

REPORT SUBMITTED BY THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A. REGARDING THE PROPOSAL OF THE SHAREHOLDER COMPENSATION BY MEANS OF A SCRIP DIVIDEND. INCREASE IN SHARE CAPITAL BY SUCH AMOUNT AS MAY BE DETERMINED PURSUANT TO THE TERMS AND CONDITIONS OF THE RESOLUTION, THROUGH THE ISSUANCE OF NEW COMMON SHARES, HAVING A PAR VALUE OF ONE (1) EURO EACH, WITH NO SHARE PREMIUM, OF THE SAME CLASS AND SERIES AS THOSE THAT ARE CURRENTLY OUTSTANDING, WITH A CHARGE TO RESERVES. OFFER TO PURCHASE FREE-OF-CHARGE ALLOTMENT RIGHTS AT A GUARANTEED PRICE. EXPRESS PROVISION FOR THE POSSIBILITY OF LESS THAN FULL ALLOTMENT. DELEGATION OF POWERS TO THE BOARD OF DIRECTORS, WHICH MAY, IN TURN, DELEGATE SUCH POWERS TO THE EXECUTIVE COMMISSION, TO SET THE TERMS AND CONDITIONS OF THE INCREASE AS TO ALL MATTERS NOT PROVIDED FOR BY THE SHAREHOLDERS AT THIS GENERAL SHAREHOLDERS' MEETING, TO TAKE SUCH ACTIONS AS MAY BE REQUIRED FOR THE IMPLEMENTATION THEREOF, TO AMEND THE TEXT OF SECTION 1 OF ARTICLE 5 OF THE BY-LAWS TO REFLECT THE NEW AMOUNT OF THE SHARE CAPITAL AND TO EXECUTE SUCH PUBLIC AND PRIVATE DOCUMENTS AS MAY BE NECESSARY FOR THE IMPLEMENTATION OF THE CAPITAL INCREASE. APPLICATION TO THE APPROPRIATE DOMESTIC AND FOREIGN AUTHORITIES FOR ADMISSION TO TRADING OF THE NEW SHARES ON THE MADRID, BARCELONA, BILBAO AND VALENCIA STOCK EXCHANGES THROUGH THE AUTOMATED QUOTATION SYSTEM (SISTEMA DE INTERCONEXIÓN BURSÁTIL) (CONTINUOUS MARKET) AND ON THE FOREIGN STOCK EXCHANGES ON WHICH THE SHARES OF TELEFÓNICA, S.A, ARE LISTED (CURRENTLY LONDON AND BUENOS AIRES AND, THROUGH ADSs, NEW YORK AND LIMA) IN THE MANNER REQUIRED BY EACH OF SUCH STOCK EXCHANGES, TO BE SUBMITTED TO THE APPROVAL OF THE ANNUAL SHAREHOLDERS' MEETING (ITEM III ON THE AGENDA).

1. SUBJECT-MATTER OF THE REPORT

Under Item III on the Agenda of the Annual Shareholders' Meeting of Telefónica, S.A., called for May 29 and 30, 2014, a proposal is submitted to the approval of the shareholders regarding the remuneration of the shareholder through scrip dividend comprising the approval of an increase of capital stock by an amount to be determined on the terms of the resolution, by issuing new common shares, each with a par value of one (1) euro, without additional paid-in capital, of the same class and series as those currently outstanding, with a charge to reserves (the "**Increase**" or the "**Capital Increase**"), and the assumption by Telefónica, S.A., or a company of its Group, an undertaking to purchase the free allocation rights that are granted to shareholders as a

result of the increase. Pursuant to Sections 286 and 296 of the Companies Act (*Ley de Sociedades de Capital*), submission of the Capital Increase and the consequent amend of the bylaws to the approval of the Annual Shareholders' Meeting requires that the Board of Directors prepare a report justifying the proposal, since the approval of the proposal and its performance necessarily entail the amendment of Article 5 of the bylaws on capital stock and on the number of shares into which the capital stock is divided.

With a view to facilitating comprehension of the proposal submitted to the Shareholders' Meeting, shareholders are first offered a description of the purpose for and justification. Thereafter they are given a description of its main terms and conditions. Lastly, the report includes unabridged the proposed resolution.

