



Telefónica, S.A.

REPORT FROM THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A. CONCERNING THE PROPOSED RESOLUTION THAT WILL BE SUBMITTED FOR APPROVAL AT THE GENERAL SHAREHOLDERS' MEETING, REGARDING INCREASES IN THE CAPITAL STOCK THAT WILL BE CHARGED AGAINST FREELY AVAILABLE RESERVES. (ITEM VI ON THE AGENDA).

1. PURPOSE OF THE REPORT.

Item VI on the Agenda for the Meeting of the Annual General Shareholders' Meeting of "Telefónica, S.A." that has been called for June 14 and 15, 2001 includes a proposal to increase the capital stock of the Company, said increase being charged against freely available reserves. Said item also includes the corresponding amendment of Article 5 of the Company's Bylaws so as to delegate to the Board of Administration the powers needed to execute said capital increase within a maximum period of one year.

Pursuant to the provisions of Article 144.1 (a) of the current Corporation Law, in order to present the aforementioned capital stock increase resolution for its approval at the General Shareholders' Meeting, the Board of Directors must prepare a written report justifying the proposal.

2. JUSTIFICATION OF THE PROPOSAL.

The Board of Directors proposes that the shareholders at the General Shareholders' Meeting approve two capital stock increases to be charged against the Company's freely available reserves and executed via the issue of new shares that will be fully paid in and distributed completely free of charge to the Company's shareholders.

Said proposal shall be recorded according to the Company's policy of compensating the shareholders differently than the Board, by way of dividends.

The options for compensating shareholders include the free distribution of shares charged against reserves, a procedure that the Board of Directors proposed during the 1998, 1999 and 2000 fiscal years and was approved at the corresponding General Shareholders' Meetings.



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Consequently, the Company remains loyal to its objective of creating value with a full return thereof for the shareholder, while meeting the Company's resource needs in order to undertake new projects that generate value and enabling shareholders to obtain additional liquidity at the same time by trading on the market the shares that have been distributed to them free of charge.

And this has been done while bearing in mind that said procedure helps improve the liquidity of the value and the fluidity in the trading thereof, factors that continue to be important in the market.

Based on the foregoing, the Board of Directors requests that the shareholders at the General Shareholders' Meeting approve two capital stock increases to be charged against freely available reserves. This request recognizes the shareholders' right to a free, proportionate distribution calculated at one new share for every 50 shares already held.

The Board of Directors requests the shareholders' approval of said transactions and their approval of the Board's delegation of the powers necessary to execute the corresponding resolutions in accordance with the provisions of Article 153.1. (a) of the current Corporation Law.

The Company's closing balance sheet dated December 31, 1999 shall serve as a reference for both transactions.

Given the Company's abundance of available reserves and the different origin and nature of the items comprising them, the Board of Directors has decided to propose to the shareholders at the General Shareholders' Meeting that the freely available reserves to be used for both of the aforementioned transactions should correspond to certain items included under the heading of Revaluation Reserves.

3. PROPOSED RESOLUTION PRESENTED FOR APPROVAL AT THE GENERAL SHAREHOLDERS' MEETING.

A) Increasing the Company's capital stock and charging the increase to freely available reserves, in an amount equal to 2% of the Company's subscribed and paid-in capital stock at the time of the adoption hereof, via the issue of new shares of common stock of the same series and having the same rights as those currently outstanding. Each new share shall have a face value of one (1) euro, shall be recorded through entries in the books of account, and shall be distributed to the Company's shareholders free of charges.



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The amount of the capital increase referred to in this resolution, whose amount has been set at 2% of the Company's subscribed and paid-in capital stock at the time of the adoption hereof, may be increased, if necessary, provided that during the time between date of the adoption hereof and the day immediately preceding the commencement of the period of the aforementioned free distribution, the Company's capital stock has been increased in order to provide for any requests for conversion of convertible debentures into shares and/or because of the successful execution of any or all of the capital increases approved at the Annual General Shareholders' Meeting. In that case, the amount of the capital increase referred to in the foregoing paragraph shall be incremented by 2% of any increases undergone by the Company's capital stock.

The Balance Sheet dated December 31, 2000, duly audited and approved at the Annual General Shareholders' Meeting, shall serve as the basis for the transaction.

The capital increase shall be charged against the Revaluation Reserves –which is freely disposable- coming under the name “RVA Revalorización Inmovilizado Material 1986” (Revaluation of Tangible Fixed Assets 1986), which was effected in reliance on the provisions of Article 3 of the Law of December 31, 1945 and whose value totaled 265.310 billion pesetas as of December 31, 2000.

