REPORT PREPARED BY THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A.

REGARDING THE PROPOSAL FOR COMPENSATING THE SHAREHOLDERS BY MEANS OF A SCRIP DIVIDEND UNDER ITEM VI OF THE AGENDA FOR THE 2015 ORDINARY GENERAL SHAREHOLDERS' MEETING

April 29, 2015

1. SUBJECT-MATTER OF THE REPORT

A proposal for compensating the shareholders by means of a scrip dividend structured through an increase in share capital with a charge to reserves by an amount to be determined according to the terms of the resolution, by issuing new ordinary shares, each with a par value of one euro, without a share premium, of the same class and series as those currently outstanding, and the assumption by the Company or by another company of its Group of an undertaking to purchase the corresponding free allotment rights that are granted to shareholders, is submitted for the approval of the shareholders at the General Shareholders' Meeting under item VI on the agenda for the Ordinary Shareholders' Meeting of Telefónica, S.A. (the "**Company"**) called for June 11 and 12, 2015 on first and second call, respectively.

Pursuant to the provisions of Sections 286 and 296 of the Companies Act (*Ley de Sociedades de Capital*), the Board of Directors must prepare a report providing a rationale for the proposal in order for the capital increase and the resulting amendment of the By-Laws to be submitted for the approval of the shareholders at the General Shareholders' Meeting.

In order to facilitate an understanding of the proposal being submitted for the approval of the shareholders at the General Shareholders' Meeting, a description is first provided of the purpose and rationale, followed by a description of the main terms and conditions thereof. Lastly, a full verbatim transcription is provided of the corresponding proposed resolution.

2. PURPOSE OF AND RATIONALE FOR THE PROPOSAL

2.1 Purpose of the transaction

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

The Company wishes to again offer its shareholders, probably on November 2015, the alternative of the scrip dividend, also named "Telefónica Flexible Dividend", a form of shareholder compensation that allows them to receive paid-up shares of the Company as an alternative, without in any way limiting their ability to receive all of their compensation in cash if they so desire.

Therefore, the purpose of the proposal submitted to the shareholders at the Ordinary General Shareholders' Meeting is to allow for the implementation of a new edition of the Telefónica Flexible Dividend in fiscal year 2015.

2.2. Structure of the transaction and options open to shareholders

This new edition of the Telefónica Flexible Dividend, which allows shareholders, in their discretion, to receive their compensation in paid-up shares or in cash, is structured through a capital increase with a charge to reserves, through the issuance of paid-up shares, which is submitted to the shareholders at the 2015 Ordinary Shareholders' Meeting for approval under item VI of the agenda.

At the time the Board of Directors, or the Executive Commission by delegation therefrom, decides to carry out the Capital Increase:

(i) The shareholders will receive one free allotment right for each share they own. These rights may be traded on the Spanish continuous market for a period of at least 15 calendar days, at the end of which the rights will be automatically converted into newly-issued shares of the Company vested in the holders thereof. The exact number of shares to be issued as a result of the Increase and, accordingly, the number of rights needed to receive a new share, will depend on the market price of the Company's share taken as a reference at the time of implementation of the increase (the "**Reference Market Price**") in accordance with the procedure described in this report.

    In any event, as explained below, the maximum number of shares to be issued in the capital increase shall be such that the market price of such shares, calculated at the Reference Market Price, will be approximately 1,702,519,437.85 euros.

(ii) The Company or an entity within its Group will assume an irrevocable commitment to purchase the free allotment rights received by the shareholders at a fixed price (the "**Purchase Undertaking**"). This fixed price will be calculated prior to the beginning of trading period for the free allotment rights, based on the Reference Market Price (such that the price of each right will be the result of dividing the Reference Market Price by the number of rights needed to receive a new share plus one). Thus, the Company guarantees all its shareholders the ability to monetize the rights received for free, thus allowing them to receive their compensation in cash.