2. PURPOSE AND JUSTIFICATION OF THE PROPOSAL

A) Purpose of the transaction

Telefónica, S.A. has been compensating its shareholders in recent years through payment of cash dividends, repurchase of shares and, for the first time, in May 2012, by means of a scrip dividend.

Telefónica, S.A. wishes to again offer its shareholders, foreseeable in November 2014, the alternative of a scrip dividend, which also enables them to receive Telefónica, S.A. free-of charge shares, without limiting in any way the possibility of those shareholders who so desire to receive the total amount of their compensation in cash. Therefore, the purpose of the proposal to increase capital to be submitted to the Annual Shareholders' Meeting is to offer all shareholders of Telefónica, S.A. the possibility of receiving, if they so choose, newly-issued Telefónica, S.A. shares free of charge, without this altering Telefónica's policy of compensating its shareholders in cash.

B) Structure of the transaction and options open to shareholders

The offer made to shareholders of the option to receive, if they so choose, either Telefónica, S.A. shares or cash (the "**Alternative Option**") has been structured through the Capital Increase, with a charge to reserves which is submitted to the Annual

Shareholders' Meeting for approval under item III. Whenever the Board of Directors or, by delegation, the Executive Commission decides to carry out the Capital Increase:

- (a) The shareholders of Telefónica, S.A. will receive one free-of-charge allotment right for each Telefónica, S.A. share they own. These rights will be able to be traded on the market during a period of at least 15 calendar days. Once this period ends, the rights will automatically be converted into newly-issued Telefónica, S.A. shares which will be allotted to their holders. The exact number of shares to be issued in the Increase and, accordingly, the number of rights needed to receive a new share, will depend on the market price of the Telefónica S.A. share at the time the Increase is carried out (the "**Market Price**") in accordance with the procedure described in this report. In any case, as explained below, the maximum number of shares to be issued in the Increase will be such that the market value of those shares calculated at the Market Price will be, approximately, 1,592,858,605.10 euros, i.e., the amount of the Alternative Option stipulated for the free-of-charge Capital Increase.
- (b) Telefónica, S.A. or an entity in its Group will make an irrevocable undertaking to purchase the free allocation rights received free of charge by the shareholders at a fixed price (the "**Purchase Undertaking**"). This fixed price will be calculated prior to the beginning of the free-of-charge allotment rights trading period, on the basis of the Market Price (such that the price of each right will be the result of dividing the Market Price by the number of rights needed to receive a new share plus one). Thus, Telefónica, S.A. guarantees all its shareholders the possibility of turning into cash the rights received free of charge.

Therefore, when each Increase is carried out, the shareholders of Telefónica, S.A. will have the option, if they so choose:¹

¹ The options available to holders of Telefónica, S.A. shares which are admitted to trading outside Spain (including those traded in the form of ADSs) may have certain differences with respect to those described herein due to the characteristics of each market and to the terms and conditions applicable to the programs in which such holders participate.

- (a) not to transfer their free-of-charge allotment rights. In this case, at the end of the trading period the shareholder will receive, entirely free of charge, the related number of new shares as fully paid-in;
- (b) to transfer all or part of their free-of-charge allotment rights to Telefónica, S.A., or, where appropriate, the corresponding company of its Group, pursuant to the Purchase Undertaking. Thus, instead of receiving shares, the shareholder would be opting to convert his rights into cash and to receive the Alternative Option in cash;
- (c) to transfer all or part of their free-of-charge allotment rights on the market. In this case, the shareholder would also be opting to convert his rights into cash, albeit not at a guaranteed fixed price, unlike in option (b) above.

The same gross value will be received by the shareholder under options (a) and (b), given that the Market Price will be used to determine both the fixed price of the Purchase Undertaking and the number of free-of-charge allotment rights needed for the subscription of a new share. On the other hand, nowadays, the tax treatment of each option is different. See Section 3.F below for a summary of the tax regime applicable to the transaction in Spain.

C) Amount of the Alternative Option and price of the Purchase Undertaking

The proposed structure consists of offering the shareholder free-of-charge shares whose value, set in accordance with the Market Price, will total 1,592,858,605.10 million euros gross (the “**Amount of the Alternative Option**”), which entails approximately 0.35 euro per share.

