

TELEFONICA S A
Form 6-K
April 15, 2011

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**FORM 6-K
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Report of Foreign Private Issuer
Pursuant to Rule 13a-16 or 15d-16
of the Securities Exchange Act of 1934
For the month of April, 2011
Commission File Number: 001-09531
Telefónica, S.A.**

(Translation of registrant's name into English)

**Distrito C, Ronda de la Comunicación s/n,
28050 Madrid, Spain
3491-482 85 48**

(Address of principal executive offices)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-F Form 40-F

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes No

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes No

Indicate by check mark whether by furnishing the information contained in this Form, the registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes No

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

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Official Calling and Agenda

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Mandatory report of the Board of Directors on Point VI of the Agenda

Disclosures required under article 116 bis of the Spanish Securities Market Law

Account Auditor's Report, Annual Accounts and Management Report of the Consolidated Group of Companies, all for the Fiscal Year 2010

Account Auditor's Report, Annual Accounts and Management Report of Telefónica, S.A., all for the Fiscal Year 2010

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Telefónica, S.A., as provided in article 82 of the Spanish Stock Market Act (Ley del Mercado de Valores), hereby reports the following

SIGNIFICANT EVENT

Telefónica, S.A. has resolved to call the Annual General Shareholders Meeting of the Company to be held in Madrid, at the Recinto Ferial de la Casa de Campo, Pabellón de Cristal, Avenida de Portugal, sin número, on **May 17, 2011 at 1:00 p.m. on first call**, or, in the event that the legally required quorum is not reached and therefore the Meeting cannot be held on first call, on **May 18, 2011 on second call, at the same place and time.**

To this end, the following documents are hereby enclosed to this report:

Full text of the official calling

Full text of the proposals to be submitted for approval of the Annual General Shareholders Meeting.

Disclosures required under former article 116 bis of the Spanish Securities Market Law (Ley del Mercado de Valores).

The aforesaid proposals, together with the additional information, are available to shareholders, for examination, at the Company's registered office. Additionally, these documents will be accessible on-line via TELEFÓNICA, S.A.'s website: www.telefonica.com.

Madrid, April 15th, 2011

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TELEFÓNICA, S.A.

Ordinary General Shareholders Meeting

By resolution of the Board of Directors of TELEFÓNICA, S.A., the shareholders are hereby called to the Ordinary General Shareholders Meeting, to be held in **Madrid, at the Recinto Ferial de la Casa de Campo, Pabellón de Cristal, Avenida de Portugal, sin número**, on May 17, 2011 at 1:00 p.m. on first call, or, in the event that the legally required quorum is not reached and therefore the Meeting cannot be held on first call, on May 18, 2011 on second call, at the same place and time, in order to deliberate and decide upon the matters included in the following

AGENDA

- I. Examination and approval, if applicable, of the Individual Annual Accounts, the Consolidated Financial Statements (Consolidated Annual Accounts) and the Management Report of Telefónica, S.A and of its Consolidated Group of Companies, as well as of the proposed allocation of the profits/losses of Telefónica, S.A. and the management of its Board of Directors, all with respect to Fiscal Year 2010.
- II. Compensation of shareholders: Distribution of dividends to be charged to Unrestricted Reserves.
- III. Amendment of the By-Laws.
 - III.1 Amendment of Articles 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 *bis* and 36 of the By-Laws for adjustment thereof to the latest legislative developments.
 - III.2 Addition of a new paragraph 5 to Article 16 of the By-Laws.
 - III.3 Addition of a new Article 26 *bis* to the By-Laws.
- IV. Amendment of the Regulations for the General Shareholders Meeting.
 - IV.1 Amendment of Articles 5, 8.1, 11 and 13.1 of the Regulations for the General Shareholders Meeting for adjustment to the latest legislative developments.
 - IV.2 Amendment of Article 14.1 of the Regulations for the General Shareholders Meeting.

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- V. Re-election, appointment and ratification, if applicable, of Directors:
 - V.1 Re-election of Mr. Isidro Fainé Casas.
 - V.2 Re-election of Mr. Vitalino Manuel Nafría Aznar.
 - V.3 Re-election of Mr. Julio Linares López.
 - V.4 Re-election of Mr. David Arculus.
 - V.5 Re-election of Mr. Carlos Colomer Casellas.
 - V.6 Re-election of Mr. Peter Erskine.
 - V.7 Re-election of Mr. Alfonso Ferrari Herrero.
 - V.8 Re-election of Mr. Antonio Massanell Lavilla.
 - V.9 Appointment of Mr. Chang Xiaobing.
- Determination of the number of Directors.
- VI. Authorization granted to the Board of Directors to increase the share capital pursuant to the terms and conditions of Section 297.1.b) of the Companies Act, over a maximum period of five years, delegating the power to exclude pre-emptive rights pursuant to Section 506 of the Companies Act.
- VII. Re-election of the Auditor for Fiscal Year 2011.
- VIII. Long-term incentive plan based on shares of Telefónica, S.A. Approval of a long-term incentive Plan consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executive Team of the Telefónica Group (including Executive Directors).
- IX. Restricted Share Plan of Telefónica, S.A. Approval of a long-term incentive restricted Plan consisting of the delivery of shares of Telefónica, S.A. aimed at Employees and Executive Personnel and linked to their continued employment in the Telefónica Group.
- X. Global incentive share purchase Plan of Telefónica, S.A. Approval of an incentive share purchase Global Plan for the Employees of the Telefónica Group.
- XI. Delegation of powers to formalize, interpret, correct and implement the resolutions adopted by the shareholders at the General Shareholders Meeting.

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In addition, and following the presentation of the matters included on the Agenda, the shareholders at the Meeting will be informed of the amendments to the Regulations of the Board of Directors of the Company pursuant to Section 516 of the Companies Act (*Ley de Sociedades de Capital*), and a Report explaining the matters included in the former Section 116.bis of the Securities Market Act (*Ley del Mercado de Valores*) (included in the Company's Management Report) will be submitted to them.

SUPPLEMENT TO THE CALL TO THE GENERAL SHAREHOLDERS MEETING

Pursuant to the provisions of Section 172 of the Companies Act (*Ley de Sociedades de Capital*), shareholders representing at least five percent of the share capital may request the publication of a supplement to this call to the General Shareholders Meeting, including one or more items in the Agenda. This right must be exercised by means of verifiable notice (which will include the corresponding documents evidencing shareholder status) that must be received at the Company's registered office (Gran Vía, número 28, Madrid, código postal 28013, to the attention of the General Secretary & Secretary of the Board of Directors) within five days of the publication of this call to Meeting.

RIGHT TO RECEIVE INFORMATION

In connection with Items I, III, IV and VI on the Agenda, and pursuant to applicable laws and regulations, it is stated for the record that shareholders have the right to examine and obtain at the Company's registered office, or to request the Company to send them, immediately and free of charge, a copy of the following documents:

Individual and consolidated Annual Accounts of Telefónica, S.A. and the proposed allocation of profits/losses, all for fiscal year 2010.

Individual and consolidated Management Reports of Telefónica, S.A. for fiscal year 2010.

Audit Reports on the individual and consolidated Annual Accounts of Telefónica, S.A. for fiscal year 2010.

Report of the Board of Directors relating to the proposal for amendment of the By-Laws of Telefónica, S.A. referred to in item III of the Agenda, which includes the complete text of the proposed amendments.

Report of the Board of Directors relating to the proposal for amendment of the Regulations for the General Shareholders Meeting of Telefónica, S.A. referred to in item IV of the Agenda, which includes the complete text of the proposed amendments.

Report of the Board of Directors relating to the proposal for granting authorization to that body to increase the share capital and to exclude pre-emptive rights referred to in item VI of the Agenda.

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In addition, the following documents are made available to the shareholders at the registered office of the Company:
Complete text of the proposed resolutions set forth in items on the Agenda that are submitted by the Board of Directors.

Summary of the professional profile of each of the Directors and of the persons included in the proposed resolutions relating to item V of the Agenda.

Current text of the Regulations of the Board of Directors.

The explanatory report relating to matters contemplated in the former Section 116.*bis* of the Securities Market Act (included in the Company's Management Report).

The Report on Directors' Compensation Policy.

The Annual Corporate Governance Report for fiscal year 2010.

All of the documents set forth above will be available electronically on the Company's website (www.telefonica.com). Pursuant to Sections 197 and 527 of the Companies Act, the shareholders may, until the seventh day prior to the date on which the General Shareholders' Meeting is scheduled to be held and by completing the form posted on the Company's website for such purpose, or by postal correspondence sent to the Company's registered office (Gran Vía, número 28, Madrid, código postal 28013, to the attention of the Oficina del Accionista [Office of the Shareholder]), request such information or clarifications as they deem necessary, or ask such questions as they deem appropriate, regarding the matters included on the Agenda or about the information available to the public that has been provided by Telefónica, S.A. to the National Securities Market Commission (*Comisión Nacional del Mercado de Valores*) since June 2, 2010, i.e., the date on which the last General Shareholders' Meeting was held.

