

**REPORT PREPARED BY THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A.
REGARDING THE PROPOSED DELEGATION TO THE BOARD OF DIRECTORS OF
THE POWER TO INCREASE THE SHARE CAPITAL PURSUANT TO THE
PROVISIONS OF SECTION 297.1.B) OF THE COMPANIES ACT, AND OF THE
POWER TO EXCLUDE PRE-EMPTIVE RIGHTS, SUBMITTED UNDER ITEM IX OF
THE AGENDA FOR THE 2015 ORDINARY GENERAL SHAREHOLDERS' MEETING**

April 29, 2015

1. SUBJECT-MATTER OF THE REPORT

A proposal regarding delegation to the Board of Directors, with express powers of substitution, for a period of five years, of the power to increase the share capital pursuant to the provisions of Section 297.1.b) of the Companies Act (*Ley de Sociedades de Capital*), with delegation of the power to exclude the pre-emptive right of the shareholders pursuant to the provisions of Section 506 of the Companies Act, is submitted for the approval of the shareholders at the General Shareholders' Meeting under item IX of the agenda for the Ordinary General 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, 297.1.b) and 506 of the Companies Act, in order for the proposed delegation to the Board of Directors of the power to increase share capital and to exclude pre-emptive rights to be submitted for approval of the shareholders at the General Shareholders' Meeting, the Board of Directors must prepare a report providing a rationale for the proposal.

2. RATIONALE FOR THE PROPOSAL

Section 297.1.b) of the Companies Act gives authority to the shareholders at General Shareholders' Meetings of Corporations (*sociedades anónimas*), upon compliance with the same requirements as for the amendment of the By-Laws, to delegate to the members of the Board the power to approve an increase in share capital on one or more occasions up to a particular amount, at the times and in the amounts that it decides, without previous authorization of the General Shareholder's Meetings .

The law provides that such increases may under no circumstances exceed one-half of the capital of the Company at the time of the authorization and must be made by means of cash contributions within a maximum period of five years from the date of the shareholders' resolution.

The Board of Directors of the Company believes that the proposed resolution submitted for approval of the shareholders at the General Shareholders' Meeting is justified by the appropriateness of this mechanism to attract financial resources. This is intended to give the Company's Board of Directors quick responsiveness to act within an environment in which the success of a strategic initiative frequently depends on the ability to rapidly implement it, without the costs and delays involved in the holding of a General Shareholders' Meeting.

Market requirements demand that commercial companies, and especially listed companies, cause their governance and management bodies to be in a position to make use of the abilities provided by the regulatory framework to provide a quick and efficient response to the needs arising within the business environment in which major companies are currently operating.

Pursuant to Section 297.1 b) of the Companies Act, the proposal contemplates that payment for any new shares issued in reliance on the delegation be made in the form of cash contributions, and expressly provides for the possibility of an incomplete subscription, pursuant to the provisions of Section 311 of such Act.

In addition, the proposed resolution includes an authorization to the Board of Directors to take all steps required for the new shares to be admitted to trading on the Stock Exchanges on which the Company's shares are listed.

Pursuant to the provisions of Section 506 of the current Companies Act, the proposed delegation to the Board of Directors of the power to increase share capital includes the grant to the Directors of the power to exclude pre-emptive rights, subject to the statutory requirements established in the above-mentioned Section 506 of the Act and in related provisions.

The Board of Directors believes that the power to exclude pre-emptive rights as a supplement to the power to increase capital by means of the issuance of new shares with monetary contributions is justified for various reasons. However, following the recommendations of the Code of Good Governance for listed companies, the possibility of excluding pre-emptive rights is limited to 20% of the share capital.

First, the exclusion of pre-emptive rights tends to reduce the costs associated with the transaction (especially the fees of the financial institutions participating in the issuance) as compared to an issuance with pre-emptive rights.

Second, with the power to exclude pre-emptive rights, the Board of Directors is able to considerably speed the actions and responses required by current financial markets, allowing the Company to take advantage of those times at which market conditions are most favorable. In any event, the total or partial exclusion of pre-emptive rights is a power granted to the Board of Directors by the shareholders acting at the General Shareholders' Meeting, and therefore, such power will be exercised within the discretion of the Board of Directors itself, with due regard to the circumstances and in compliance with all legal requirements existing at any time.

In the event that the Board of Directors decides to make use of the power to exclude pre-emptive rights with respect to a specific increase in capital that it approves in the use of the authorization granted by the shareholders at the General Shareholders' Meeting, the Directors' report and the report of an auditor other than the auditor of the Company must be prepared, as required by Section 308 of the Companies Act. Both reports must be made available to the shareholders and notice thereof given to them at the next General Meeting held after the resolution providing for the increase, as required by the provisions of Section 506 of the Companies Act.

The proposal is completed with an authorization to the Board of Directors such that it may in turn delegate the powers to which this proposed resolution refers pursuant to the provisions of Section 249 of the Companies Act.

3. PROPOSED RESOLUTION SUBMITTED FOR THE APPROVAL OF THE SHAREHOLDERS AT THE ORDINARY GENERAL SHAREHOLDERS' MEETING

Set forth below is the full text of the proposal regarding this item on the agenda that is submitted to the shareholders for approval at the Ordinary General Shareholders' Meeting:

To delegate to the Board of Directors, as broadly as required by Law, pursuant to the provisions of Section 297.1.b) of the Companies Act, the power to increase the share capital on one or more occasions and at any time, within a period of five years from the date of adoption of this resolution, by the maximum nominal amount of 2,469,208,757 euros, equal to one half of the share capital of Telefónica, S.A. (the "Company") on the date of adoption of this resolution.

Capital increases under this delegation shall be carried out by means of the issuance and flotation of new shares -with or without a share premium- the consideration for which shall be monetary contributions.

In connection with each increase, it shall fall upon the Board of Directors to decide whether the new shares to be issued are to be ordinary, preferred or any other type of shares permitted by law. The Board of Directors may also set the terms and conditions of the capital increases as to all matters not provided for in this resolution and the characteristics of the shares, with express provision for the possibility of incomplete subscription, and may freely offer the new shares not subscribed within the period or periods for the exercise of preemptive rights. The Board of Directors may also provide that, in the event of incomplete subscription, the capital shall only be increased by the amount of the subscriptions made, and may amend the article of the By-Laws regarding the share capital and number of shares.

Furthermore, in connection with the capital increases implemented in reliance on this delegation, the power is delegated to the Board of Directors to exclude preemptive rights in whole or in part upon the terms of Section 506 of the Companies Act. However, the power to exclude preemptive rights is limited to 20% of the Company's share capital on the date of adoption of this resolution.

The Company shall, where appropriate, make application for admission to trading on any secondary market, whether official or unofficial, organized or not, and domestic or foreign, of the shares issued by virtue of this delegation, with the Board of Directors being authorized to take all steps and actions needed for admission to listing with the appropriate bodies of the various domestic or foreign securities markets on which its shares are listed.

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.

The delegation to increase share capital granted by the shareholders at the General Shareholders' Meeting of the Company held on May 18, 2011 is deprived of effect to the extent of the unused amount.