Given that, as stated above, the purpose of the Purchase Undertaking is to enable shareholders to convert the Amount of the Alternative Option into cash, and considering that with the Increase each outstanding share will grant its holder one free-of-charge allotment right, the gross price per right at which the Purchase Undertaking will be made will be equal to the result of dividing the Amount of the Alternative Option

indicated above by the number of outstanding shares, i.e., approximately 0.35 euro gross.²

The purchase price of free-of-charge allotment rights will be stipulated and made public pursuant to Section 3.C.

3. MAIN TERMS AND CONDITIONS OF THE CAPITAL INCREASE

The main terms and conditions of the Capital Increase are described below.

A) Amount of the Capital Increase, number of shares to be issued and number of free-of-charge allotment rights needed to receive one new share

As detailed in the calculation formulas and in the definitions included in this section, the Board of Directors, or, by delegation, the Executive Commission, when it decides to carry out the Capital Increase, will determine the number of shares to be issued as follows:

The number of shares to be issued in the Capital Increase will be the result of dividing the total number of outstanding Telefónica, S.A. shares on that date, by the number of free-of-charge allotment rights needed for the allotment of one New Share. The number so calculated will be rounded off in order to obtain a whole number of shares.

The number of rights will be that resulting from dividing the total outstanding Telefónica, S.A. shares on the date on which it is decided to carry out the Capital Increase by the provisional number of shares to be issued, rounded up to the nearest whole number.

At its turn, the provisional number of shares to be issued will be the result of dividing the Amount of the Alternative Option by the value of the Telefónica, S.A. share at the time the Board of Directors or, by delegation, the Executive Commission, decides to carry out said Increase (i.e., the Market Price).

² This figure could eventually be rounded off in accordance with the formulas set forth in section 3.A of this report.

Additionally, in order to obtain a conversion ratio of rights which is a whole, Telefónica, S.A. (or a company in its Group) will waive the necessary number of free-of-charge allotment rights.

Once the number of shares to be issued in the Increase is established, the amount of the Capital Increase will be the result of multiplying the number of new shares to issue by the par value of Telefónica, S.A. shares (1 euro per share). The Capital Increase will be made at par value, with no additional paid-in capital.

For the purposes of clarifying the procedure described above, the amount of the Increase and the number of free-of-charge allotment rights needed for the allotment of one new share will be determined using the following formula (rounded down to the nearest whole number):

$$\text{NAN} = \text{NTAcc} / \text{Number of Rights}$$

where,

NAN = Number of new shares to be issued;

NTAcc = Number of outstanding Telefónica, S.A. shares on the date the Board of Directors or, by delegation, the Executive Commission decides to carry out the Increase; and

Number of rights = Number of free-of-charge allotment rights needed for the allotment of one new share, which number will be obtained by applying the following formula, rounded up to the nearest whole number:

$$\text{Number of rights} = \text{NTAcc} / \text{Provisional number of shares.}$$

where,

$$\text{Provisional number of shares.} = \text{Amount of the Alternative Option} / \text{PreCot.}$$

For such purpose:

“Amount of the Alternative Option” will be an amount of 1,592,858,605.10 million euros.

“PreCot” is the arithmetic mean of the average weighted prices of the Telefónica, S.A. share on the Automated Quotation System (*Sistema de Interconexión Bursátil Español*) (Continuous Market) in the 5 trading sessions prior to the decision of the Board of Directors or, by delegation, the Executive Commission, to carry out the Capital Increase, rounded off to the nearest one-thousandth of a euro and, in the case of one-half of one thousandth of a euro, rounded up to the nearest one-thousandth (amount referred to as “Market Price” in this report). In any case, PreCot cannot be less than the par value of the shares and, accordingly if the result of the foregoing calculation were less, PreCot would be equal to one (1) euro.

Example calculation of the number of new shares to be issued, the amount of the Increase and the number of free-of-charge allotment rights needed for the allotment of one new share:

An example calculation of the formula included in this section is included below, solely for the purpose of facilitating comprehension of how the formula is to be applied. The results of these calculations are not representative of what the results could be when the Capital Increase is actually carried out, since actual results will depend on the various variables used in the formula.