Therefore, upon the implementation of the capital increase that is being submitted to the shareholders for approval at the General Shareholders' Meeting, the shareholders of the Company will have the option, if they so choose:[1]

(a) not to transfer their free allotment rights. In this case, the shareholders will receive the number of new fully paid-up shares to which they are entitled at the end of the trading period;

(b) to transfer all or part of their free allotment rights to the Company or, if applicable, to the corresponding company of its Group, pursuant to the Purchase Undertaking. Thus, the shareholders would be opting to monetize their rights and receive their compensation in cash instead of receiving paid-up shares;

(c) to transfer all or part of their free allotment rights on the market. In this case, the shareholders would also be opting to monetize their rights, albeit not at a guaranteed fixed price, unlike in option (b) above.

The gross value received by the shareholder under options (a) and (b) will be the same, given that the Reference Market Price will be used to determine both the fixed price of the Purchase Undertaking and the number of free allotment rights needed to subscribe for one new share. However, the tax treatment of each of the alternatives is different (see Section 3.6 below for a summary of the tax regime applicable in Spain).

2.3. Cash amount of the capital increase and price of the Purchase Undertaking

The structure proposed to implement the Telefónica Flexible Dividend Program consists of offering the shareholders paid-up shares with a value, established in accordance with the Reference Market Price that will total approximately 1,702,519,437.85 euros. This is in line with the objective -as announced in the dividend policy -of distributing approximately 0.35 euro per share.

Given that, as stated above, the purpose of the Purchase Undertaking is to allow the shareholders to monetize their compensation, and considering that under the capital increase each share will give the holder thereof one free allotment right, the gross price per right at which the Purchase Undertaking will be made will be similar to the result of dividing the aforementioned amount (1,702,519,437.85) by the number of shares of the Company after the capital reduction resolution referred to in the previous point V agenda, i.e., approximately, the aforementioned figure of 0.35 gross per share.[2]

The purchase price of free allotment rights will be stipulated and made public pursuant to Section 3.3. below.

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[1] The options available to holders of shares of the Company that are admitted to trading outside Spain (including those traded in the form of ADSs) may have certain differences with respect to those described herein based on the nature of each market and the terms and conditions applicable to the programs in which such holders participate.

[2] This figure is subject to possible rounding by application of the formulas set forth in Section 3.1 of this report.

3. <u>MAIN TERMS AND CONDITIONS OF THE CAPITAL INCREASE</u>

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

3.1. Amount of the Capital Increase, number of shares to be issued, and number of free allotment rights needed to receive one new share

As described in the calculation formulas and in the definitions included in this section, when the Board of Directors, or the Executive Commission by delegation therefrom, decides to implement the capital increase, it will determine the number of shares to be issued as follows:

The number of shares to be issued will be the result of dividing the total number of shares of the Company on that date, by the number of free allotment rights needed for the allotment of one new share. The number so calculated will be subject to rounding in order to obtain a whole number of shares.

The number of rights will be the result of dividing the total number of shares of the Company on the date on which it is decided to implement the capital increase by means of a scrip dividend by the provisional number of shares to be issued, rounded up to the nearest whole number.

In turn, the provisional number of shares to be issued will be the result of multiplying 1,702,519,437.85 euros by the PreCot/(PreCot-0.35) factor –with a maximum of 1,800,000,000.00 euros in any case– (the **“Reference Amount”**) and dividing the Reference Amount by the Reference Market Price.

In addition, the Company (or a company within its Group) will waive the necessary number of free allotment rights in order to obtain a subscription ratio that is a whole number.

Once the number of new paid-up shares to be issued is established, the amount of the capital increase will be the result of multiplying such number by the par value of the Company’s shares (1 euro per share). The capital increase will be at par, with no additional paid-in capital.

In accordance with the foregoing, the amount of the increase and the number of free allotment rights needed for the allotment of one new share will be determined using the following formulas.

