

**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 Law of Corporations 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 increasing the share capital of the Company by 2,180,809 euros, by means of the issuance of the same number of ordinary shares with the exclusion of the preferred subscription right, to which the Report of the Board of Directors of the Company, dated February 27, 2002, is attached, that will be submitted to the Annual General Shareholders' Meeting for approval.

The Directors of the Company have drawn up the report attached, which includes the valuation methods applied to the shares in order to justify the issue rate of these which must correspond to the real value. When speaking of the valuation of shares one may only make feasible estimates of judgements on what their real value is, which depend greatly on the subjective valuations of extremely variable business aspects. The Directors have opted for the application of the method and factors included in the report attached.

Our responsibility is that of issuing a professional opinion, as independent experts, regarding whether the valuation methods used are the appropriate ones under the circumstances, and if these and the calculations carried out by the Directors of the Company in order to set the issue rate of the shares are correctly set forth and expressed in the Directors' report. Our responsibility, consequently, has not been that of valuating the Company.

The Directors have proposed to the Annual General Shareholders' Meeting the execution of an incentive plan aimed at the employees of the Dutch company Endemol Entertainment Holding N.V. and dependent companies (hereinafter referred to as "Endemol" and with its dependent companies, "Endemol Group"), as a consequence of the agreements signed by Telefónica for the acquisition of Endemol, that will consist of a subscription offer for a 2,180,809 shares of Telefónica, S.A. at a price of 12.61 euros per share, corresponding to 1 euro per share for share capital and, the balance, 11.61 euros per share, for issue premium. The price has been calculated taking into account the arithmetic mean of the weighted average quotations of Telefónica, S.A. shares on the continuous market over the five exchange days preceding the Board meeting held by the Directors of Telefónica, S.A. on February 27<sup>th</sup>, 2002. The capital increase will be subscribed to by one or various Financial Entities that will act as Plan Agents and will be duly determined by the Board of Directors of the Company.

Our work, has been based on the consolidated annual accounts of Telefónica, S.A. corresponding to the annual fiscal year ending on December 31, 2001, that were audited by us and regarding which we issued our audit report dated March 14, 2002, in which we expressed an 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, and the reviewing of the documentation that underpins the valuation methods used by the Company and its bases for calculation.
- 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 of 12.61 euros for the new shares are duly expressed in the attached report, as the proposed issue price is greater than the consolidated net asset value corresponding to each of the shares of the Company as of December 31, 2001.

For information purposes, we indicate that, for quoted companies, the criterion normally used for the valuation of their shares is the quotation value, unless circumstances occur that change this, circumstances of which we are unaware in this case.

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.

ARTHUR ANDERSEN

Eduardo Sanz Hernández

March 14, 2002