Merely for the purposes of this example:

-The Amount of the Alternative Option is 1,592,858,605.10 euros.

-A PreCot of 12.00 euros (closing price of the Telefónica, S.A. share on April 23, 2014) is assumed.

-The NTAcc is 4,551,024,586 (number of outstanding Telefónica, S.A. shares on the date of this report).

Therefore:

Provisional number of shares = Amount of the Alternative Option / PreCot =
 $1,592,858,605.10 / 12.00 = 132,738,217.09$

Number of rights = NTAcc / Provisional number of shares = $4,551,024,586 / 132,738,217.09 = 34.285714 = 35$ (rounded up)

NAN = NTAcc / Number of rights = $4,551,024,586 / 35 = 130,029,273.89 = 130,029,273$ (rounded down)

Consequently, in this example, (i) the number of new shares to be issued in the Increase would be 130,029,273, (ii) the amount of the Increase would be 130,029,273 euros ($130,029,273 \times 1$), and (iii) 35 free-of-charge allotment rights (or old shares) would be needed for the allotment of one new share.

B) Free-of-charge allotment rights

In the Increase, each outstanding Telefónica, S.A. share will grant its holder one free-of-charge allotment right.

The number of free-of-charge allotment rights needed to receive one new share will be determined automatically according to the proportion between the number of new shares issued in the Increase and the number of outstanding shares, calculated in accordance with the formula set forth in Section 3.A above.

Holders of debentures or other instruments convertible into shares of Telefónica, S.A. existing at any time will not have the free-of-charge allotment right, although they will have, where appropriate, the right to modify the conversion rate of instruments into shares (or the minimum or/and maximum limits of this rate, when it is variable), in proportion to the amount of the increase.

If the number of free-of-charge allotment rights needed for the allotment of one share (35 in the above example) multiplied by the number of new shares (130,029,273 in the same example) is lower than the number of outstanding shares (4,551,024,586), Telefónica, S.A. or a company in its Group, will waive a number of free-of-charge

allotment rights equal to the difference between the two figures (i.e., 31 rights in the above example) for the sole purpose of having a whole number of new shares and not a fraction.

The free-of-charge allotment rights will be allotted to the shareholders of Telefónica, S.A. who appear as such in the book-entry records of *Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U.* (Iberclear) at 11:59 p.m. in Madrid on the day of publication of the notice of the Capital Increase in the Official Commercial Registry Gazette (*Boletín Oficial del Registro Mercantil*). The free-of-charge allotment rights may be traded during the term stipulated by the Board or, by delegation, the Executive Commission, which cannot be less than fifteen calendar days.

C) Undertaking to purchase free-of-charge allotment rights

As explained above, when the Capital Increase is carried out, Telefónica or whichever Telefónica, S.A. group company is determined will make an irrevocable undertaking to purchase the free-of-charge allotment rights of the Increase (the “Purchase Undertaking”, as defined above), so that the shareholders of Telefónica, S.A. will be guaranteed the possibility of selling to Telefónica, S.A. or to a company in its Group, the rights received free of charge on the reference date, receiving in return, if they so choose, all or part of the Alternative Option in cash. The Purchase Undertaking will be in force for the time, during the free-of-charge allotment rights trading period, stipulated by the Board of Directors or, by delegation, the Executive Commission. To this end, it is agreed to authorize Telefónica, S.A., or the corresponding Group company, to acquire such rights of free allocation, with a maximum limit of the total number of rights issued, and complying with the legal limitations in any case. The purchase price under the Purchase Undertaking will be fixed and will be calculated prior to the opening of free-of-charge allotment rights trading period according to the following formula (in which the definitions set forth in Section 3.A above will apply), rounded off to the nearest one-thousandth of a euro and, in the event of one-half of one-thousandth of a euro, rounded up to the nearest one-thousandth (the “**Purchase Price**”):

Purchase Price = PreCot / (Number of rights +1).

The final Purchase Price so calculated will be stipulated and made public when the Increase is carried out.

Telefónica, S.A. is expected to waive entitlement to the new shares relating to the free-of-charge allotment rights acquired by Telefónica, S.A. under the Purchase Undertaking, capital stock thus being increased only by the amount relating to free-of-charge allotment rights not waived.