The number of new shares will be the number that results from applying the following formula, rounded down to the nearest whole number

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

where,

“**NAN**” is the number of new shares to be issued;

“**NTAcc**” is the number of shares of the Company on the date the Board of Directors, or the Executive Commission by delegation therefrom, resolves to implement the capital increase; and

“**Number of Rights”** is the number of free allotment rights required for the allotment of one new share, which number will result from applying the following formula, rounded up to the nearest whole number:

Number of Rights = NTAcc / Provisional number of shares

where,

Provisional number of shares = Reference Amount / PreCot.

For such purposes:

“**Reference Amount**” is the reference market value of the capital increase, which will be equal to the amount of 1.702,519,437.85 euros multiplied by the PreCot/(PreCot-0.35) factor, with a maximum of 1,800,000,000,00 euros in any case.

“**PreCot”** is the Reference Market Price, which will be the arithmetic mean of the average weighted prices of the shares of the Company on the Automated Quotation System (*Sistema de Interconexión Bursátil Español*) (Continuous Market) during the 5 trading sessions prior to the decision of the Board of Directors, or the Executive Commission by delegation therefrom, to carry out the capital increase, rounded 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. In any case, PreCot cannot be less than the par value of the shares, such that if the result of such calculation is less, PreCot will be equal to one euro.

<u>Examples of calculations of the number of new shares to be issued, the amount of the increase and the number of free allotment rights needed for the allotment of one new share, using different Reference Market Prices:</u>

Examples of calculations of the formulas included in this section are included below, solely for the purpose of facilitating comprehension of how the formula is to be applied. The results of these calculations are provided as examples only, since actual figures will depend on the circumstances prevailing at the time the capital increased is implemented.

a) Example using the Reference Market Price as of April 28, 2015

A PreCot of 13.655 euros (Reference Market Price on April 28, 2015) and a NTAcc of 4,864,341,251 (number of shares which is expected to be divided the capital of the Company as of the date of execution of this increase[3]) are assumed.

Therefore, applying the aforementioned formulas:

- Reference Amount = 1,702,519,437.85 × (PreCot / PreCot – 0.35) = 1,702,519,437.85 × (13.655/13.305) = 1,747,305.743.99

- Provisional number of shares = Reference Amount / PreCot = 1,747,305,743.99 / 13.655 = 127,960,874.70

- Number of Rights = NTAcc / Provisional number of shares = 4,864,341,251 / 127,960,874.70 = 39 (rounded up)

- NAN = NTAcc / Number of Rights = 4,864,341,251 / 39 = 124,726,698 (rounded down)

Consequently, in this example, (i) the number of new shares to be issued would be 124,726,698, (ii) the nominal amount of the capital increase would amount to 124,726,698.00 euros, (iii) 39 free allotment rights (or existing shares) would be needed for the allotment of one new share, and (iv) the Company, or another entity within its Group, would have to waive 29 free allotment rights to fit the subscription ratio.

b) Example using the Reference Market Price as of April 28, 2015, increased by 5%:

In this example, a PreCot of 14.338 euros (Reference Market Price as of April 28, 2015 increased by 5%) and a NTAcc of 4,864,341,251 (number of shares which is expected to be divided the capital of the Company as of the date of execution of this increase[4]) are assumed.

Therefore, applying the aforementioned formulas, it follows that:

- Reference Amount = 1,702,519,437.85 × (PreCot / PreCot – 0.35) = 1,702,519,437.85 × (14.338/13.988) = 1,745,118,937.65

- Provisional number of shares = Reference amount / PreCot = 1,745,118,937.65 / 14.338 = 121,712,856.58

[3] Number of shares that the share capital of the Company is divided by as of the date of this report net of shares that are subject to amortization according to the capital reduction resolution referred to in the previous item V of the agenda.
[4] See previous footnote.

