



Telefónica, S.A.

**REPORT OF THE BOARD OF DIRECTORS OF TELEFONICA, S.A. ON THE PROPOSED REDUCTION OF SHARE CAPITAL THROUGH THE AMORTIZING OF TREASURY STOCK, WITH THE EXCLUSION OF THE RIGHT TO OPPOSITION BY CREDITORS, THROUGH THE REDRAFTING OF THE ARTICLE IN THE BY-LAWS THAT REFERS TO THE SHARE CAPITAL, WHICH SHALL BE SUBMITTED TO THE ORDINARY GENERAL SHAREHOLDERS' MEETING FOR APPROVAL (POINT VI ON THE AGENDA).**

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**1. SUBJECT-MATTER OF THE REPORT**

The Agenda of the Annual General Shareholders' Meeting of Telefónica, S.A. called for 10<sup>th</sup> and 11<sup>th</sup> April 2003, includes at point VI a proposal - which is submitted for the approval of the General Shareholders' Meeting - on the reduction of the share capital by the amount of the nominal value of certain own shares of the Company which are to be redeemed, and to redraft the article of the By-laws relating to share capital.

**2. REASONS FOR THE PROPOSAL**

The Board of Directors believes the share capital should be reduced by the amount of the nominal value of certain own shares of Company, by redemption thereof, in order to bring the true structure of the Company's share capital into line with the actual position, to concentrate capital in external shareholders and to increase the Company's earnings per share.

To facilitate implementation of the resolution it is proposed to adopt, it is suggested that the General Shareholders' Meeting should authorise the Board of Directors to implement the resolution in question (enabling the latter, in turn, to delegate the power granted to the Management Committee), within the time-limit of one year from adoption of the resolution, with no obligation to previously consult the General Meeting.

On that basis, it is proposed to the General Shareholders' Meeting that the share capital should be reduced by 101,140,640 euros with the redemption of 101,140,640 own shares, the number of which corresponds to approximately 2% of the current share capital of the Company, authorising the Board of Directors to implement the resolution in question within one year.

It is also considered expedient, in the interests of simplifying implementation, to exclude, under article 167.3 of the current text of Spanish Law of Corporations



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(*Ley de Sociedades Anónimas*), the right of creditors under article 166 of that current text, to object to the reduction, and to apply the amount of the nominal value of the shares redeemed to a capital redemption reserve, which would only be available on satisfaction of the same requirements as those required for a reduction in share capital.

3. **DRAFT RESOLUTION SUBMITTED FOR THE APPROVAL OF THE GENERAL SHAREHOLDERS' MEETING**

The Resolution proposed by the Board of Directors to the General Shareholders' Meeting for approval in relation to this matter reads as follows:

*To reduce the share capital of the Company by 101,140,640 euros, by the redemption of 101,140,640 own shares that were acquired previously as authorised at the time by the General Meeting within the limits established in article 75 et seq and additional provision 1.2 of the Spanish Law of Corporations (Ley de Sociedades Anónimas). Consequently, article 5 of the By-laws on the company share capital shall be amended.*

*The reduction in share capital shall be charged to reserves and the undistributable reserve referred to in article 79.3 of the Spanish Law of Corporations shall be cancelled. The reduction shall not give rise to the repayment of contributions since the Company itself is the owner of the shares redeemed. The purpose of the reduction, therefore, is the cancellation of the own shares.*

*Under article 167.3 of the Spanish Law of Corporations and for the purpose of exclusion of the right to opposition to the reduction contained in article 166 thereof, the amount of the nominal value of the redeemed shares shall be applied to a capital redemption reserve, which may only be disposed of subject to the same requirements as those for the reduction in share capital.*

*It is declared, for the purposes of article 289.1 of the Spanish Law of Corporations, that the consent of the Syndicates of Bondholders relating to issues of bonds in circulation is not required, provided the reduction in capital hereby resolved does not reduce the initial ratio between the total capital plus reserves and unredeemed bonds.*

*Lastly, as regards the time-limit for carrying out the reduction, the Board of Directors is instructed and given powers, with authority to delegate power in turn to the Management Committee with express power to subdelegate, to execute the*



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*capital reduction resolution before a Notary Public within no more than one year, and file the corresponding deed at the Mercantil Register (Registro Mercantil) for registration.*