D) Rights carried by the new shares

The new shares to be issued in the Increase will be common shares, each with a par value of one (1) euro, of the same class and series as those currently outstanding, represented by book entries, the records of which will be kept by *Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear)* and its participating entities. Holders of the new shares will have the same dividend and voting rights as the holders of the common Telefónica, S.A. shares currently outstanding, from the date on which the Increase is declared to have been subscribed and paid in. The new shares will be awarded fully paid in and entirely free of charge.

E) Balance sheet and reserves to which the Capital Increase will be charged

The balance sheet which will serve as a basis for the Capital Increase is the balance sheet as of December 31, 2013, which was audited by Ernst & Young, S.L. on March 19, 2014 and which is submitted to the Annual Shareholders' Meeting for approval under item I of its agenda.

The Capital Increase will be charged in full to one of the reserves provided for under Article 303.1 of the Companies Act. When the Increase is carried out, the Board of Directors or, by delegation, the Executive Commission will specify the reserve to be used and the amount thereof in accordance with the balance sheet serving as a basis for the Increase.

F) Tax regime

The tax regime applicable to shareholders in Spain, on the basis of the tax regulations in force in the common territory and the interpretation made by the Directorate General for Taxation (*Dirección General de Tributos*) across the answers to several binding consultations will be generally the following (without prejudice to the specialties that can be applied to certain shareholders, such as non-residents or those subject to taxation in the regional territories, as well as potential future regulatory changes that could affect the applicable tax regime):

The award of shares under the Capital Increase will be treated for tax purposes as an award of fully paid-in free-of-charge shares and, therefore, will not be treated as income for the purposes of personal income tax (*Impuesto sobre la Renta de las Personas Físicas* or “**IRPF**”), corporate income tax (*Impuesto sobre Sociedades* or “**IS**”) or nonresident income tax (*Impuesto sobre la Renta de no Residentes* or “**IRNR**”), whether or not the shareholders act through a permanent establishment in Spain.

The acquisition cost, both of the new shares received as a result of the Capital Increase and of the shares from which they arise, will be the result of dividing the total cost by the applicable number of shares, both old and new. The acquisition date of the new free-of-charge shares will be that of the shares from which they arise.

If the shareholders sell their free-of-charge allotment rights on the market, the amount obtained with the selling of the aforesaid rights will be taxed as follows:

- For the purposes of IRPF and IRNR without a permanent establishment, the amount obtained on the sale of the free-of-charge allotment rights on the market is subject to the same rules as those applying to preemptive rights. Consequently, the amount obtained on the transfer of the free-of-charge allotment rights reduces the acquisition cost, for tax purposes, of the shares giving rise to such rights, pursuant to Article 37.1.a) of Personal Income Tax Law 35/2006. Thus, if the amount obtained on the transfer is higher than the acquisition cost of the securities from which the rights arise, the difference will be treated as a capital gain for the transferor in the tax period in which the transfer takes place.

- For the purposes of IS and IRNR with a permanent establishment in Spain, provided that a full business cycle has been completed, the tax treatment will be in line with the applicable accounting rules.

In the event that the holders of free-of-charge allotment rights accept the Purchase Undertaking, the tax regime applicable to the amount obtained on the transfer to Telefónica, S.A. or to a subsidiary thereof of the free-of-charge allotment rights they hold as shareholders will be that applicable to dividends distributed directly in cash and, accordingly, will be subject to the related withholding tax.

G) Delegation of powers and performance of the Increase

A proposal is made to delegate to the Board of Directors, with the authority to delegate to the Executive Commission, the power to set the date on which the resolution of Increase to be adopted by the Annual Shareholders' Meeting is to be performed, as well as to stipulate any terms and conditions of the Capital Increase not provided for by the shareholders at the Ordinary General Meeting, all pursuant to Article 297.1.a) of the Companies Act. Notwithstanding the foregoing, if the Board of Directors does not consider it advisable to carry out the Capital Increase by implementing the Alternative Option, it may decide not to carry it out, in which case it must report its decision to the shareholders at the next Annual Shareholders' Meeting. The Increase will be rendered ineffective if the Board of Directors does not exercise the powers delegated to it within the one-year period stipulated by the shareholders for the performance of the resolution.