The shareholders are recognized as having—on the terms provided by law—a right to the free distribution of the new shares at a ratio of one new share for every 50 old shares held. The rights of free distribution shall be transferable under the same conditions as the shares on which they are based.

For purposes of the foregoing, the term "shareholders of the Company" shall refer to all persons or legal entities who, at the end of the day immediately preceding the date of the commencement of the period of the free distribution referred to in the following paragraph, appear as holders of shares of the Company in the books of account kept by the member institutions of the Spanish Securities Clearing and Settlement Service.

The rights of free distribution may be exercised during the 15-day period starting as of the day following the publication of the announcement of the capital increase in the Official Gazette of the Mercantile Register. The distribution of the shares forming the subject matter of the capital increase may be processed through any of the member institutions of the Spanish Securities Clearing and Settlement Service.

Should any shares not be distributed, then a share deposit shall be created. Said deposit shall be maintained for three years starting as of the termination of the period



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of gratuitous distribution. Once said period has ended, the shares may be sold in accordance with the provisions of Article 59 of the Corporation Law, at the expense and risk of the interested parties. Once the expenses pertaining to the sale and the aforementioned deposit have been deducted, the net amount of the sale shall be deposited with the Bank of Spain or the General Savings and Loan Institution and placed at the disposal of the interested parties.

An application will be made to officially trade the shares forming the subject matter of this capital increase on the four Spanish stock exchanges, to include them in the Automated Quotation Market System, to admit said shares for listing on the foreign markets to which the Company's shares have been admitted for listing, and to include said shares in the Stock Exchange Automated Quotation System (SEAO International), subject to the regulations governing said stock markets.

B) In accordance with the provisions of Article 153.1 a) of the current Corporation Law Companies, delegating to the Board of Directors the power (which in turn may be subdelegated in whole or in part to its Standing Committee and/or in any of the Directors with delegated powers to specify any conditions for the capital increase that have not been provided for in the foregoing resolutions. In particular, the powers granted to the Board of Directors to the fullest extent permissible by law shall include but shall not be limited to the following:

- a) To set the date on which the resolution undertaken to increase the share capital may be executed, which must be within the period of one year calculated from the date of its undertaking.
- b) To set the exact amount of the capital increase should the case set forth in the second paragraph of resolution A) above be applicable.
- c) Determining the date as of which the newly issued shares will participate in the Company's profits or losses.
- d) Declaring the capital increase to have been executed and concluded once the aforementioned distribution period has ended.
- e) Drafting a new version of Article 5 of the Company Bylaws to reflect the new amount of capital stock resulting from the execution of the capital increase.
- f) Completing all necessary formalities to ensure that the new shares forming the subject matter of the capital increase are recorded in the books of account kept with the Spanish Securities Clearing and Settlement Service and admitted for



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trading on the domestic and foreign stock markets on which the Company's shares are listed, in accordance with the procedures established in each of said stock markets.

- g) Taking whatever measures are necessary or advisable in order to implement the execution and formalization of the capital increase vis-à-vis any public or private agencies or organizations, whether in Spain or abroad, including clarification or supplementation or the correction of defects or omissions that might hinder or impede the full effectiveness of the foregoing resolutions.
- C) Increasing the Company's capital stock by charging it against freely available reserves once the transaction referred to in the foregoing resolutions A) and B) has been concluded. Said increase shall be effected via the issue of new shares of common stock of the same series and having the same rights as those currently outstanding. Said shares shall have a face value of one (1) euro each, shall be recorded through entries in the books of account, and shall be distributed to the Company's shareholders free of charge.

The amount of the capital increase referred to in this resolution shall be equivalent to 2% of the Company's capital stock once the transaction referred to in the foregoing resolutions A) and B) has been finalized and executed. If applicable, said capital stock shall be increased by the figure by which it could have been increased through the successful execution of any or all of the capital increases approved at the Annual General Shareholders' Meeting and/or in order to provide for any requests for the conversion of outstanding convertible debentures into shares, said requests having been made in the time between the commencement of the period of distribution corresponding to the capital increase referred to in the foregoing resolutions A) and B), and the commencement of the period of distribution corresponding to the capital increase indicated in this resolution C). Therefore, in the final analysis, the amount of the capital increase shall be the result of applying said 2% to the amount of subscribed capital upon the commencement of the period of distribution corresponding to the capital increase transaction referred to in this resolution C).

The Balance Sheet dated December 31, 2000, which has been duly audited and approved at the General Shareholders' Meeting, shall serve as the basis for the transaction.