- Number of Rights = NTAcc / Provisional number of shares = 4,864,341,251 / 121,712,856.58 = 40 (rounded upwards)

- NAN = NTAcc / Number of Rights = 4,864,341,251 / 40 = 121,608,531 (rounded downwards)

Therefore, in this example, (i) the number of new shares to be issued would be 121,608,531, (ii) the nominal amount of the capital increase would amount to 121,608,531.00 euros, (iii) 40 free allotment rights (or existing shares) would be needed for allotment of one new share, and (iv) the Company, or another entity within its Group, would have to waive 11 free allotment rights to fit the subscription ratio.

c) Example using the Reference Market Price as of April 28, 2015, reduced by 5%:

In this example, a PreCot of 12.972 euros (Reference Market Price as of April 28, 2015 reduced by 5%) and a NTAcc of 4,864,341,251 (number of shares which is expected to be divided the capital of the Company as of the date of execution of this increase[5]) are assumed. Therefore, applying the aforementioned formulas, it follows that:

- Reference Amount = 1,702,519,437.85 × (PreCot/ PreCot – 0.35) = 1,702,519,437.85× (12.972/12.622) = 1,749,729,214.69

- Provisional number of shares = Reference amount / PreCot = 1,749,729,214.69 / 12.972 = 134,885,076.68

- Number of Rights = NTAcc / Provisional number of shares = 4,864,341,251 / 134,885,076.68 = 37 (rounded upwards)

- NAN = NTAcc / Number of Rights = 4,864,341,251 / 37= 131,468,682 (rounded downwards)

Therefore, in this example, (i) the number of new shares to be issued would be 131,468,682 (ii) the nominal amount of the capital increase would amount to 131,468,682.00 euros, (iii) 37 free allotment rights (or existing shares) would be needed for allotment of one new share, and (iv) the Company, or another entity within its Group, would have to waive 17 free allotment rights to fit the subscription ratio.

3.2. Free allotment rights

In this capital increase, each outstanding share of the Company will grant its holder one free allotment right.

The number of free allotment rights required to receive one new share will be automatically determined according to the ratio existing between the number of new

[5] See previous footnote.

shares and the number of existing shares, calculated in accordance with the formula set forth in Section 3.1 above.

In the event that the number of free allotment rights required for the allotment of one new share (39 in the above example a)) multiplied by the number of new shares (124,726,698 in the same example) results in a number that is lower than the number of shares of the Company at that time (4,864,341,251 in our example), the Company, or an entity within its Group, will waive a number of free allotment rights equal to the difference between both figures (i.e., 29 rights in the above example) for the sole purpose that the number of new shares to be issued be a whole number and not a fraction.

The free allotment rights will be allotted to the shareholders of the Company who appear as being entitled thereto in the book-entry records of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (IBERCLEAR) on the relevant date in accordance with applicable rules governing the clearing and settlement of securities. The free allotment rights may be traded during

[5]See previous footnote.

the term determined by the Board, or the Executive Commission by delegation therefrom, which term will not be less than fifteen calendar days.

3.3. Purchase Undertaking for the free allotment rights

As explained above, upon implementation of the capital increase, the Company, or such entity of its group as may be determined, will assume an irrevocable commitment to purchase the free allotment rights from the increase so that the shareholders will be guaranteed the ability to sell the rights received free of charge, receiving, in their discretion, all or part of their compensation in cash. The Purchase Undertaking will be in effect during such term, within the period for trading the free allotment rights, as is established by the Board of Directors or the Executive Commission by delegation therefrom.

For such purpose, the proposed resolution includes the respective authorization to acquire such free allotment rights, 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 commencement of the period for trading the free allotment rights according to the following formula (in which the definitions set forth in Section 3.1 above will apply), rounded to the nearest one thousandth part of a euro and, in the case of one-half of one thousandth of a euro, rounded to the next higher one thousandth part of a euro (the "**Purchase Price**"):

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

The final Purchase Price so calculated will be set and made public upon implementation of the capital increase.

It is expected that the Company will waive the exercise of the free allotment rights acquired by virtue of the Purchase Undertaking and, as a result of the foregoing, to waive the new shares corresponding to such rights, such that the share capital will be increased only by the amount corresponding to the free allotment rights that have not been waived.

3.4 Rights carried by the new shares

The new shares to be issued will be ordinary shares, each with a par value of one euro, of the same class and series as those currently outstanding, represented by book entries, the records of which will be kept by IBERCLEAR and its participating entities.