RIGHT TO ATTEND THE MEETING IN PERSON OR BY PROXY

The right to attend the General Shareholders' Meeting hereby called accrues to shareholders that hold at least 300 shares registered in their name in the corresponding book-entry registry five days in advance of the date on which the Meeting is to be held and who provide evidence thereof by means of the appropriate attendance card or by producing a certificate issued by any of the depositaries participating in the *Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A.U.* [Securities Registration, Clearing and Settlement Systems Management Company] (IBERCLEAR) or by any other means allowed under applicable law.

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Any shareholder having the right to attend the General Shareholders Meeting may be represented thereat by another person, who need not be a shareholder. A proxy may be granted by using the proxy-granting form printed on the attendance card or by any other means allowed by Law. The documents containing proxies for the General Shareholders Meeting must set forth the instructions regarding the manner of voting, provided that, where no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions submitted by the Board of Directors regarding the matters on the agenda, and shall vote in such direction as he deems most appropriate, taking into account the corporate interest and that of the shareholder granting the proxy, in relation to any other matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the General Shareholders Meeting.

If the proxy-granting form does not set forth a specific person to whom the shareholder grants the proxy, such proxy will be deemed granted in favor of the Chairman of the Board of Directors of the Company or of such other person as may replace him as Chairman of the General Shareholders Meeting. In the event that, in accordance with the foregoing, the representative is involved in a conflict of interest upon voting on any of the proposals, whether or not included in the Agenda, which are put to the vote at the General Shareholders Meeting, the proxy will be deemed granted to the Secretary for the General Shareholders Meeting in his capacity as a shareholder having the right to attend.

Shareholders who do not hold the minimum number of shares required to attend may grant a written proxy in respect thereof in favor of another shareholder having the right to attend, or come together with other shareholders that are in the same situation such that they reach the required number of shares and grant a written proxy to one of such shareholders.

PARTICIPATION OF A NOTARY AT THE MEETING

The Board of Directors has resolved to request the presence of a Notary Public to draw up the minutes of the Meeting, pursuant to Section 203 of the Companies Act, read together with Sections 101 and 103 of the Regulations of the Commercial Registry.

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PROTECTION OF PERSONAL DATA

The personal data sent by the shareholders to the Company to exercise their rights to attend and vote at the General Shareholders Meeting or to grant proxies, or the personal data provided for such purpose by the entities which are the depositaries of the shares held by such shareholders, shall be used by Telefónica, S.A. to manage the development, compliance with and control of the existing shareholding relationship. Furthermore, pursuant to the Personal Data Protection Act (Organic Act 15/1999, of December 13), the data received will be kept in a database for which Telefónica, S.A. is responsible, the purpose of which is to send shareholders information relating to their investment and any advantage inherent to their status as shareholders in the telecommunications, new information technologies, tourism, culture, insurance, financial and home assistance industries. Shareholders have 30 days from the date of the General Shareholders Meeting to object to such treatment (which they may do by calling toll-free at 900 111 004); upon expiration of such period they will be deemed to have given their consent for such purpose. The rights of access, correction, cancellation and challenge may be exercised by letter accompanied by a copy of the Identity Document (DNI), addressed to the Office of the Shareholder of Telefónica, S.A., Distrito C, Ronda de la Comunicación s/n, Edificio Oeste 2, planta baja, 28050 Madrid.

ACCESSES TO THE RECINTO FERIAL DE LA CASA DE CAMPO PABELLÓN DE CRISTAL

Entrance on Paseo de Extremadura (Puerta del Ángel or Main Gate)

Underground stations: Alto de Extremadura or Puerta del Ángel , line 6 and Lago , line 10

FOR ANY ADDITIONAL INFORMATION, SHAREHOLDERS MAY CONTACT TELEFÓNICA S OFFICE OF THE SHAREHOLDER BY CALLING TOLL-FREE AT 900 111 004, FROM 9:00 A.M. TO 7:00 P.M., MONDAY THROUGH FRIDAY.

Madrid, April 15, 2011

General Secretary and Secretary of the Board

Mr. Ramiro Sánchez de Lerín García-Ovies

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Telefónica, S.A.

***ORDINARY GENERAL SHAREHOLDERS MEETING
OF TELEFÓNICA, S.A. 2011
PROPOSED RESOLUTIONS SUBMITTED BY THE BOARD OF DIRECTORS
TO THE SHAREHOLDERS FOR DECISION AT THE
GENERAL SHAREHOLDERS MEETING***

May 17/18, 2011

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Telefónica, S.A.

Proposal regarding Item I on the Agenda: Examination and approval, if applicable, of the Individual Annual Accounts, the Consolidated Financial Statements (Consolidated Annual Accounts) and the Management Report of Telefónica, S.A. and of its Consolidated Group of Companies, as well as of the proposed allocation of the profits/losses of Telefónica, S.A. and the management of its Board of Directors, all with respect to Fiscal Year 2010.

- A) To approve the Individual Annual Accounts (Balance Sheet, Income Statement, Statement of Changes in Shareholders' Equity, Cash Flow Statement and Notes), the Consolidated Financial Statements (Consolidated Annual Accounts (Statements of Financial Condition, Income Statements, Global Income Statements, Statements of Changes in Shareholders' Equity, Cash Flow Statements, and Notes to the Consolidated Financial Statements), and the Management Reports of Telefónica, S.A. and its Consolidated Group of Companies for Fiscal Year 2010 (ended on December 31, 2010), as finalized by the Company's Board of Directors at its meeting of February 23, 2011, as well as the corporate management of the Board of Directors of Telefónica, S.A. during such Fiscal Year. In the Individual Annual Accounts, the Balance Sheet as of December 31, 2010 discloses assets, liabilities and shareholders' equity in the amount of 93,117 million euros each, and the Income Statement as of the end of the Fiscal Year shows a profit of 4,130 million euros. In the Consolidated Financial Statements (Consolidated Annual Accounts), the Balance Sheet as of December 31, 2010 reflects assets, liabilities and shareholders' equity in the amount of 129,775 million euros each, and the Income Statement as of the end of the Fiscal Year reports a profit of 10,167 million euros.

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B) To approve the following Proposal for the Allocation of the Profits and Losses of Telefónica, S.A. for Fiscal Year 2010:

To allocate the profits posted by Telefónica, S.A. in Fiscal Year 2010, in the amount of 4,130,219,259.19 euros, as follows:

2,938,011,020.75 euros to payment of an interim dividend (fixed gross amount of 0.65 euro per share entitled to receive it). Such dividend was paid in full on May 11, 2010.

1,690,464.00 euros to funding a restricted reserve for Goodwill.

The balance of profits (1,190,517,774.44 euros) to a Discretionary Reserve.

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Proposal regarding Item II on the Agenda: Compensation of shareholders: Distribution of dividends to be charged to Unrestricted Reserves.

To approve a distribution of Unrestricted Reserves by means of payment to each of the existing and outstanding shares of the Company that are entitled to participate in such distribution on the payment date, of the fixed gross amount of 0.77 euro per share, to be charged to the aforementioned Unrestricted Reserves.

Payment will be made on November 7, 2011, through the Entities participating in the Sociedad de Gestión de los Sistemas de Registro, Compensación y Liquidación de Valores, S.A. (*Securities Registration, Clearing and Settlement Systems Management Company*) (IBERCLEAR).

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Telefónica, S.A.

Proposal regarding Item III on the Agenda: Amendment of the By-Laws.

III.1 Amendment of Articles 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 bis and 36 of the By-Laws for adjustment thereof to the latest legislative developments.

It is resolved to amend the aforementioned by-law provisions, which shall henceforth read as follows:

New text of Article 1 of the By-Laws:

Article 1. Corporate name

The Company is named Telefónica, S.A. and shall be governed by these By-Laws and, as to matters not otherwise contemplated or provided for herein, by the Companies Act (Ley de Sociedades de Capital) and other legal provisions applicable thereto.

New text of paragraph 2 of Article 6 of the By-Laws:

2. Modifications to features of shares represented in book-entry form, once formalized in accordance with the provisions of the Companies Act (Ley de Sociedades de Capital) and the Securities Market Act (Ley del Mercado de Valores), shall be published in the Official Bulletin of the Commercial Registry (Boletín Oficial del Registro Mercantil) and in one of the newspapers of wider circulation in Madrid.

New text of Article 7 of the By-Laws:

Article 7. Pending disbursements

1. Pending disbursements shall be paid within the period that is established, within legal limits, by the Board of Directors.

2. In the case of arrears in the payment of pending disbursements, the delinquent shareholder shall be subject to the effects provided for under Law. In the event of a transfer of shares that have not been fully paid up, the transferee of any such shares and all prior transferors shall be jointly and severally liable.

