

TELEFÓNICA, S.A.

**SPECIAL REPORT ON THE EXCLUSION OF THE PREFERRED SUBSCRIPTION RIGHT IN
THE HYPOTHESIS OF ARTICLE 159 OF THE REVISED TEXT OF THE LAW OF
CORPORATIONS**

Special report on exclusion of the preferred subscription right in the hypothesis of Article 159 of the Revised Text of the Law of Corporations

To the Annual General Shareholders' Meeting of
Telefónica, S.A.:

For the purposes provided in Article 159 of the Revised Text of the Corporation Law and subsequent modifications of this article incorporated in the Law 50/1998, of December 30, 1998, on Fiscal and Administrative Measures and those of a Social Nature, and in accordance with the order received from Telefónica, S.A. (hereinafter referred to indiscriminately as the "Company"), we issue this Special Report on the proposal for issuance of bonds convertible into shares of Telefónica, S.A. or any other company pertaining to the Group of companies of which Telefónica, S.A. is the parent with the exclusion of the preferred subscription right, to which we are attaching the Report of the Board of Directors of the Company, dated February 27, 2002, that will be submitted to the approval of the Annual General Shareholders' Meeting. The issuance of convertible debentures proposed will give rise, if applicable, to an increase in the share capital of the Company in the amount necessary to meet the possible conversion of the aforementioned debentures into Telefónica, S.A. shares.

Article 159.1.c) of the Revised Text of the Law of Corporations establishes the possibility that in capital increases with an exclusion of the preferred subscription right, companies quoted on the stock exchange may issue new shares at the issue price that they judge suitable, provided that the said price is greater than the net asset value of each of the shares of the entity. The Report prepared by the Board of Directors proposes that the issue price of the new shares be determined by the Board of Directors of the Company setting as the minimum issue price the average of the closing quotations on the Madrid Stock Exchange for the shares of the Company over the 10 days preceding the date of opening of the subscription of the securities and as a maximum issue price 200 percent of the said quotation; they cannot, however, in any case, be issued for an amount less than their net asset value, as stated above.

Our work, based on the consolidated annual accounts of Telefónica, S.A. corresponding to the fiscal year ending December 31, 2001, that were audited by us and based on which we issued our audit report dated March 14, 2002, in which we expressed our opinion with the following reservation:

"Due to the changes in the economic situation in Argentina, the Argentine government decided to amend the Convertibility Law, which had been in force since March 1991, and adopted certain measures the main effects of which were the devaluation of the Argentine peso with respect to the U.S. dollar and the pesification of certain assets and liabilities in Argentina denominated in foreign currency, the introduction of restrictions on the withdrawal of funds deposited at financial institutions, restrictions on making transfers abroad of financial loan servicing payments and dividends and an increase in domestic prices.

The Telefónica Group's net investment in the various businesses in which it has a presence in Argentina (mainly in companies operating in the wireline telephony, wireless telephony and media businesses, see Exhibit I) amounts to €3,582 million (see Note 2-d). The consolidated financial statements referred to above include an estimate of the quantifiable impact of these measures on the accompanying consolidated stockholders' equity (translation differences in consolidation) and on the consolidated statement of income referred to above, amounting to €1,424 million and €369 million, respectively. This impact reflects mainly the loss arising from valuing at a year-end exchange rate of ARP 1.5149/€1 the Group's assets and liabilities in Argentina and the exchange losses derived from adjusting to the year-end exchange rate of ARP 1.7/US\$ 1 the loans arranged by the Argentine companies in this currency, after considering the related hedging transactions (see Note 2-d).

However, it is not possible to assess the additional impact that the uncertainties described in Note 2-d might have on these holdings, relating mainly to the normal course of operations and the coverage of the companies' financial needs, through either borrowings or capital increases, since this will depend on the success of the economic measures adopted in Argentina, and particularly on the renegotiation of the wireline telephony ratemaking system."

Our task has also included the following procedures:

- a) The posing of questions to the Board of the Company as to the major events that could have affected the Company in a significant way between the closing date of the mentioned audited consolidated annual accounts and the date of this Special Report;
- b) The evaluating of the methods and factors set forth by the Directors in their report for the setting of the issue rate proposed for the shares.
- c) The obtaining of a document from the Board of the Company by which we were informed that they had made known to us all the relevant hypotheses, data or information, as well as the subsequent significant events.

Taking into account all the above indicated, in our professional opinion, the factors used by the Board of Directors of the Company in the setting of the issue price for the new shares which will eventually be converted into the securities duly are stated in the attached Report, even if this price has not been set on the date of this Special Report, due to its being referenced on the quotation value of the Telefónica, S.A. shares on a subsequent date.

This Special Report was prepared exclusively for the purposes provided in Article 159 of the Revised Text of the Law of Corporations, hence, it must not be used for any other purpose. On this same date, we have issued a Special Report, due to the application of the Technical Auditing Standard relating to the issuance of convertible securities, that must be read together with this Special Report.

ARTHUR ANDERSEN

Eduardo Sanz Hernández

March 14, 2002