Holders of the new shares will have the same dividend and voting rights as the holders of the ordinary shares of the Company that are currently outstanding, from the date of implementation of the capital increase.

3.5 Balance sheet and reserves to which the increase will be charged

The balance sheet used as the basis for the capital increase is the balance sheet as of December 31, 2014, which was audited by Ernst & Young, S.L. on February, 27, 2015 and which is submitted to the shareholders at this General Shareholders' Meeting for approval under item I on the agenda thereof.

The capital increase will be made in its entirety with a charge to the reserves provided for in Section 303.1 of the Companies Act. When implementing the increase, the Board of Directors, or the Executive Commission by delegation therefrom, will determine the reserve to be used and the amount thereof in accordance with the balance sheet used as the basis for the transaction.

3.6 Tax regime

The tax regime applicable to shareholders in Spain, based on the tax regulations in force in the common territory and the interpretation provided by the Directorate General for Taxation *(Dirección General de Tributos)* through its answers to several binding consultations will be generally the one described below (without prejudice to the particularities that might apply to certain shareholders, such as non-residents or those subject to taxation in the regional (*foral*) territories, as well as potential future regulatory changes that could affect the applicable tax regime):

The delivery of the paid-up shares as a result of the capital increase will be treated for tax purposes as the delivery of paid-up shares, and will therefore not be treated as income for the purposes of the Personal Income Tax (*Impuesto sobre la Renta de las Personas Físicas*) ("**IRPF**"), Corporate Income Tax (*Impuesto sobre Sociedades*) ("**IS**") or Nonresident Income Tax (*Impuesto sobre la Renta de no Residentes*) ("**IRNR**"), whether or not the shareholders receiving such shares act through a permanent establishment in Spain. In line with the foregoing, the delivery of new shares is not subject to any withholding or payment on account.

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 such paid-up shares will be that of the shares from which they arise.

If the shareholders sell their free allotment rights on the market, the amount obtained from the transfer of such rights will be taxed as follows:

- For the purposes of IRPF and IRNR without a permanent establishment, the amount obtained in the market for the free allotment rights is subject to the same rules as those applying to preemptive rights. Consequently, the amount obtained on the transfer of the free allotment rights reduces the acquisition cost of the shares giving rise to such rights for tax purposes, pursuant to the current text of Section 37.1.a) of Personal Income Tax Law 35/2006, in accordance with the interim regime applicable to this type of transaction established in Final Provision Six of Law 26/2014 of November 27 amending Law 35/2006 of November 28 on Personal Income Tax (applicable through December 31, 2016).

- Thus, if the amount obtained in such 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, all without prejudice to the potential application to persons liable to IRNR without a permanent establishment of the double taxation treaties signed by Spain and to which they may be entitled.

- 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 allotment rights accept the Purchase Undertaking, the tax regime applicable to the amount obtained in the transfer to the Company, or to the relevant entity of its Group, of the free allotment rights will be that applicable to dividends distributed directly in cash and, accordingly, will be subject to the related withholding tax.

3.7 Delegation of powers

A proposal is made to delegate to the Board of Directors, with express powers of substitution, the power to set the date of implementation of the approved increase in capital by means of a scrip dividend, as well as to set the terms and conditions thereof to the extent not provided for by the shareholders at the General Shareholders' Meeting, all pursuant to Section 297.1.a) of the Companies Act. Notwithstanding the foregoing, if the Board of Directors does not consider it advisable to carry out this capital increase, it may decide not to carry it out, in which case it must report its decision to the shareholders at the next General Shareholders' Meeting. In any event, the increase will be nullified if the Board of Directors does not exercise the powers delegated thereto within the one-year period stipulated by the shareholders for the implementation of the resolution.

Once the Board of Directors, or the Executive Commission by delegation therefrom, decides to implement the capital increase, stipulating all its final terms, where not already stipulated by the shareholders at the Shareholders' Meeting, the Company. will make those terms public. In particular, prior to the beginning of the free-of-charge allotment trading period, the Company. will make available to the public a document containing information on the number and nature of the shares and the reasons for the capital increase, all in accordance with Article 26.1.e) of Royal Decree 1310/2005 of November 4, partially implementing Securities Market Law 24/1988 of July 28.