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New text of Article 14 of the By-Laws:

Article 14. Powers of the Shareholders Acting at a General Shareholders Meeting

The shareholders acting at a General Shareholders Meeting shall decide on the matters assigned thereto by Law or these By-Laws and, in particular, regarding the following:

- 1) Appointment and removal of Directors.*
- 2) Appointment and removal of Auditors and liquidators.*
- 3) Commencement of claims for liability against Directors, liquidators or Auditors.*
- 4) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decisions regarding the allocation of profits/losses.*
- 5) Increase and reduction of share capital.*
- 6) Issuance of debentures.*
- 7) Amendment of the By-Laws.*
- 8) Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.*
- 9) The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.*
- 10) The transformation of the Company into a holding company through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.*
- 11) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.*
- 12) Transactions the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.*
- 13) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.*

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New text of paragraph 1 of Article 16 of the By-Laws:

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and on the Company's website (www.telefonica.com), as much in advance of the date set for the Meeting as is at a minimum required by Law. The notice published on the Company's website shall be accessible at least until the date of the Meeting. Furthermore, the Board of Directors may publish notices in other media, if it deems it appropriate in order to give broader publicity to the call to meeting.

New text of paragraph 4 of Article 17 of the By-Laws:

4. Proxy representation must be granted in writing (in paper or electronic form) and specifically for each Meeting. A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

Without prejudice to the provisions of Section 187 of the Companies Act, a proxy must be granted pursuant to the provisions of Section 184.2 of such Act.

New text of paragraph 4 of Article 18 of the By-Laws:

4. In cases of increase or reduction in share capital, issuance of convertible debentures, merger, split-off, overall assignment of assets and liabilities and relocation of the Company's registered address abroad, the information required by Law in connection with such cases shall be made available.

New text of Article 31 bis of the By-Laws:

Article 31 bis. Audit and Control Committee

1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of a minimum of three Directors and a maximum of five, to be appointed by the Board of Directors. All of the members of such Committee shall be external or non-executive Directors. At least one of them shall be an independent Director, who shall be appointed taking into account his knowledge and experience in accounting, auditing or both.

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2. *The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.*

3. *The Audit and Control Committee shall have the following powers, at a minimum:*

(i) To report, through its Chairman, to the shareholders at the General Shareholders Meeting regarding matters raised therein by the shareholders in connection with the matters for which the Committee is responsible.

(ii) To propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor referred to in Section 264 of the Companies Act, as well as, if appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment.

(iii) To supervise the effectiveness of the Company's internal control system, the internal audit and the risk management systems as well as to discuss with the Auditor the significant weaknesses in the internal control system detected during the audit.

(iv) To supervise the process of preparation and submission of regulated financial information.

(v) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

In any event, the Audit and Control Committee must receive annually written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor, or by the persons or entities related thereto, pursuant to Law 19/1988, of July 12, on Auditing of Financial Statements.

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(vi) *To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in paragraph V above.*

(vii) *Any other powers granted under the Regulations of the Board of Directors.*

New text of Article 36 of the By-Laws:

Article 36. Grounds for dissolution

The Company shall be dissolved upon any of the grounds set forth in the Companies Act.

III.2 Addition of a new paragraph 5 to Article 16 of the By-Laws.

It is resolved to add a new paragraph 5 to Article 16 of the By-Laws, with the following text:

5. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

III.3 Addition of a new Article 26 bis to the By-Laws.

It is resolved to add a new Article 26 bis to the By-Laws, with the following text:

Article 26 bis. Director conflict of interest

1.- The Directors shall notify the Board of Directors of any situation of direct or indirect conflict with the interest of the Company that may affect them. The Director involved shall abstain from voting on resolutions or decisions relating to the transaction affected by the conflict.

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Directors shall also provide notice, both regarding themselves and persons related thereto, of (a) direct or indirect interests held by them, and (b) positions they hold or duties they perform at any company effectively in competition with the Company.

The conflict of interest situations set forth in the preceding paragraphs shall be included in the annual report.

2.- Directors may not carry out, on their own behalf or on behalf of others, activities that may entail effective competition with the Company, except with the express authorization of the Company by means of a resolution of the shareholders at a General Shareholders Meeting, for which purpose they shall provide the notice set forth in paragraph 1 of this article.

For the purposes of this paragraph and the previous one, the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled by the Company (within the meaning of Article 42 of the Commercial Code) and (ii) companies with which Telefónica, S.A. maintains a strategic alliance. Neither shall proprietary Directors of competitor companies appointed at the request of the Company or as a result of the equity interest held by the Company in such competitor companies be deemed to be in breach of the prohibition on competition.

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Proposal regarding Item IV on the Agenda: Amendment of the Regulations for the General Shareholders Meeting.

IV.1 Amendment of Articles 5, 8.1, 11 and 13.1 of the Regulations for the General Shareholders Meeting for adjustment to the latest legislative developments.

It is resolved to amend the aforementioned articles of the Regulations, which shall henceforth read as follows:

New text of Article 5 of the Regulations for the General Shareholders Meeting:

Article 5. Powers of the of the shareholders at the General Shareholders Meeting

The shareholders acting at the General Shareholders Meeting shall have the power to deliberate upon and adopt resolutions on all such matters as legal provisions and the By-Laws reserve for decision thereat, and, in general, on all matters which fall within the scope of powers assigned by Law to the shareholders and are submitted at the General Shareholders Meeting at the behest of the Board of Directors and of the shareholders themselves, in such instances and in such manner as are provided in the Law and the By-Laws. In particular, the shareholders shall decide the following matters:

- a) Appointment and removal of Directors.*
- b) Appointment and removal of auditors and liquidators.*
- c) Commencement of claims for liability against the Directors, liquidators or Auditors*
- d) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decisions regarding the allocation of profits/losses.*
- e) Increase and reduction of share capital.*
- f) Issuance of debentures.*
- g) Amendment of the By-Laws.*

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- h) Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.*
- i) The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.*
- j) The transformation of the Company into a holding company through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.*
- k) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.*
- l) Transactions the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.*
- m) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.*

New text of section 1 of Article 8 of the Regulations for the General Shareholders Meeting:

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and on the Company's website (www.telefonica.com), as much in advance of the date set for the Meeting as is at a minimum required by Law. The notice published on the Company's website shall be accessible at least until the date of the Meeting. Furthermore, the Board of Directors may publish notices in other media, if it deems it appropriate in order to give broader publicity to the call to meeting.

The call to the General Shareholders Meeting shall also be reported to the National Securities Market Commission and to such Market Supervisory Authorities as may be appropriate.

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New text of Article 11 of the Regulations for the General Shareholders Meeting:

Article 11. Electronic Shareholders Forum and suggestions made by the shareholders

1. Without prejudice to the shareholders right, in such cases and under such terms as are provided in the Law, to have certain matters included in the Agenda for the Meeting that they request be called, the shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders Meeting and the powers of the shareholders thereat.

2. On occasion of the call to meeting and until each General Shareholders Meeting is held, the Company shall place into operation on its website (www.telefonica.com) an Electronic Shareholders Forum, which shall be accessible, with appropriate safeguards, by both individual shareholders and by any voluntary associations they may create as provided by law, in order to facilitate their communication prior to a General Shareholders Meeting being held. Proposed resolutions sought to be presented as a supplement to the agenda notified in the call to meeting may be published in the Forum, together with requests for adherence to such proposals, initiatives to reach the percentage sufficient to exercise a minority right provided by Law as well as proxy offers or solicitations. The Board of Directors may further develop the above-mentioned rules and establish the procedures, terms and other conditions for the operation of the Electronic Shareholders Forum.

New text of paragraph 1 of Article 13 of the Regulations for the General Shareholders Meeting:

1. Every shareholder having the right to attend the General Shareholders Meeting may be represented thereat by another person, even if not a shareholder. The proxy must be granted specifically for each Meeting, either by using the proxy-granting form printed on the attendance card or in any other manner permitted by the Law, without prejudice to the provisions of the Companies Act (Ley de Sociedades de Capital) regarding cases of proxies granted to family relatives and general proxies.

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The documents setting forth the proxies or powers of attorney for the General Shareholders Meeting shall contain instructions regarding the direction of the vote. If no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda.

If there are no voting instructions because the shareholders acting at the General Shareholders Meeting are to decide matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the Meeting, the proxy-holder shall vote in such direction as he deems most appropriate, taking into account the interest of the Company and that of the shareholder granting the proxy. The same rule shall apply when the relevant proposal or proposals submitted to the shareholders at the Meeting have not been made by the Board of Directors.

If the document setting forth the proxy or power of attorney does not state the specific person or persons to whom the shareholder grants the proxy, such proxy shall be deemed granted in favor of any of the following: the Chairman of the Board of Directors of the Company, or the person that stands in for him as Chairman of the General Shareholders Meeting, or such person as is appointed by the Board of Directors, with notice of such appointment being given in advance in the official notice of the call to meeting.

In cases in which a public proxy solicitation has been carried out, the Director who obtains such proxy shall be subject to the voting restriction established in Section 514 of the Companies Law for conflict of interest situations.

A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

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IV.2 Amendment of Article 14.1 of the Regulations for the General Shareholders Meeting.

It is resolved to amend paragraph 1 of Article 14 of the Regulations for the General Shareholders Meeting, which shall henceforth read as follows:

1. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

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Telefónica, S.A.

Proposal regarding Item V on the Agenda: Re-election, appointment and ratification, if applicable, of Directors.