When the Board of Directors or, by delegation, the Executive Commission, agrees to perform the Alternative Option, carrying out the Increase and stipulating all its final terms, where not already stipulated by the shareholders at the Shareholders' Meeting, Telefónica, S.A. will make those terms public. In particular, prior to the beginning of the free-of-charge allotment period, Telefónica, S.A. will make available to the public a document containing information on the number and nature of the shares and the reasons for the Increase, all in accordance with Articles 26.1.e) and 41.1.d) of Royal Decree 1310/2005, partially implementing Securities Market Law 24/1988.

At the end of the free-of-charge allotment rights trading period of the Increase:

- (a) The new shares will be allotted to the holders of free-of-charge allotment rights in the necessary proportion.
- (b) The Board of Directors or, by delegation, the Executive Commission will close the free-of-charge allotment rights trading period and will record the application of an amount of reserves equal to the Increase, thus fully paying in the new shares.

Lastly, the Board of Directors or, by delegation, the Executive Commission will adopt the resolutions required to amend the bylaws in order to reflect the new amount of capital stock resulting from the Increase and to apply for admission of the new shares to trading.

H) Admission of the new shares to trading

Telefónica, S.A. will apply for the admission of the new shares to trading on the Madrid, Barcelona, Bilbao and Valencia Stock Markets through the Automated Quotation System (*Sistema de Interconexión Bursátil Español*) (Continuous Market), and will take such steps and actions as may be necessary and file the required documents with the authorities of the foreign Securities Markets on which Telefónica, S.A. shares are traded (currently, London and Buenos Aires and, through ADSs (*American Depository Shares*), New York and Lima) in order for the new shares issued under the Increase to be admitted to trading.

4. PROPOSED RESOLUTION TO BE SUBMITTED TO THE ANNUAL SHAREHOLDERS' MEETING FOR APPROVAL

The full text of the proposal in connection with this matter, submitted to the Annual Shareholders' Meeting for approval, is as follows:

1.- Capital increase

Those present resolved to increase capital stock by the amount resulting from multiplying (a) the par value of one (1) euro per share in Telefónica, S.A. by (b)

the number of new Telefónica, S.A. shares to be determined using the formula indicated under item 2 below (the “New Shares”).

The capital increase is performed by issuing and allotting the New Shares, which shall be common shares, each with a par value of one (1) euro, of the same class and series as those currently outstanding, represented by book entries.

The capital increase is performed in full with a charge to one of the reserves provided for under Article 303.1 of the Corporate Enterprises Law.

The New Shares are issued at par, i.e., for their par value of one (1) euro, without additional paid-in capital, and will be allotted free of charge to those shareholders of Telefónica, S.A. that exercise free-of-charge allotment rights.

Pursuant to Article 311 of the Corporate Enterprises Law, provision is made for the possibility of an incomplete allotment of the increase. If such incomplete allotment occurs, capital will be increased by the appropriate amount.

2.- New Shares to be issued

The number of New Shares will be equal to the result of applying the following formula, rounded down to the nearest whole number:

$$NAN = NTAcc / \text{Number of rights}$$

where,

NAN = Number of New Shares to be issued;

NTAcc = Number of outstanding Telefónica, S.A. shares on the date the Board of Directors or, by delegation, the Executive Commission decides to carry out the increase; and

Number of rights = Number of free-of-charge allotment rights needed for the allotment of one New Share, which number will be obtained by applying the following formula, rounded up to the nearest whole number:

$$\text{Number of rights} = \text{NTAcc} / \text{Provisional number of shares}$$

where,

$$\text{Provisional number of shares} = \text{Amount of the Alternative Option} / \text{PreCot.}$$

For such purposes:

“Amount of the Alternative Option” will be 1,592,858,605.10 euros.

“PreCot” is the arithmetic mean of the average weighted prices of the Telefónica, S.A. share on the Automated Quotation System (Sistema de Interconexión Bursátil Español) (Continuous Market) in the 5 trading sessions prior to the decision of the Board of Directors or, by delegation, the Executive Commission to carry out the capital increase, rounded off to the nearest one-thousandth of a euro and, in the case of one-half of one thousandth of a euro, rounded up to the nearest one-thousandth (amount referred to as “Market Price” in this report). In any case, PreCot cannot be less than the par value of the shares and, accordingly, if the result of the foregoing calculation were less, PreCot would be equal to one (1) euro.