At the end of the period for trading the free allotment rights:

(a) The new shares will be allotted to the holders of free allotment rights in the required proportion.

(b) The Board of Directors, or the Executive Commission by delegation therefrom, will close the free allotment rights trading period and will record the application of an amount of reserves equal to the increase, with the increase thus being fully paid-up.

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

3.8 Admission of the new shares to trading

The Company will apply for the admission of the new shares ultimately issued to trading on the Madrid, Barcelona, Bilbao and Valencia Stock Exchanges through the Automated Quotation System (*Sistema de Interconexión Bursátil Español*) (Continuous Market), with the taking of such steps and actions as are required the submission of the required documents to the appropriate bodies of the foreign Stock Exchanges on which the shares of the Company are listed (currently London and Buenos Aires and, through American Depositary Shares (ADSs), New York and Lima) in order for the new shares issued under the increase to be admitted to trading.

4. PROPOSED RESOLUTION SUBMITTED FOR APPROVAL BY THE SHAREHOLDERS AT THE ORDINARY GENERAL SHAREHOLDERS' MEETING

The full text of the proposal in connection with this item on the agenda that is submitted for approval by the shareholders at the Ordinary General Shareholders' Meeting is as follows:

1.- Capital increase with a charge to reserves

The share capital is increased by the amount resulting from multiplying (a) the nominal value of one euro per share of Telefónica, S.A. (the "**Company**") by (b) the number of new shares of the Company to be determined using the formula indicated under item 2 below (the "**New Shares**").

The capital increase is carried out by means of the issuance and flotation of the New Shares, which will be ordinary shares, having a nominal value of one euro each, of the same class and series as those that are currently outstanding, represented by book entries.

The capital increase is carried out in its entirety with a charge to one of the reserves provided for in Section 303.1 of the Companies Act (*Ley de Sociedades de Capital*).

The New Shares are issued at par, i.e., at their nominal value of one euro, without a share premium, and will be allotted without charge to those shareholders who exercise their free allotment rights.

Pursuant to the provisions of Section 311 of the Companies Act, provision is made for the possibility of an incomplete allotment of the Capital Increase, in the event that the Company, a company within its Group or a third party waives all or part of the free allotment rights to which they are entitled at the time of implementation of the increase. In the event of such incomplete allotment, the share capital will be increased by the corresponding amount

2.- New Shares to be issued

The number of New Shares will be the number that results from the application of the following formula, with the resulting number being rounded downwards to the next lower integer:

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

where

"**NAN**" is the Number of New Shares to be issued;

"**NTAcc**" is the number of shares of the Company on the date on which the Board of Directors, or the Executive Commission by delegation therefrom, resolves to implement the capital increase; and

"**Number of Rights**" is the number of free allotment rights required for the allotment of one New Share, which number will result from the application of the following formula, with the result being rounded to the next higher integer:

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

where

$$\boxed{\text{Provisional number of shares} = \text{Reference Amount} / \text{PreCot.}}$$

For these purposes:

“**Reference Amount**” will be the reference market value of the capital increase, which will be equal to the sum of 1,702,519,437.85 euros multiplied by the factor PreCot/(PreCot-0.35), with a maximum of 1,800,000,000.00 euros in all cases.

“**PreCot**” is the arithmetic mean of the average weighted listing prices of the Company’s Shares on Spain’s Electronic Trading System in the five trading sessions prior to the resolution of the Board of Directors, or the Executive Commission by delegation therefrom, to implement the capital increase, rounded up or down to the closest one-thousandth part of a euro and, in the case of half of one thousandth of a euro, rounded to the next higher one thousandth part of a euro. In any event, PreCot may not be less than the nominal value of the shares, such that if the result of such calculation is less, PreCot shall be equal to one euro.

3.- Free allotment rights

Each share of the Company will grant its holder one free allotment right.