- V.1 To re-elect Director Isidro Fainé Casas, as proprietary Director, appointing him for a new five-year term. It is expressly stated for the record that Mr. Isidro Fainé Casas holds the position of Vice-Chairman of the Board of Directors of Abertis Infraestructuras, S.A.
- V.2 To re-elect Director Vitalino Manuel Nafría Aznar, as proprietary Director, appointing him for a new five-year term.
- V.3 To re-elect Director Julio Linares López, as executive Director, appointing him for a new five-year term.
- V.4 To re-elect Director David Arculus, as independent Director, appointing him for a new five-year term.
- V.5 To re-elect Director Carlos Colomer Casellas, as independent Director, appointing him for a new five-year term.
- V.6 To re-elect Director Peter Erskine, as other external Director, appointing him for a new five-year term.
- V.7 To re-elect Director Alfonso Ferrari Herrero, as independent Director, appointing him for a new five-year term.
- V.8 To re-elect Director Antonio Massanell Lavilla, as proprietary Director, appointing him for a new five-year term.
- V.9 To appoint as Director of the Company Mr. Chang Xiaobing, as proprietary Director, for a five-year term. It is expressly stated for the record that Mr. Chang Xiaobing holds the position of Chairman and Chief Executive Officer of China Unicom (Hong Kong) Limited. And, if appropriate, the proposed resolution shall be submitted to the shareholders at the General Shareholders Meeting for ratification of Director appointments made on an interim basis to fill vacancies that the Board of Directors might approve from the call to the General Shareholders Meeting until the moment immediately prior to the Meeting being held.

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Determination of the number of Directors

Following the above resolutions, to set at 18 the number of Directors making up the Company's Board of Directors, within the minimum and maximum limits established by the By-Laws.

In any event, pursuant to the provisions of Article 24 of the By-Laws, it is stated for the record that the number of Directors will be determined to be the number at such time in accordance with the resolutions adopted under this item on the agenda, and which will be reported to the shareholders at the General Shareholders Meeting.

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Proposal regarding Item VI on the Agenda: Authorization granted to the Board of Directors to increase the share capital pursuant to the terms and conditions of Section 297.1.b) of the Companies Act, over a maximum period of five years, delegating the power to exclude pre-emptive rights pursuant to Section 506 of the Companies Act.

To authorize the Board of Directors, as broadly as necessary under the law, in order that, under Section 297.1.b) of the Companies Act, it may increase the share capital on one or more occasions and at any time, within the term of five years as from the date of this General Shareholders Meeting, by up to the maximum amount of 2,281,998,242.50 euros, equal to one-half of the Company's current capital. Capital increases pursuant to this authorization shall be made through the issuance and placement into circulation of new shares with or without a premium the consideration for which shall consist of cash contributions. For each increase, the Board of Directors shall determine whether the new shares to be issued are common, preferred, redeemable, non-voting or any other type permitted by Law. The Board of Directors may also determine, to the extent not otherwise provided, the terms and conditions applicable to the capital increases and the characteristics of the shares, expressly providing for the possibility of an incomplete subscription, as well as freely offer new unsubscribed shares during the period or periods for exercise of pre-emptive rights. The Board of Directors may also establish 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 relating to capital and number of shares.

Likewise, with respect to capital increases made pursuant to this authorization, the Board of Directors is authorized to totally or partially exclude pre-emptive rights as permitted by Section 506 of the Companies Act.

Whenever appropriate, the Company shall make application for listing on Spanish or foreign, official or unofficial, organized or other secondary markets of the shares issued by the Company pursuant to this delegation of powers, and the Board of Directors is authorized to conduct all formalities and take all actions that may be necessary for admission to listing with the appropriate authorities of the various Spanish or foreign securities markets on which the shares of the Company are listed.

Under the provisions of Section 249.2 of the Companies Act, the Board of Directors is expressly authorized, in turn, to delegate the powers granted in this resolution.

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Telefónica, S.A.

Proposal regarding Item VII on the Agenda: Re-election of the Auditor for Fiscal Year 2011.

Pursuant to the proposal made by the Audit and Control Committee, the Board of Directors submits the following resolution for approval of the shareholders at the General Shareholders Meeting:

To re-elect as Auditor of Telefónica, S.A. and its Consolidated Group of Companies for fiscal year 2011 the firm Ernst & Young, S.L., with registered office in Madrid, at Plaza Pablo Ruiz Picasso, 1, and Tax Identification Code (C.I.F.) B-78970506.

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Proposal relating to Item VIII on the Agenda: Long-term incentive plan based on shares of Telefónica, S.A. Approval of a long-term incentive Plan consisting of the delivery of shares of Telefónica, S.A. aimed at members of the Executive Team of the Telefónica Group (including Executive Directors).

To approve a long-term incentive Plan based on shares of Telefónica, S.A. aimed at members of the Executive Team of the Telefónica Group (including Executive Directors) (*Performance & Investment Plan PIP*, hereinafter, the **Plan**), in accordance with the following basic terms and conditions:

- 1.- **Description of the Plan:** For the purposes of aligning the interests of the Executive Team of the Telefónica Group with those of its shareholders, the Plan consists of delivering to the Participants (as defined below) a certain number of shares of Telefónica, S.A. in respect of variable compensation and according to the fulfillment of the objectives established for each one of the cycles into which the Plan will be divided.
- 2.- **Participants of the Plan:** The Plan may be participated in by the members of the Executive Team of the Telefónica Group (including Executive Directors and members of the Executive Committee of Telefónica, S.A., and other Executive Personnel) who, while meeting the requirements established for the purpose from time to time, are invited to participate in the Plan (the **Participants**).

Currently, the group of potential Participants is made up of, approximately, 1,900 Executives of the Telefónica Group, notwithstanding the possibility of participation in the Plan, without modifying its terms and conditions, by new potential Participants who, due to promotion, incorporation into the Telefónica Group or other reasons, come to meet the requirements established for the purpose from time to time.

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- 3.- **Term of the Plan:** The Plan shall be for a total term of five years and shall be divided into three cycles lasting three years each (that is, with the delivery of the shares that apply in each cycle three years after its commencement), independent of each other. The first cycle shall commence on July 1, 2011 (with the delivery of the shares that apply on or after July 1, 2014) and the third cycle on July 1, 2013 (with the delivery of the shares that apply on or after July 1, 2016).
- 4.- **Maximum number of shares of Telefónica, S.A. included in the Plan:** The total maximum number of shares of Telefónica, S.A. which, in the implementation of the Plan, shall be delivered to the Participants at the end of each cycle shall be that which results from dividing the maximum amount allocated to each cycle by the weighted average market price of the shares of Telefónica, S.A. in the thirty (30) stock market business days prior to July 1 of the first year of the cycle in question (hereinafter, the **Reference Value**). Exceptionally, the Reference Value for the purposes of the first cycle (which shall commence on July 1, 2011) shall be the weighted average market price of the shares of Telefónica, S.A. in the thirty (30) stock market business days prior to April 7, 2011.

The total maximum amount allocated to the Plan is set at the amount of 450,000,000.

The maximum amount allocated to each cycle of the Plan shall be determined each year by the Board of Directors, following a report from the Nominating, Compensation and Corporate Governance Committee, and may not exceed, for the three cycles of the Plan as a whole, the aforementioned amount of 450,000,000. The amounts committed but in the end not effectively used in each cycle (due to non-fulfillment of objectives, resignations/terminations, etc.) shall be available for the following cycles.

In any case, the total number of shares to be delivered under the Plan to the Participants as a whole (including Executive Directors) at the end of each cycle may never exceed 0.3% of the capital stock of Telefónica, S.A. at the beginning of the cycle in question.

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Among the Participants of the Plan are the current Executive Directors of Telefónica, S.A. who, if they fully meet the requirements and conditions established in the Plan, would be entitled to receive, at the end of the first cycle, the following number of shares (which represent the maximum number possible of shares to be received in the event of fulfillment of the Co-investment requirement defined in section 5 below and of maximum achievement of the TSR objective): Mr. César Alierta Izuel: 390,496 shares; Mr. Julio Linares López: 234,298 shares; and Mr. José María Álvarez-Pallete López: 124,249 shares.

For each of the remaining cycles, the Board of Directors, following a report from the Nominating, Compensation and Corporate Governance Committee, shall determine the maximum amounts that shall serve as the basis for, according to the relevant Reference Value, establishing the maximum number of shares that may be delivered, although, in no event, may such maximum amount exceed, for the two (2) remaining cycles of the Plan as a whole (i.e., excluding the first cycle referred to in the preceding paragraph), the amount of 37,000,000 (applicable to the case of maximum achievement of the TSR objective) for all of the Executive Directors that Telefónica, S.A. has from time to time.

The number of shares that in implementing the Plan are effectively delivered to each Executive Director at the end of each cycle, as well as the number of shares effectively delivered to the senior management personnel and other executive personnel shall be communicated in accordance with the legal provisions currently in force.

- 5.- **Requirements and conditions for the delivery of the shares:** The specific number of shares of Telefónica, S.A. which, within the maximum amount established, shall be delivered to the Participants at the end of each cycle shall be conditional on, and determined according to, the total shareholder return (hereinafter, as defined below, the **TSR**) on the share of Telefónica, S.A. (from the Reference Value), during the period of duration of each cycle, in relation to the TSRs experienced by the companies comprising the Dow Jones Global Sector Titans Telecommunications Index which for the purposes of the Plan shall constitute the comparison group (the **Comparison Group**).

