



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 SHARE CAPITAL TO BE CHARGED TO UNRESTRICTED RESERVES. (Point V ON THE AGENDA).

1. PURPOSE OF THE REPORT.

Point V on the Agenda for the Meeting of the Annual General Shareholders' Meeting of "Telefónica, S.A." that has been called for April 11 and 12, 2002 includes a proposal of increases in Company's share capital to be charged to unrestricted reserves. Said item also includes the corresponding amendment of Article 5 of the Company's Bylaws so as to delegate to the Board of Directors the powers needed to execute said capital increase within a maximum period of one year from the undertaking of the corresponding resolution.

Pursuant to the provisions of Articles 152.2 and 144.1 a) of the current Law of Corporations, in order to present the aforementioned share capital increase resolution for its approval at the Annual General Shareholders' Meeting, the Board of Directors must prepare a written report justifying the proposal, in the extent of the approval of this and its execution must include the amending of article 5 of the by-laws regarding the figure for the share capital.

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 to the Company's unrestricted reserves and through 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 in accordance with the Company's policy of compensating the shareholders other than 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 in previous fiscal years, at all times to be submitted to the approval of the Annual General Shareholders' Meeting.



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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, in some cases with a more favourable fiscal treatment 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 Annual General Shareholders' Meeting approve two capital stock increases to be charged to unrestricted 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 Law of Corporations.

The Company's closing Balance sheet dated December 31, 2001, which will previously have been submitted for approval by the Annual General Shareholders' Meeting, 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 Annual 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.

The resolutions to be presented by the Board of Directors to be approved by the Annual General Shareholders' Meeting regarding this item are outlined below:

- A) Increasing the Company's capital stock and charging the increase to unrestricted 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 ordinary shares of the



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same series and having the same rights as those currently outstanding. Each new share shall have a nominal value of one (1) euro, shall be represented by account entries, and shall be distributed to the Company's shareholders free of charges.

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 beginning of the period of free distribution which will later be referred to, the Company's capital stock has been increased in order to provide for any requests for conversion of convertible bonds into shares and/or because of the execution of any of the capital increases approved at the Annual General Shareholders' Meeting and that are pending execution, be it total or partial, at the beginning of the aforementioned period, due to the fact that the Board of Directors of the Company have resolved to increase the share capital by virtue of the authorization granted by 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, 2001, 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 Euros 1,594,546,250.77 as of December 31, 2001.

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 natural or legal persons who, at the end of the day immediately preceding the date of the beginning 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 Entities of the Spanish Securities Clearance and Settlement Service.



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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 Entities of the Spanish Securities Clearance 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 Law of Corporations, at the expense and risk of the interested parties, and the liquid amount of the sale, having deducted the expenses of this and those of the previous deposit, shall be deposited with the Bank of Spain (Banco de España) or the General Savings and Loan Institution (Caja General de Depósitos) 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 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.

B) In accordance with the provisions of Article 153.1 a) of the current Law of Corporations, 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) Setting the date as of which the newly issued shares will participate in the Company's profits or losses.
- d) Declare the capital increase executed and closed.



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- 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 Clearance 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 entities or organisms, 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 to unrestricted 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 ordinary shares of the same series and having the same rights as those currently outstanding. Said shares shall have a nominal 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, increasing if applicable, said capital stock in the figure by which it could have been increased if, during the period that commenced on the date of the beginning of the free allotment period corresponding to the capital increase referred to in resolutions A) and B) above and the day immediately prior to the opening of the free allotment period which will later be referred to in relation to this resolution on the capital increase, the Company's share capital had been increased in order to address the eventual requests for the conversion into shares of the convertible securities outstanding and/or due to the fact that one of the capital increases pending, be it totally or partially, as approved by the Annual General Shareholders' Meeting had been carried out, at the beginning of the aforementioned period, and/or due to the fact that the Board of Directors of the Company resolved during the aforementioned period to increase the Company's share capital by virtue of the authorization granted by the Annual General Shareholders' Meeting. Should this be the case, the amount of the capital increase referred to in the previous paragraph will be increased by 2% of the increases by



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which, should it be the case, the Company's share capital had increased. Finally, therefore, the amount of the capital increase will be the result of the application of this 2% to the share capital subscribed at the moment of the commencement of the allotment period corresponding to the capital increase operation referred to in the resolution C)

The Balance sheet dated December 31, 2001, 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 the provisions of Article 3 of the Law of December 31, 1945 and whose value totals Euros 1,594,546,250.77 as of December 31, 2001.

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 natural or legal persons 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 Entities of the Spanish Securities Clearance 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 Entities of the Securities Clearance 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 Law of Corporations, at the expense and risk of the interested parties and the liquid amount of the sale, having deducted the expenses of this and those of the previous deposit shall be deposited with the Bank of Spain (Banco de España) or the General Savings and Loan Institution (Caja General de Depósitos) and placed at the disposal of the interested parties.



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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 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 Law of Corporations, 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 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) Setting the date as of which the newly issued shares will participate in the Company's profits or losses.
- d) Declare the capital increase executed and closed.
- 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 Clearance 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



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private entities or organisms, 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 Euros 445,500,790 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 to which this point of the Agenda refers, can be executed by the Board of Directors, even if all of the holders of convertible bonds currently outstanding request a conversion of said bonds and that the complete subscription of all the capital increases be carried out, having been approved of authorized by the Annual General Shareholders’ Meeting, be they pending total or partial execution. The 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 the two capital increases to which this point of the Agenda refers. Once said resolutions have been executed, the unused portion of said reserve shall cease to have any effect.

February 27, 2002