terms that correspond to the instrumental function that such entities perform in the process of execution of the EN-SOP Program.

It is resolved that the beneficiaries may exercise such options by means of their settlement by differences, for the purpose of which the financial entities that subscribe to the increase will sell the corresponding shares in the market for the account of the beneficiaries.

In accordance with the stipulations of Article 161 of the Corporation Law, the incomplete subscription of the capital increase is expressly permitted.

3. Disbursement

The new shares of Telefonica, S.A. issued in the capital increase will be fully disbursed by means of one-time monetary contributions on the date determined by the Board of Directors within the maximum period of one year from the date of the Meeting.

4. Representation of the new shares. Rights of the new shares.

The new issue shares will be ordinary shares, equal to those currently in circulation.

They will be represented by account entries the recording of which will be conferred on the Securities Compensation and Settlement Service (SCLV) and its affiliated entities.

The new shares will confer on their holders the same political and economic rights as the Telefonica, S.A. shares currently in circulation from the time of their issuance. With respect to the economic rights, the new shares will entail a right to company dividends, on account or definitive, the distribution of which is agreed upon from that date.

5. Exclusion of the preferred subscription right

In view of the reasons of company interest that the capital increase obeys, through its aim and intended use, and considering that, due to its own characteristics, these could only be satisfied by a capital increase with exclusion of the right of preferred subscription, the total elimination of the preferred subscription right of the shareholders and holders of convertible bonds of Telefonica, S.A., with respect to the shares issued in the capital increase is resolved, within the scope of that set forth in Article 159.1 of the Corporation Law.

6. Request for admission for negotiation

Once the capital increase is executed, admission for negotiation of the new shares will be requested from the stock exchanges of Madrid, Barcelona, Bilbao, and Valencia and their contracting in the Stock Exchange Interconnection System (Continuous Market) will be requested, expressly noting the submission of the company to the norms in existence or that may be enacted relating to the Stock Exchange, and in particular, as to the contracting, continued participation, and exclusion from the official quotation as well as admission for negotiation of said shares in any other foreign exchange market where the shares of the company are admitted for negotiation at the time of the closing of the capital increase resolution (including without limitations, the stock exchanges of New York, London, Frankfort, Paris, Tokyo, Sao Paulo, Buenos Aires, and Lima). For these purposes, the Board of Directors shall be empowered with the power of substituting the Standing Committee and/or any Board members with delegate powers, so that, once the capital increase resolution is executed, it may request from all the competent national and foreign agencies admission for negotiation of the new shares of Telefonica, S.A., signing for this purpose all the documents and commitments that are required in the terms they judge to be appropriate.

For the purposes of that set forth in Article 27 of the Commercial Stock Exchange

Regulation, it is expressly noted, that in the event that the exclusion of shares of Telefonica, S.A. from quotation in the Spanish stock exchanges is later requested, this will be adopted with the same formalities established in said article and, in such a circumstance, the interests of the shareholders, and if applicable, the bond holders, who oppose or do not vote for the resolution, will be guarantied, in compliance with the requirements established in the Corporation Law and concordant provisions; all in accordance with that set forth in the mentioned Commercial Stock Exchange Regulation, the Securities Market Law and provisions that promote them.

7. Delegation in the Board of Directors

Within the scope of the provisions of Article 153.1.a) of the Corporation Law, the Board of Directors shall be empowered with the power of substitution in its Standing Committee and/or of any Board members with delegate powers, so that within the maximum period of one year reckoned from today's date, it may indicate the date on which the capital increase resolution must take effect or its execution abandoned, and in the event that it decides to execute it, to fix the conditions for it in everything not provided by the Meeting, including in an indicative manner:

- to provide new wording to Article 5 of the Bylaws to adapt them to the new share capital figure resulting from the execution of the capital increase;

- to determine the procedure, period, starting and ending date of the subscription period;

- to draw up and prescribe all the prospectus and notifications that are required under Spanish and foreign legislation and to resolve on the modifications subsequent to these that it judges to be appropriate;

- to request the admission for negotiation of the new issued shares, with all the powers that prove necessary for such purpose, in accordance with the pertinent legislation, undertaking the necessary procedures and drawing up the documents that are required for this, and to designate the entity responsible for the accounting recording of the shares, and if applicable, the depositaries issuing the deposit certificates representing the documents that were necessary for this;

- to undertake all the procedures that are required and to approve and formalize all the public and private documents that prove necessary or appropriate for the full effectiveness of the capital increase resolution in any of its aspects and contents, and in particular to correct, clarify, interpret, complete, specify, or delimit, if applicable, the adopted resolution, and in particular, correct the defects, omissions, or errors that were ascertained in the verbal or written qualification of the Mercantile Register;

– to determine the financial entity or entities that will have to subscribe to and disburse the capital increase, the number of shares to be subscribed to by it/ them and to fix the conditions that will govern their relations with Telefonica, S.A., all in conformity with that set forth in the preceding subparagraph 2.

Madrid, April 25, 2001