The number of free allotment rights required to receive one New Share will be automatically determined according to the ratio existing between the number of New Shares and the number of shares of the Company (NTAcc). Specifically, the shareholders will be entitled to receive one New Share for as many free allotment rights, determined as provided in Section 2 above (Number of Rights), as are held by them.

In the event that (i) the number of free allotment rights required for the allotment of one share (Number of Rights) multiplied by the number of New Shares (NAN) results in a number that is lower than (ii) the number of outstanding shares (NTAcc.), the Company, or an entity within its Group, will waive a number of free allotment rights equal to the difference between both figures, for the sole purpose that the number of New Shares be a whole number and not a fraction.

The free allotment rights will be allotted to the shareholders who appear as being entitled thereto in the book-entry records of Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U. (IBERCLEAR) on the relevant date, in accordance with applicable rules governing the clearing and settlement of securities.

The free allotment rights may be traded on the Spanish continuous market during such term as may be determined by the Board of Directors, or the Executive Commission by delegation therefrom, which term will not be less than fifteen calendar days. During the period for trading the free allotment rights, a sufficient number of free allotment rights may be acquired on the market in the proportion required to subscribe for New Shares.

4.- Irrevocable commitment to purchase the free allotment rights

The Company, or such company of its Group as may be determined, will assume an irrevocable commitment to purchase the free allotment rights at the price set forth below (the “**Purchase Undertaking**”).

The Purchase Undertaking will be in effect during such term, within the period for trading the rights, as is established by the Board of Directors or the Executive Commission by delegation therefrom. For such purpose the Company, or the corresponding company of its Group, is authorized to acquire such free allotment rights up to the maximum limit of the total number of rights issued, in all cases with due observance of any applicable legal restrictions.

The "**Purchase Price**" of each free allotment right under the Purchase Undertaking shall be the amount that results from the following formula, rounded up or down to the closest one thousandth part of a euro and, in the case of one-half of one thousandth of a euro, to the next higher one thousandth part of a euro:

Purchase Price = PreCot / (Number of Rights + 1)

The Company may acquire the free allotment rights pursuant to the Purchase Undertaking in whole or in part with a charge to one of the reserves provided for in Section 303.1 of the Companies Act.

5.- Balance sheet for the transaction and reserve to which the increase will be charged.

The balance sheet used as the basis for the transaction is the balance sheet for the fiscal year ended December 31, 2014, duly audited and approved by the shareholders at this General Shareholders' Meeting.

As noted above, the capital increase is made in its entirety with a charge to one of the reserves provided for in Section 303.1 of the Companies Act. When implementing the increase, the Board of Directors, or the Executive Commission by delegation therefrom, will determine the reserve to be used and the amount thereof in accordance with the balance sheet used as the basis for the transaction.

6.- Representation of the New Shares

The New Shares will be represented by book entries, the book-entry registration of which is entrusted to 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 ordinary shares of the Company that are currently outstanding, from the date on which the capital increase is declared to be subscribed and paid in.

8.- New Shares on deposit

Once the period for trading the free allotment rights has ended, the New Shares that could not be allotted for reasons not attributable to the Company will be held on deposit for those who provide evidence that they are the lawful holders of the corresponding free allotment rights.

Upon the passage of three years from the end of the period for trading the free allotment rights, the New Shares that are still pending allotment may be sold in accordance with the provisions of Section 117 of the Companies Act, for the account and risk of the interested parties. The net proceeds from such sale will be deposited with the Bank of Spain (*Banco de España*) or with the Government Depository (*Caja General de Depósitos*) at the disposal of the interested parties.

9.- Application for admission to official trading

Application will be made for admission of the New Shares issued to trading on the Madrid, Barcelona, Bilbao and Valencia Stock Exchanges, through the Automated Quotation System (*Sistema de Interconexión Bursátil*) (Continuous Market), with the taking of such steps and actions as are required or appropriate and the submission of the required documents to the appropriate bodies of the foreign Stock Exchanges on which the shares of the Company are listed (currently London and Buenos Aires and, through American Depositary Shares (ADSs), New York and Lima) in order for the New Shares to be admitted to trading, with an express statement for the record of the Company's submission to the rules that may now or hereafter exist with respect to Stock Exchange matters, and especially regarding trading, continued listing on and delisting from official markets.