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The TSR shall be the metric for determining the generation of value at the Telefónica Group in the medium and long term, as it measures the return on investment for the shareholder, defined, for the purposes of the Plan and for each cycle, as the sum of the performance of the share of Telefónica, S.A. plus the dividends or other similar items received by the shareholder during the duration of the cycle in question.

For each cycle of the Plan, the companies comprising the aforementioned index as of July 1 of the first year of such cycle shall be taken into account, excluding those belonging to the Telefónica Group, with such companies being maintained without any variation for the entire duration of each cycle.

If the aforementioned index ceases to be published during the term of the Plan or suffers material modifications in its composition, the Board of Directors of Telefónica, S.A. shall proceed at all times to adopt the appropriate measures to continue with the preparation and establishment of the appropriate index, for the sole purposes of the Plan, on a basis that is uniform and equivalent to that constituting the essence of the Plan.

At the start of the relevant cycle, each Participant shall be allocated a theoretical number of shares. The Plan shall stipulate that the number of shares to be delivered will vary between 30% of the theoretical number of shares, where the TSR on the share of Telefónica, S.A. is, at least, the median of the Comparison Group, and 100% in the event that such performance is in the third quartile or above of the Comparison Group, such percentage being calculated by linear interpolation where it falls between the median and the third quartile. In addition, the Plan may envisage for some or all Participants that where the TSR on the share of Telefónica, S.A. exceeds the third quartile, the percentage of the delivery shall be higher than 100%, up to a maximum of 125% if the aforementioned TSR is in the ninth decile or above, such percentage being calculated by linear interpolation between the third and ninth decile.

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The Plan may also envisage an additional condition that all or some of the Participants meet an objective of investment in, and holding of, Telefónica, S.A. shares (hereinafter, the **Co-Investment**), which shall be established for each one of the Participants to which applies, by the Board of Directors, following a report by the Nominating, Compensation and Corporate Governance Committee.

Moreover, notwithstanding any other conditions and requirements that may be established, in order for each one of the Participants to be entitled to receive the relevant shares, they must continue to be employees of the Telefónica Group on the delivery date of each cycle, notwithstanding any exceptions considered appropriate.

- 6.- Date of delivery of the shares: The shares shall be delivered at the end of each cycle, that is, in 2014, 2015 and 2016, respectively, with the specific delivery date being determined by the Board of Directors or the person or body to which this power is delegated.
- 7.- Telefónica Group: For the purposes of the provisions of the Plan, the Telefónica Group shall mean the group of companies whose parent company is Telefónica, S.A. within the meaning of Article 42 of the Commercial Code.
- 8.- Origin of the shares to be delivered: The shares to be delivered to the Participants may be, subject to the fulfillment of the legal requirements established for such purpose, (a) treasury shares of Telefónica, S.A. that have been acquired or are acquired by Telefónica, S.A. itself or any company in its group; or (b) newly issued shares.

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To grant authority to the Board of Directors, on the broadest terms, authority which may be delegated by the Board to the Executive Commission, the Nominating, Compensation and Corporate Governance Committee, the Executive Chairman of the Board of Directors, the Chief Operating Officer, or any other person expressly authorized by the Board for such purpose, for the execution of this resolution and for the implementation, when and how it sees fit, development, formalization, execution and settlement of the Plan, adopting such resolutions and signing such public or private documents as may be necessary or advisable to give full effect thereto, with authority to remedy, rectify, modify or supplement this resolution. And, in general, to adopt such resolutions and take such steps as may be necessary or merely advisable for the successful outcome of this resolution and of the implementation, execution and settlement of the Plan, including, merely for illustration purposes, and subject to the terms and conditions envisaged in this resolution, the following authority:

- (a) To implement and execute the Plan when it considers it advisable and in the specific manner that it considers appropriate.
- (b) To develop and establish the specific conditions of the Plan in all matters not provided for in this resolution, with the authority to approve and publish operating rules for the Plan, including, by way of example and without limitation, the terms and conditions of the Co-Investment agreements with the Participants and the possibility of establishing cases of early settlement of the Plan.
- (c) If the legal regime applicable to some of the Participants or to certain companies of the Telefónica Group so requires or advises or it were necessary for legal, regulatory, operational or other similar reasons, to adopt the basic conditions indicated, on a general or a specific basis, including, by way of example and without limitation, adapting the mechanisms for delivering the shares, without altering the maximum number of shares linked to the Plan and providing for and executing the total or partial settlement of the Plan in cash.

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- (d) To decide not to execute or to render fully or partially void the Plan or any of its cycles, as well as to exclude certain groups of potential Participants or companies of the Telefónica Group where the circumstances so advise.
- (e) To draft, sign and submit such notices and supplementary documentation as may be necessary or advisable to any public or private body for the purposes of the implementation, execution or settlement of the Plan, including, where necessary, the appropriate prior notices and prospectuses.
- (f) To carry out any step, declaration or formality in dealings with any body or entity or public or private registry, to obtain any authorization or clearance necessary to implement, execute or settle the Plan and the delivery free of charge of the shares of Telefónica, S.A.
- (g) To negotiate, agree and sign all such agreements of any kind with the financial or other entities it freely designates, on the terms and conditions it deems fit, as may be necessary or advisable for the proper implementation, execution or settlement of the Plan, including, where necessary or advisable due to the legal regime applicable to certain Participants or to certain companies of the Telefónica Group or if it were necessary or advisable for legal, regulatory, operational or other similar reasons, the establishment of any legal mechanism (including trusts or other similar mechanisms) or the securing of agreements with any type of entity for the deposit, safekeeping, holding and/or administration of the shares and/or their subsequent delivery to the Participants within the context of the Plan.
- (h) To draft and publish such notices as may be necessary or advisable.

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- (i) To draft, sign, execute and, if appropriate, certify, any type of document relating to the Plan.
- (j) To adapt the contents of the Plan to the corporate transactions and circumstances that may arise during its term, relating to both Telefónica, S.A. and the companies forming part of the reference group from time to time, on the terms and conditions deemed necessary or appropriate from time to time to maintain the purpose of the Plan.
- (k) And, in general, to take such steps, adopt such decisions and execute such documents as may be necessary or merely advisable for the validity, effectiveness, implementation, development, execution, settlement and successful outcome of the Plan and of the resolutions adopted above.

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Proposal relating to Item IX on the agenda: Restricted Share Plan of Telefónica, S.A. Approval of a long-term incentive restricted Plan consisting of the delivery of shares of Telefónica, S.A. aimed at Employees and Executive Personnel and linked to their continued employment in the Telefónica Group.

To approve a restricted Plan based on shares of Telefónica, S.A. as long-term incentive aimed at Employees and Executive Personnel of the Telefónica Group (hereinafter, the **Plan**), in accordance with the following basic terms and conditions:

1. **Description of the Plan:** The Plan consists of delivering to the participants chosen for such purpose, subject to fulfillment of the necessary requirements established therein, of a certain number of shares of Telefónica, S.A. in respect of variable compensation and linked to their continued employment in the Telefónica Group.
2. **Participants of the Plan:** The Plan shall be aimed at Employees and Executive Personnel of the Telefónica Group (excluding the Executive Directors and members of the Executive Committee of Telefónica S.A.) who meet, from time to time, the suitability requirements which, for such purpose, are established by the Board of Directors de Telefónica, S.A., and who are expressly invited to participate in the Plan (the **Participants**). In addition, the status of Participant of the Plan may be acquired by employees of companies that join the Telefónica Group in the future, and who come to meet the aforementioned requirements.
3. **Duration of the Plan:** The Telefónica Group may make initial allocations of shares under this Plan until December 31, 2015.
4. **Maximum amount allocated to the Plan:** The total maximum amount allocated to the Plan is set at the amount of 50,000,000.
5. **Requirements and conditions for the delivery of shares:** The effective delivery of the shares that apply to each Participant at the end of the Plan, notwithstanding any other conditions and requirements that may be established, shall be conditional on the continuation of the Participant as an employee of the Telefónica Group on the delivery date.

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The delivery of the shares may be conditional on a minimum continued employment of one year and a maximum of five years at the Telefónica Group.

6. **Telefónica Group**: For the purposes of this Plan, the Telefónica Group shall mean the companies comprising such group, in accordance with the provisions of Article 4 of Securities Market Law 24/1988, of July 28, 1988.
7. **Origin of the shares**: The shares of Telefónica, S.A. to be delivered to the Participants may be (a) treasury shares of Telefónica, S.A., which have been acquired or are acquired, both by Telefónica, S.A. itself and by any companies in its Group, subject to fulfillment of the legal requirements established for the purpose; or (b) newly issued shares, originating from capital increases carried out for such purpose from time to time.