3.- Free-of-charge allotment rights

Each outstanding Telefónica, S.A. share will grant one free-of-charge allotment right.

The number of free-of-charge allotment rights needed to receive one new Share will be determined automatically according to the proportion between the number of New Shares and the number of outstanding Shares (NTAcc). In particular, shareholders will be entitled to receive one New Share for every

number of free-of-charge allotment rights determined automatically pursuant to section 2 above (Number of rights) they own.

Holders of debentures or other instruments convertible into shares of Telefónica, S.A. existing at any time will not have the free-of-charge allotment right, although they will have, where appropriate, the right to modify the conversion rate of instruments into shares (or the minimum or/and maximum limits of this rate, when it is variable), in proportion to the amount of the increase.

If (i) the number of free-of-charge allotment rights needed for the allotment of one share (Number of rights) multiplied by the New Shares (NAN) is lower than (ii) the number of outstanding shares (NTAcc), Telefónica, S.A. or an entity in its Group, will waive a number of free-of-charge allotment rights equal to the difference between the two figures, for the sole purpose of having a whole number of New Shares and not a fraction.

The free-of-charge allotment rights will be allotted to the shareholders of Telefónica, S.A. who appear as such in the book-entry records of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear) at 11:59 p.m. in Madrid on the day of publication of the notice of the capital increase in the Official Commercial Registry Gazette. During the free-of-charge allotment rights trading period, sufficient free-of-charge allotment rights may be acquired on the market in the proportion necessary for subscribing to new Shares. The free-of-charge allotment rights may be traded on the market during the term stipulated by the Board or, by delegation, by the Executive Commission, which cannot be less than fifteen calendar days.

4.- Undertaking to purchase free-of-charge allotment rights

Telefónica, S.A. or whichever Telefónica group company is determined, will make an irrevocable undertaking to purchase the rights received free of charge by shareholders at the price indicated below (the "Purchase Undertaking"). The Purchase Undertaking will be in force for the time, during the free-of-charge

allotment rights trading period, stipulated by the Board of Directors or, by delegation, by the Executive Commission. To this end, it is agreed to authorize Telefónica, S.A., or the corresponding Group company, to acquire such rights of free allocation (as well as the actions that correspond to them), with a maximum limit of the total number of rights issued, and complying with the legal limitations in any case. The "Purchase Price" of each free-of-charge allotment right will be equal to that resulting from the following formula, rounded off to the nearest one-thousandth of a euro and, in the event of one-half of one-thousandth of a euro, rounded up to the nearest one-thousandth:

$$\text{Purchase Price} = \text{PreCot} / (\text{Number of rights} + 1)$$

5.- Transaction balance sheet and reserves to which the increase will be charged

The balance sheet which will serve as a basis for the transaction is the balance sheet as of December 31, 2013, duly audited and approved by this Annual Shareholders' Meeting.

As indicated, the capital increase will be charged in full to one of the reserves provided for under Article 303.1 of the Corporate Enterprises Law. When the increase is carried out, the Board of Directors or, by delegation, the Executive Commission will determine the reserve to be used and the amount thereof in accordance with the balance sheet serving as a basis for the transaction.

6.- Representation of the New Shares

The shares to be issued will be represented by book entries, the records of which will be kept by Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (Iberclear) and its participating entities.

7.- Rights carried by the New Shares

Holders of the New Shares will have the same voting and dividend rights as the holders of the common Telefónica, S.A. shares currently outstanding, from the date on which the increase is declared to have been subscribed and paid in.

8.- Shares on deposit

After the free-of-charge allotment rights trading period has ended, any New Shares unable to be allotted for reasons not attributable to Telefónica, S.A. will be held on deposit and will be available to those who evidence lawful ownership of the related free-of-charge allotment rights. Three years after the date of the end of the free-of-charge allotment rights trading period, any share still pending allotment may be sold pursuant to Article 117 of the Corporate Enterprises Law, for the account and at the risk of the interested parties. The net proceeds from the aforesaid sale will be deposited with the Bank of Spain (Banco de España) or with the Government Depository (Caja General de Depósitos) and will be available to the interested parties.