The capital increase shall be charged against the Revaluation Reserve- which is freely disposable- coming under the name "RVA Revalorización Inmovilizado Material 1986" (Revaluation of Tangible Fixed Assets 1986), which was effected in reliance on



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the provisions of Article 3 of the Law of December 31, 1945 and whose value totals 265.310 billion pesetas as of December 31, 2000.

The shareholders are recognized as having—on the terms provided by law—a right to the free distribution of the new shares at a ratio of one new share for every 50 old shares held. The rights of free distribution shall be transferable under the same conditions as the shares on which they are based.

For purposes of the foregoing, the term "shareholders of the Company" shall refer to all persons or legal entities who, at the end of the day immediately preceding the date of the commencement of the period of the free distribution referred to in the following paragraph, appear as holders of shares of the Company in the books of account kept by the member institutions of the Spanish Securities Clearing and Settlement Service.

The rights of free distribution may be exercised during the 15-day period starting as of the day following the publication of the announcement of the capital increase in the Official Gazette of the Mercantile Register. The distribution of the shares forming the subject matter of the capital increase may be processed through any of the member institutions of the Securities Clearing and Settlement Service.

Should any shares not be distributed, then a share deposit shall be created. Said deposit shall be maintained for three years starting as of the termination of the period of free distribution. Once said period has ended, the shares may be sold in accordance with the provisions of Article 59 of the Corporation Law, at the expense and risk of the interested parties. Once the expenses pertaining to the sale and the aforementioned deposit have been deducted, the net amount of the sale shall be deposited with the Bank of Spain or the General Savings and Loan Institution and placed at the disposal of the interested parties.

An application will be made to officially trade the shares forming the subject matter of this capital increase on the four Spanish stock exchanges, to include them in the Automated Quotation Market System (Continuous Market), to admit said shares for listing on the foreign markets to which the Company's shares have been admitted for listing, and to include said shares in the Stock Exchange Automated Quotation System (SEAQ International), subject to the regulations governing said stock markets.

D) In accordance with the provisions of Article 153.1 a) of the current Corporation Law, delegating to the Board of Directors the power (which in turn may be subdelegated in whole or in part to its Standing Committee and/or in any of the Directors with delegated powers to specify any conditions for the capital increase that have not been provided for in the foregoing resolution C). In particular, the powers granted to the



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Board of Directors to the fullest extent permissible by law shall include but shall not be limited to the following:

- a) To set the date on which the resolution undertaken to increase the share capital may be executed, which must be within the period of one year calculated from the date of its undertaking and once the capital increase operation referred to in resolutions A) and B) above has been finalized and executed.
 - b) To set the exact amount of the capital increase should the case set forth in the second paragraph of resolution C) above.
 - c) Determining the date as of which the newly issued shares will participate in the Company's profits or losses.
 - d) Declaring the capital increase to have been executed and concluded once the aforementioned distribution period has ended.
 - e) Drafting a new version of Article 5 of the Company Bylaws to reflect the new amount of capital stock resulting from the execution of the capital increase.
 - f) Completing all necessary formalities to ensure that the new shares forming the subject matter of the capital increase are recorded in the books of account kept with the Spanish Securities Clearing and Settlement Service and admitted for trading on the domestic and foreign stock markets on which the Company's shares are listed, in accordance with the procedures established in each of said stock markets.
 - g) Taking whatever measures are necessary or advisable in order to implement the execution and formalization of the capital increase vis-à-vis any public or private agencies or organizations, whether in Spain or abroad, including clarification or supplementation or the correction of defects or omissions that might hinder or impede the full effectiveness of the foregoing resolutions.
- E) Setting up a non-disposable reserve in the amount of 35,000 million pesetas by charging it to the "RVA Revalorización Inmovilizado Material 1986" (Revaluation of Tangible Fixed Assets 1986), which was effected in reliance on the provisions of Article 3 of the Law of December 31, 1945. The purpose of said non-disposable reserve shall be to ensure that the two capital increases thus approved can be executed by the Board of Directors, even if all of the holders of convertible debentures currently outstanding request a conversion of said debentures and if all of the capital increases approved at this General Shareholders' Meeting are effectively subscribed. The



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aforementioned reserve shall remain unavailable for one year starting as of the date of the adoption of this resolution, whose term coincides with the working period in which the Board of Directors shall execute the resolutions concerning said capital increase transactions. Once said resolutions have been executed, the unused portion of said reserve shall cease to have any effect.

Madrid, April 25, 2001