To grant authority to the Board of Directors, on the broadest terms, authority which may be delegated by the Board to the Executive Commission, the Nominating, Compensation and Corporate Governance Committee, the Executive Chairman of the Board of Directors, the Chief Operating Officer, or any other person expressly authorized by the Board for such purpose, for the execution of this resolution and for the implementation, when and how it sees fit, development, formalization, execution and settlement of the Plan, adopting such resolutions and signing such public or private documents as may be necessary or advisable to give full effect thereto, with authority to remedy, rectify, modify or supplement this resolution. And, in general, to adopt such resolutions and take such steps as may be necessary or merely advisable for the successful outcome of this resolution and of the implementation, execution and settlement of the Plan, including, merely for illustration purposes, and subject to the terms and conditions envisaged in this resolution, the following authority:

- (a) To implement and execute the Plan when it considers it advisable and in the specific manner that it considers appropriate.

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- (b) To develop and establish the specific conditions of the Plan in all matters not provided for in this resolution, including, by way of example and without limitation, the possibility of establishing cases of early settlement of the Plan.
- (c) If the legal regime applicable to some of the Participants or to certain companies of the Telefónica Group so requires or advises or it were necessary for legal, regulatory, operational or other similar reasons, to adopt the basic conditions indicated, on a general or a specific basis, including, by way of example and without limitation, adapting the mechanisms for delivering the shares, without altering the maximum number of shares linked to the Plan and providing for and executing the total or partial settlement of the Plan in cash.
- (d) To decide not to execute or to render void the Plan, at any time prior to the date of commencement of same, as well as to exclude certain groups of potential participants or companies of the Telefónica Group where the circumstances so advise.
- (e) To draft, sign and submit such notices and supplementary documentation as may be necessary or advisable to any public or private body for the purposes of the implementation, execution or settlement of the Plan, including, where necessary, the appropriate prior notices and prospectuses.
- (f) To carry out any step, declaration or formality in dealings with any body or entity or public or private registry, to obtain any authorization or clearance necessary to implement, execute or settle the Plan and the delivery of the shares of Telefónica, S.A.

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- (g) To negotiate, agree and sign all such agreements of any kind with the financial or other entities it freely designates, on the terms and conditions it deems fit, as may be necessary or advisable for the proper implementation, execution or settlement of the Plan, including, where necessary or advisable due to the legal regime applicable to certain participants or to certain companies of the Telefónica Group.
- (h) To draft and publish such notices as may be necessary or advisable.
- (i) To draft, sign, execute and, if appropriate, certify, any type of document relating to the Plan.
- (j) And, in general, to take such steps, adopt such decisions and execute such documents as may be necessary or merely advisable for the validity, effectiveness, implementation, development, execution, settlement and successful outcome of the Plan and of the resolutions adopted above.

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Telefónica, S.A.

Proposal relating to Item X on the Agenda: Global incentive share purchase Plan of Telefónica, S.A. Approval of an incentive share purchase Global Plan for the Employees of the Telefónica Group.

To approve an incentive share purchase Global Plan (hereinafter, the Plan), aimed at Employees, including Executive Personnel, as well as Executive Directors of the Telefónica Group, in accordance with the following basic terms and conditions:

1. **Description of the Plan:** For the purposes of aligning the interests of the employees of the Telefónica Group with those of its shareholders, the Plan is aimed at offering to Employees, including Executive Personnel, and to Executive Directors of the Telefónica Group the possibility of acquiring shares of Telefónica, S.A. with the commitment from the latter to deliver free of charge to the recipients who sign up for the Plan a certain number of additional shares in Telefónica, S.A., provided that certain requirements are met.
2. **Recipients of the Plan:** The recipients of the Plan shall be the Employees (including the Senior Managers and other Executive Personnel) and the Executive Directors of the Telefónica Group who fulfill, from time to time, the seniority and other suitability requirements established for such purpose by Telefónica, S.A. to sign up for the Plan. The recipients who sign up for the Plan by fulfilling the formalities and requirements established from time to time for such purpose shall be referred to hereinafter as the **Participants** .
3. **Term of the Plan:** The Plan shall be for a minimum term of two years and a maximum of four years as from its implementation, an implementation which must be take place within a maximum period of eighteen months from the date of this resolution.
The Plan will have a period for acquiring the shares (the **Purchase Period**) with a term of one year and a period for holding the shares (the **Holding Period**) with a term of, at least, one year from the end of the Purchase Period.

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4. **Acquisition procedure:** The Participants will have the possibility of acquiring the shares of Telefónica, S.A. at their market value through an investment agreement (the **Investment Agreement**) whereby the Participants will determine the part of their remuneration that they wish to allocate for such purpose during the Purchase Period. The specific amount that may be allocated to the acquisition of shares of Telefónica, S.A. (the **Acquired Shares**) by each Participant will be determined by the Board of Directors once the total amount that the Participants as a whole wish to allocate to the acquisition of shares is known. In no case may the amount exceed 1,500 per Participant, and the Board of Directors may determine a lower amount.
5. **Free-of-charge delivery of additional shares:** The Participants will be entitled to the delivery free of charge of additional shares of Telefónica, S.A. (the **Additional Shares**) at the end of the Holding Period according to the number of shares acquired under the Plan and provided that the Acquired Shares are held to the end of such period. If all or part of the Acquired Shares are sold before the end of the Holding Period, the Participant will forfeit the right to the free-of-charge delivery of the Additional Shares corresponding to the Acquired Shares sold. In addition, the Board of Directors may resolve to recognize to the Participants the right to receive the amount of the economic rights derived from the Additional Shares, or an equivalent remuneration, as from the purchase of the Acquired Shares.
The Board of Directors will determine, at the beginning of the Purchase Period, the proportion of Additional Shares to be delivered at the end of the Holding Period for each one of the Acquired Shares. However, as a maximum, a Participant will receive one Additional Share for each Acquired Share.

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Telefónica, S.A.

For the Additional Shares to be delivered free of charge, the following requirements in particular must be met: (i) the Participant must remain in the Telefónica Group through to the end of the Holding Period, and (ii) the corresponding Acquired Shares must be held to the end of the Holding Period. The Board of Directors may establish such additional conditions or exceptions to same as it sees fit.

6. Maximum number of Additional Shares to be delivered free of charge: The maximum number of Additional Shares to be delivered free of charge to the Participants under the Plan will be the result of dividing the amount allocated to the Plan by the price at which the shares acquired pursuant to the various Investment Agreements during the Holding Period have been purchased.

The amount allocated to the Plan will be determined by the Board of Directors, following a report from the Nominating, Compensation and Corporate Governance Committee, and will not exceed the amount of 65,000,000.

In any event, the total amount of Additional Shares for the entire Plan may never exceed 0.2% of the capital stock of Telefónica, S.A. on the date of approval of this resolution.

Of the total amount of Additional Shares under the Plan, the maximum number to be delivered to the executive Directors of Telefónica, S.A. will be 1,000 shares of Telefónica, S.A. with a par value of one euro.

7. Origin of the Additional Shares to be delivered free of charge: The Additional Shares to be delivered free of charge to the Participants may be, subject to the fulfillment of the legal requirements established for such purpose, (a) shares of Telefónica, S.A. held as treasury stock that have been acquired or that Telefónica, S.A. itself or any company in its group has acquired; or (b) newly issued shares.

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Telefónica, S.A.

To grant authority to the Board of Directors, on the broadest terms, authority which may be delegated by the Board to the Executive Commission, the Nominating, Compensation and Corporate Governance Committee, the Executive Chairman of the Board of Directors, the Chief Operating Officer, or any other person expressly authorized by the Board for such purpose, for the execution of this resolution and for the implementation, when and how it sees fit, development, formalization, execution and settlement of the Plan, adopting such resolutions and signing such public or private documents as may be necessary or advisable to give full effect thereto, with authority to remedy, rectify, modify or supplement this resolution. And, in general, to adopt such resolutions and take such steps as may be necessary or merely advisable for the successful outcome of this resolution and of the implementation, execution and settlement of the Plan, including, merely for illustration purposes, and subject to the terms and conditions envisaged in this resolution, the following authority:

- (a) To implement and execute the Plan when it considers it advisable and in the specific manner that it considers appropriate.
- (b) To develop and establish the specific conditions of the Plan in all matters not provided for in this resolution, including, by way of example and without limitation, the terms and conditions of the Investment Agreements, the possibility of establishing cases of early settlement of the Plan as well as establishing, inter alia, the dates of acquisition of the shares during the Purchase Period, the term of the Holding Period and the date of delivery of the Additional Shares.

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Telefónica, S.A.

- (c) If the legal regime applicable to some of the Participants or to certain companies of the Telefónica Group so requires or advises or it were necessary for legal, regulatory, operational or other similar reasons, to adopt the basic conditions indicated, on a general or a specific basis, including, by way of example and without limitation, adapting the mechanisms for delivering the shares, without altering the maximum number of shares linked to the Plan, providing for and executing the total or partial settlement of the Plan in cash, without the physical delivery of shares, establishing different durations of the Holding Period for different categories of Participants, adapting the period for delivering the Additional Shares as well as establishing the procedure for paying the remuneration equivalent to the economic rights of the Additional Shares.
- (d) To decide not to execute or to render void the Plan, at any time prior to the date of commencement of the Purchase Period, as well as to exclude certain groups of potential Participants or companies of the Telefónica Group where the circumstances so advise.
- (e) To draft, sign and submit such notices and supplementary documentation as may be necessary or advisable to any public or private body for the purposes of the implementation, execution or settlement of the Plan, including, where necessary, the appropriate prior notices and prospectuses.
- (f) To carry out any step, declaration or formality in dealings with any body or entity or public or private registry, to obtain any authorization or clearance necessary to implement, execute or settle the Plan and the delivery free of charge of the shares of Telefónica, S.A.