It is expressly stated for the record, for appropriate legal purposes, that in the event of a subsequent request for delisting of the Company's shares, such delisting will be carried out with such formalities as apply thereto and, in such event, the interests of the shareholders opposing or not voting on the resolution to delist will be safeguarded, in compliance with the requirements set out in applicable laws and regulations.

10.- Implementation of the increase

Within a period of one year from the date of this resolution, the Board of Directors, may resolve, if it so deems appropriate, to implement the increase and set the terms and conditions thereof as to all matters not provided for in this resolution.

If the Board of Directors does not deem it advisable to implement the capital increase, it may decide not to implement it, in which case it must report such decision to the shareholders at the next General Shareholders' Meeting held. The capital increase to which this resolution refers will be deprived of any and all effect in the event that the Board of Directors does not exercise the powers delegated thereto within the aforementioned period of one year

Once the period for trading the free allotment rights has ended:

(a) The New Shares will be allotted to the holders of the free allotment rights, according to the records maintained by IBERCLEAR and its participating entities, in the proportion resulting from Section 3 above.

(b) The Board of Directors or the Executive Commission by delegation therefrom, will declare the period for trading the free allotment rights to have ended and will formalize the appropriation of an amount of reserves equal to the amount of the capital increase, with which appropriation such Capital Increase will thus be fully paid in.

Likewise, once the period for trading the free allotment rights has ended, the Board of Directors, will adopt the resolutions required to amend the By-Laws in order to reflect the new amount of share capital resulting from the increase, and to apply for admission of the New Shares to listing on the Spanish and foreign Stock Exchanges on which the shares of the Company are listed.

11.- Delegation of powers for implementation of the increase

Pursuant to the provisions of Section 297.1.a) of the Companies Act, the power to set the terms and conditions of the capital increase as to all matters not provided for in this resolution is delegated to the Board of Directors.

In particular, and by way of example only, the following powers are delegated to the Board of Directors, with express power of substitution:

1.- To set the date on which the Capital Increase is to be carried out, which shall be within a period of one year from approval thereof, and to determine the reserves, from among those listed in Section 303.1 of the Companies Act, with a charge to which such increase will be implemented.

2.- To set the reference date and time for allotment of the free allotment rights and the duration of the period for trading the free allotment rights, which shall not be less than fifteen calendar days.

3.- To determine the exact amount of the capital increase, the number of New Shares and the free allotment rights needed for the allotment of New Shares, applying the rules established in this resolution for such purpose.

4.- To establish the terms and conditions of the Purchase Undertaking.

5.- To amend article 6 of the By-Laws regarding the share capital to bring it into line with the result of the capital increase.

6.- To waive the free allotment rights held by the Company or the respective company of its Group at the end of the period for trading such rights as a result of the Purchase Undertaking and, thus, the New Shares corresponding to such rights.

7.- To waive free allotment rights, if appropriate, for the sole purpose of facilitating the number of New Shares being a whole number and not a fraction.

8.- To declare the capital increase to be closed and implemented.

9.- To take all steps required for the New Shares resulting from the capital increase to be included in the book-entry records of IBERCLEAR and admitted to listing on the Spanish and foreign Stock Exchanges on which the Company's shares are listed, in accordance with the procedures established at each of such Stock Exchanges.

10.- To take all such actions as are necessary or appropriate to implement and formalize the capital increase with any public or private entities or agencies, whether domestic or foreign, including acts for purposes of representation or supplementation or to cure defects or omissions that might prevent or hinder the full effectiveness of the foregoing resolutions.

The Board of Directors is expressly authorized to in turn delegate to the Executive Commission or the Executive Chairman of the Board of Directors, the powers referred in this resolution, without prejudice to the powers that may be granted to any person for specific acts of execution.

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