



Telefónica, S.A.

**REPORT BY THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A.,
CONCERNING THE PROPOSED RESOLUTION AUTHORIZING THE BOARD OF
DIRECTORS TO INCREASE THE STOCK CAPITAL, TO BE SUBMITTED FOR
APPROVAL BY THE ANNUAL GENERAL MEETING OF THE SHAREHOLDERS
(ITEM VII ON THE AGENDA)**

1. PURPOSE OF THE REPORT

Item VII of the Agenda for the Annual General Shareholders' Meeting of Telefónica, S.A., scheduled for 14 and 15 June 2001, includes a proposal to authorize the Board of Directors to increase the stock capital of the Company up to the maximum limit permitted by Law when the needs of the Company so require, with consequent amendment of Article 5 of the Bylaws.

Under Article 144.1.a) of the Corporation Law, submission for approval by the General Meeting of Shareholders of said proposal to authorize the Board of Directors to increase the stock capital requires that the Board of Directors prepare a written report justifying the proposal.

2. JUSTIFICATION OF THE PROPOSAL

The resources needed by Telefónica in order to make the investments under way and scheduled for the coming years, require access to whatever sources of financing are available on the market, with use at any time of those sources that are most appropriate for the Company in terms of cost of the resources, financial solvency, and structure of the liabilities.

The Company intends to obtain outside funding, preferably on the domestic and international debt markets in which Telefónica is prominently present because of its financial rating, size, and experience.

Access to the debt markets, however, sometimes, is subject to temporary limitations resulting from economic policy measures that at certain times could reduce or impede the growth of the monetary and lending variables and the development of the financial



Telefónica, S.A.

markets. Therefore, Telefónica wishes to keep the capital-increase routes open, both directly and through hybrid debt and capital instruments, for possible utilization when market conditions make this advisable in terms of cost of funds obtained, always with preservation of the principles of financial solvency, profitability, and value of the Company's stock.

Consequently, in order to give the Company the necessary flexibility and capability to gain access to all available sources of financing, the Annual General Shareholders' Meeting is being asked to authorize the Board of Directors to increase the stock capital up to the maximum permitted by law, when the conditions on the financial markets and the interest of the Company make this advisable, with nullification at the appropriate time of the unused portion of the authorization granted to the Board of Directors to increase the stock capital in conformity with the provisions of Article 153.1.b of the Corporation Law, pursuant to resolution of the Annual General Shareholders' Meeting, dated 26 March 1999.

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

- A) To rescind, in the unused part, the authorization granted to the Board of Directors for increasing the share capital as stipulated in Article 153.1.b of the prevailing Corporation Law, by resolution of the General Shareholders' Meeting, dated March 26, 1999.
- B) Authorize the Board of Directors, in the most ample and effective legal manner possible and as stipulated in Article 153.1.b) of the prevailing Corporation Law, so that, within the maximum period of five years reckoned from the resolution of the General Shareholders' Meeting and without the need for a convocation, nor agreement subsequent to this, to decide, one or several times, when and to the extent that the needs of the company so require in the judgment of the Board itself, to increase the share capital in a maximum amount equivalent to half the current share capital of the company, issuing and placing into circulation for this purpose the corresponding new ordinary, redeemable or of any other type of those permitted under the law, including with fixed or variable premium, with or without a preferred subscription right, complying in this latter case with the requirements, conditions and formalities established in Article 159 and concordant stipulations of the Corporation Law – in particular, that of the issuance of new shares at an issue price, increased, if



Telefónica, S.A.

applicable, by the amount of the issue premium, corresponding to the actual value of the shares that results from the mandatory report of the Accounts Auditor of the company, and, in all cases, with the disbursement of the shares issued by means of monetary contributions and expressly providing the possibility for incomplete subscription of the shares that are issued as provided in Article 161.1 of the same Law. The power so delegated will extend to the fixing of the various aspects and conditions of each issue, according to the characteristics of each operation that it is decided to undertake within the scope of the authorization referred to in the present agreement, including the power to reword the article of the Bylaws relative to the share capital, once the increase is agreed upon and executed; said power can be delegated, in turn, by the Board of Directors to the Standing Committee, within the scope of Article 141, number 1, second paragraph, of the Corporation Law.

Madrid, April 25, 2001