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Telefónica, S.A.

- (g) To negotiate, agree and sign all such agreements of any kind with the financial or other entities it freely designates, on the terms and conditions it deems fit, as may be necessary or advisable for the proper implementation, execution or settlement of the Plan, including, where necessary or advisable due to the legal regime applicable to certain Participants or to certain companies of the Telefónica Group or if it were necessary or advisable for legal, regulatory, operational or other similar reasons, the establishment of any legal mechanism (including trusts or other similar mechanisms) or the securing of agreements with any type of entity for the deposit, safekeeping, holding and/or administration of the Additional Shares and/or their subsequent delivery to the Participants within the context of the Plan.
- (h) To draft and publish such notices as may be necessary or advisable.
- (i) To draft, sign, execute and, if appropriate, certify, any type of document relating to the Plan.
- (j) And, in general, to take such steps, adopt such decisions and execute such documents as may be necessary or merely advisable for the validity, effectiveness, implementation, development, execution, settlement and successful outcome of the Plan and of the resolutions adopted above.

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Telefónica, S.A.

Proposal regarding Item XI on the Agenda: Delegation of powers to formalize, interpret, correct and implement the resolutions adopted by the shareholders at the General Shareholders Meeting.

To authorize the Executive Chairman of the Board of Directors, the Chief Operating Officer, the Secretary of the Board of Directors and the Assistant Secretary of the Board of Directors, jointly and severally, without prejudice to any powers delegated in the foregoing resolutions and to any powers granted to convert resolutions into a public instrument, in order for any of them to formalize and implement the preceding resolutions, with authority to execute all such public or private documents as may be necessary or appropriate (including documents designed to interpret, clarify, further develop, supplement, correct errors and cure defects) for their more accurate implementation and for registration thereof, to the extent mandatory, with the Commercial Registry or any other Public Registry, as well as to deposit the financial statements of the company.

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Telefónica, S.A.

REPORT OF THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A. RELATING TO THE PROPOSAL FOR AMENDMENT OF ARTICLES 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 BIS AND 36 OF THE BY-LAWS AND ADDITION OF A NEW PARAGRAPH 5 TO ARTICLE 16 AND OF A NEW ARTICLE 26 BIS TO THE BY-LAWS, WHICH REPORT SHALL BE SUBMITTED FOR APPROVAL OF THE SHAREHOLDERS AT THE 2011 ORDINARY GENERAL SHAREHOLDERS MEETING (ITEM III OF THE AGENDA).

1. PURPOSE OF THE REPORT

The Agenda for the Ordinary General Shareholders Meeting of Telefónica, S.A., called to be held on May 17/18, 2011, on first and second call, respectively, includes in item III a proposal relating to the amendment of Articles 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 *bis* and 36 of the By-Laws and the addition of a new paragraph 5 to Article 16 and a new Article 26 *bis* to the By-Laws.

In this regard, Section 286 of the restated text of the Companies Act (*Ley de Sociedades de Capital*) requires preparation of a written report by the Directors, setting forth the rationale for the proposed amendments to the By-Laws, for which purpose the Board of Directors of Telefónica, S.A. issues this Report, which also includes the full text of such amendments.

2. RATIONALE FOR THE PROPOSAL

The purpose of the majority of the By-Law amendments proposed to the shareholders at the Ordinary General Shareholders Meeting of Telefónica, S.A. is conforming the Company's By-Laws to the latest legislative developments relating to stock companies and listed corporations, in particular: (i) Law 12/2010, of June 30, which amends Law 19/1988, of July 12, on Financial Statements Auditing, Law 24/1988, of July 28, on the Securities Market, and the restated text of the Companies Act (*Ley de Sociedades Anónimas*) approved by Royal Legislative Decree 1564/1989, of December 22, for conformance to European Community law (**Law 12/2010**); (ii) the restated text of the Companies Act (*Ley de Sociedades de Capital*) (the **Companies Act**) approved by Royal Legislative Decree 1/2010, of July 2; and (iii) Royal Decree-law 13/2010, of December 3, regarding tax, labor and liberalizing actions for the promotion of investment and job creation (**RDL 13/2010**).

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This amendment of the By-Laws is also supplemented by the amendment of the Regulations for the General Shareholders Meeting of Telefónica, S.A., which is proposed under item IV of the Agenda.

Finally, two additional amendments to the By-Laws are proposed (addition of a new paragraph 5 to Article 16 and addition of a new Article 26 *bis*) which do not entail a mere adjustment to the law but the introduction of improvements into the By-Laws.

For the purpose of voting, and without prejudice to the provision of an individual rationale for each of the amendments proposed, such amendments have been grouped into three blocks: those amendments relating to mere adaptations to legislative developments, the addition of a new paragraph 5 to Article 16 and the addition of a new Article 26 *bis*.

Each of the amendments to the By-Laws proposed to the shareholders at the General Shareholders Meeting is set forth and explained below.

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Proposal for amendment of Article 1 of the By-Laws:

It is proposed to amend Article 1 of the By-Laws to replace the reference to the *Ley de Sociedades Anónimas* by a reference to the *Ley de Sociedades de Capital*.

Current text

Article 1. Corporate name

The Company is named Telefónica, S.A. and shall be governed by these By-Laws and, as to matters not otherwise contemplated or provided for herein, by the Companies Act [Ley de Sociedades Anónimas] and other legal provisions applicable thereto.

New proposed text

Article 1. Corporate name

The Company is named Telefónica, S.A. and shall be governed by these By-Laws and, as to matters not otherwise contemplated or provided for herein, by the Companies Act [Ley de Sociedades ~~Anónimas~~ de Capital] and other legal provisions applicable thereto.

Proposal for amendment of Article 6.2 of the By-Laws:

It is proposed to amend paragraph 2 of Article 6 of the By-Laws to replace the reference to the *Ley de Sociedades Anónimas* by a reference to the *Ley de Sociedades de Capital*.

Current text

2. Modifications to features of shares represented in book-entry form, once formalized in accordance with the provisions of the Companies Act and the Securities Market Act [Ley del Mercado de Valores], shall be published in the Official Bulletin of the Commercial Registry [Boletín Oficial del Registro Mercantil] and in one of the newspapers of wider circulation in Madrid.

New proposed text

2. Modifications to features of shares represented in book-entry form, once formalized in accordance with the provisions of the Companies Act [Ley de Sociedades ~~Anónimas~~ de Capital] and the Securities Market Act [Ley del Mercado de Valores], shall be published in the Official Bulletin of the Commercial Registry [Boletín Oficial del Registro Mercantil] and in one of the newspapers of wider circulation in Madrid.

Proposal for amendment of Article 7 of the By-Laws:

It is proposed to amend Article 7 of the By-Laws to conform to the new terminology of the Companies Act, which substitutes the phrase *dividendos pasivos* (capital calls) with *desembolsos pendientes* (pending disbursements).

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Current text

New proposed text

Article 7. Capital Calls

Article 7. ~~Capital Calls~~ Pending disbursements

1. Capital calls shall be paid within the period that is established, within legal limits, by the Board of Directors.

1. ~~Capital Calls~~ pending disbursements shall be paid within the period that is established, within legal limits, by the Board of Directors.

2. In the case of arrears in the payment of capital calls, the delinquent shareholder shall be subject to the effects provided for under Law. In the event of a transfer of shares that have not been fully paid up, the transferee of any such shares and all prior transferors shall be jointly and severally liable.

2. In the case of arrears in the payment of ~~capital calls~~ pending disbursements, the delinquent shareholder shall be subject to the effects provided for under Law. In the event of a transfer of shares that have not been fully paid up, the transferee of any such shares and all prior transferors shall be jointly and severally liable.

Proposal for amendment of Article 14 of the By-Laws:

It is proposed to amend Article 14 of the By-Laws to adjust, to the extent possible, the enumeration of powers of the shareholders at the General Shareholders Meeting to the text of Section 160 of the Companies Act.

Current text

New proposed text

Article 14. Powers of the Shareholders Acting at a General Shareholders Meeting

Article 14. Powers of the Shareholders Acting at a General Shareholders Meeting

The shareholders acting at a General Shareholders Meeting shall decide on the matters assigned thereto by Law or these By-Laws and, in particular, regarding the following:

The shareholders acting at a General Shareholders Meeting shall decide on the matters assigned thereto by Law or these By-Laws and, in particular, regarding the following:

1°) Appointment and removal of Directors.

1) Appointment and removal of Directors.

2°) Appointment of Auditors.

2) Appointment and removal of Auditors and liquidators.

3°) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decisions regarding the allocation of profits/losses.

3) Commencement of claims for liability against Directors, liquidators or Auditors.