9.- Application for admission to official trading

Those present resolved to apply for admission of the New Shares to trading on the Madrid, Barcelona, Bilbao and Valencia Stock Markets through the Automated Quotation System (Sistema de Interconexión Bursátil Español) (Continuous Market), and to take such steps and actions as may be necessary and file the required documents with the authorities of the foreign Securities Markets on which Telefónica, S.A. shares are traded (currently, London and Buenos Aires and, through ADSs (American Depository Shares), New York and Lima) in order for the New Shares issued under the capital increase to be admitted trading, expressly stating the submission of Telefónica, S.A. to the provisions in force now or in the future in connection with the Stock Market and, especially, on trading, continued listing and delisting.

It is expressly recorded, for the appropriate statutory purposes, that if the delisting of Telefónica, S.A. shares is subsequently requested, the request will comply with the formalities imposed by the applicable legislation and, in such

case, the interests of shareholders opposing or not voting on the delisting resolution will be guaranteed in compliance with the requirements stipulated in the Corporate Enterprises Law, the Securities Market Law and other concordant or implementing provisions.

10.- Performance of the increase

Within one year after the date of this resolution, the Board of Directors or, by delegation, the Executive Commission may resolve, when deem appropriate, to carry out the increase and stipulate any terms of the increase not provided for in this resolution.

If the Board of Directors does not consider it advisable to carry out the capital increase, it may decide not to carry it out, in which case it must report its decision to the shareholders at the next Annual Shareholders' Meeting. The capital increase referred to in this resolution will be rendered ineffective if the Board of Directors does not exercise the powers delegated to it within the one-year period stipulated by the shareholders for the performance of the resolution.

After the free-of-charge allotment rights trading period has ended:

(a) The New Shares will be allotted to the holders of free-of-charge allotment rights, according to the book-entry records of Iberclear and its participating entities, in the proportion resulting from Section 3 above.

(b) The Board of Directors or, by delegation, the Executive Commission will close the free-of-charge allotment rights trading period and will record the application of an amount of reserves equal to the capital increase, which shall thus be fully paid in.

Also after the free-of-charge allotment rights trading period has ended, the Board of Directors or, by delegation, the Executive Commission will adopt the related resolutions to amend the bylaws in order to reflect the new amount of capital stock resulting from the increase and to apply for admission of the New

Shares to trading on the Spanish and foreign stock markets on which Telefónica, S.A. shares are listed.

11.- Delegation for carrying out the increase

Those present resolved to delegate to the Board of Directors, pursuant to Article 297.1.a) of the Corporate Enterprises Law, with express authority to delegate to the Executive Commission , the power to stipulate any terms of the capital increase not provided for in this resolution. In particular, without limitation, the following powers are delegated to the Board of Directors:

1.- *To indicate, within one year from its approval, the date on which the resolution thus adopted to increase capital stock is to be carried out, the reserve to which the increase is to be charged from among those provided for in the resolution and the length of the free-of-charge allotment rights trading period.*

2.- *To specify the exact amount of the capital increase, the number of New Shares and the free-of-charge allotment rights needed for the allotment of New Shares, applying for such purpose the rules stipulated by this Shareholders' Meeting.*

3.- *To stipulate the terms and conditions of the Purchase Undertaking.*

4.- *To amend Article 5.1 of the bylaws of Telefónica, S.A. on capital stock, to bring it into line with the result of the capital increase.*

5.- *To waive the New Shares relating to free-of-charge allotment rights acquired by Telefónica, S.A. or the related company in its Group pursuant to the Purchase Undertaking.*

6.- *To declare the capital increase to be closed and performed.*

7.- *To take all necessary steps to ensure that the New Shares issued for the capital increase are recorded in the Iberclear book-entry records and admitted to trading on the national and foreign stock markets on which Telefónica, S.A.*

shares are traded, in accordance with the procedures stipulated on each of said stock markets.

8.- To take all such actions as are necessary or appropriate to carry out and formalize the capital increase vis-à-vis any public or private entities or bodies, whether Spanish or foreign, including actions for the purpose of declaration, supplementation or correction of errors or omissions which could serve as an impediment or obstacle to the full effectiveness of the foregoing resolutions.

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Madrid, April 25, 2014