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Current text

- 4°) Increase and reduction of share capital.
- 5°) Issuance of Debentures.
- 6°) Amendment of the By-Laws.
- 7°) Dissolution, merger, split-off and transformation of the Company.
- 8°) The transformation of the Company into a holding company, through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.
- 9°) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.
- 10°) Transactions the effect of which is tantamount to liquidating the Company.
- 11°) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.

New proposed text

- 4) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decisions regarding the allocation of profits/losses.
- 45) Increase and reduction of share capital.
- 56) Issuance of debentures.
- 67) Amendment of the By-Laws.
- 78) Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.
- 9) The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.
- 810) The transformation of the Company into a holding company, through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.
- 911) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.
- 1012) Transactions the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.
- 1113) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.

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Proposal for amendment of Article 16.1 of the By-Laws and for addition of a new paragraph 5 to Article 16 of the By-Laws:

It is proposed to amend paragraph 1 of Article 16 of the By-Laws to adjust it to the text of Section 137 of the Companies Act as amended by paragraph 2 of Section 6 of RDL 13/2010.

Current text

New proposed text

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and in one of the newspapers of wider circulation in the province where the Company's registered office is located, as much in advance of the date set for the Meeting as is at a minimum required by Law.

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and ~~in one of the newspapers of wider circulation in the province where the Company's registered office is located~~ on the Company's website (www.telefonica.com), as much in advance of the date set for the Meeting as is at a minimum required by Law. The notice published on the Company's website shall be accessible at least until the date of the Meeting. Furthermore, the Board of Directors may publish notices in other media, if it deems it appropriate in order to give broader publicity to the call to meeting.

Furthermore, it is proposed to include a new paragraph 5 in Article 16 of the By-Laws in order to allow for the possibility that the General Shareholders Meeting is held outside of the city where the registered address is located (which may be any other location within Spain) if so determined by the Board of Directors, pursuant to Section 175 of the Companies Act.

Current text

New proposed text

5. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

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Proposal for amendment of Article 17.4 of the By-Laws:

It is proposed to amend paragraph 4 of Article 17 to replace the references to sections of the *Ley de Sociedades Anónimas* by the corresponding provisions of the *Ley de Sociedades de Capital*.

Current text

4. Proxy representation must be granted in writing (in paper or electronic form) and specifically for each Meeting.

A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

Without prejudice to the provisions of Section 108 of the Companies Act, a proxy must be granted pursuant to the provisions of Section 106.2 of such Act.

New proposed text

4. Proxy representation must be granted in writing (in paper or electronic form) and specifically for each Meeting.

A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

Without prejudice to the provisions of Section ~~108~~187 of the Companies Act, a proxy must be granted pursuant to the provisions of Section ~~106.2~~184.2 of such Act.

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Proposal for amendment of Article 18.4 of the By-Laws:

It is proposed to amend paragraph 4 of Article 18 of the By-Laws to align it with the new text setting forth the powers of the shareholders at the General Shareholders Meeting proposed for Article 14 of the By-Laws, which expressly includes among the powers of the shareholders at the General Shareholders Meeting the overall assignment of assets and liabilities and the relocation of the registered address abroad.

Current text

4. In cases of increase or reduction in share capital, issuance of convertible debentures, merger or split-off of the Company, the information required by Law in connection with such cases shall be made available.

New proposed text

4. In cases of increase or reduction in share capital, issuance of convertible debentures, merger ~~or~~, split-off, overall assignment of assets and liabilities and relocation of the Company's registered address abroad, the information required by Law in connection with such cases shall be made available.

Proposal for addition of a new Article 26 bis to the By-Laws:

It is proposed to add a new Article 26 bis to the By-Laws in order to include the rules governing specific and permanent conflicts of interest affecting Directors that are contained in Sections 229 and 230 of the Companies Act, while providing that the authorization of the shareholders at the General Shareholders Meeting set forth in Section 230.1 of such Act shall only be required in the event of conduct of activities that entail effective competition with the Company. The purpose of such addition is to have the By-Laws reflect in this regard the logical and purpose-oriented interpretation of Sections 229.2 and 230.1 of the Companies Act which is widespread in practice. Thus, the purpose of these provisions which is to avoid and control permanent conflicts of interests that might arise from situations where a Director may be deemed to be in competition with the company shall be included at the highest level of the internal regulations of Telefónica, S.A.

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Current text

New proposed text

Article 26 bis. Director conflict of interest

1.- The Directors shall notify the Board of Directors of any situation of direct or indirect conflict with the interest of the Company that may affect them. The Director involved shall abstain from voting on resolutions or decisions relating to the transaction affected by the conflict.

Directors shall also provide notice, both regarding themselves and persons related thereto, of (a) direct or indirect interests held by them, and (b) positions they hold or duties they perform at any company effectively in competition with the Company.

The conflict of interest situations set forth in the preceding paragraphs shall be included in the annual report.

2.- Directors may not carry out, on their own behalf or on behalf of others, activities that may entail effective competition with the Company, except with the express authorization of the Company by means of a resolution of the shareholders at a General Shareholders Meeting, for which purpose they shall provide the notice set forth in paragraph 1 of this article.

For the purposes of this paragraph and the previous one, the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled by the Company (within the meaning of Article 42 of the Commercial Code) and (ii) companies with which Telefónica, S.A. maintains a strategic alliance. Neither shall proprietary Directors of competitor companies appointed at the request of the Company or as a result of the equity

interest held by the Company in such competitor companies be deemed to be in breach of the prohibition on competition.

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Proposal for amendment of Article 31 bis of the By-Laws:

It is proposed to amend Article 31 *bis* of the By-Laws to adjust the powers of the Audit and Control Committee pursuant to the new text of additional provision eighteen of the Securities Market Act, as amended by Law 12/2010.

Current text

Article 31 bis. Audit and Control Committee

1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of a minimum of three Directors and a maximum of five, to be appointed by the Board of Directors. All of the members of such Committee shall be external Directors

2. The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.

New proposed text

Article 31 bis. Audit and Control Committee

1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of a minimum of three Directors and a maximum of five, to be appointed by the Board of Directors. All of the members of such Committee shall be external or non-executive Directors. At least one of them shall be an independent Director, who shall be appointed taking into account his knowledge and experience in accounting, auditing or both.

2. The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.

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Current text

New proposed text

3. The Audit and Control Committee shall have the following powers, at a minimum:

(i) to report, through its Chairman, to the shareholders at the General Shareholders Meeting regarding matters raised therein by the shareholders in connection with the matters for which the Committee is responsible;

(ii) to propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor referred to in Section 204 of the Companies Act, as well as, if appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment;

(iii) to monitor the internal audit services;

(iv) to know the process for gathering financial information and the internal control systems;

(v) To maintain relations with the Auditor in order to receive information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and to receive information from and maintain the communications with the Auditor provided for in auditing legislation and in technical auditing regulations; and

(vi) any other powers granted under the Regulations of the Board of Directors.

3. The Audit and Control Committee shall have the following powers, at a minimum:

(i) ~~to report~~To report, through its Chairman, to the shareholders at the General Shareholders Meeting regarding matters raised therein by the shareholders in connection with the matters for which the Committee is responsible;

(ii) ~~to propose~~To propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor referred to in Section 204~~264~~ of the Companies Act [Ley de Sociedades Anónimas de Capital], as well as, if appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment;..

(iii) ~~to monitor the internal audit services;~~To supervise the effectiveness of the Company's internal control system, the internal audit and the risk management systems as well as to discuss with the Auditor the significant weaknesses in the internal control system detected during the audit.

(iv) ~~to monitor~~To supervise the process of preparation and submission of regulated financial information ~~and the internal control systems;~~

(v) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and ~~to receive information from and maintain the~~ such other communications as may be provided for in auditing legislation and in technical auditing regulations; ~~and~~.

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Current text

New proposed text

In any event, the Audit and Control Committee must receive annually written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor, or by the persons or entities related thereto, pursuant to Law 19/1988, of July 12, on Auditing of Financial Statements.

(vi) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in paragraph V above.

(vii) ~~(vi) any~~ Any other powers granted under the Regulations of the Board of Directors.

Proposal for amendment of Article 36 of the By-Laws:

It is proposed to amend Article 36 of the By-Laws to replace the reference to the *Ley de Sociedades Anónimas* by a reference to the *Ley de Sociedades de Capital*.

Current text

New proposed text

Article 36. Grounds for Dissolution

Article 36. Grounds for Dissolution

The Company shall be dissolved upon any of the grounds set forth in Section 260 of the Companies Act.

*The Company shall be dissolved upon any of the grounds set forth in ~~Section 260~~ of the Companies Act [*Ley de Sociedades Anónimas* de Capital].*

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

The resolutions that the Board of Directors submits for approval of the shareholders at the General Shareholders Meeting relating to this item on the Agenda are set forth below:

III.1 Amendment of Articles 1, 6.2, 7, 14, 16.1, 17.4, 18.4, 31 bis and 36 of the By-Laws for their adjustment to new legislative developments.

It is resolved to amend the aforementioned By-Law provisions, which shall henceforth read as follows:

New text of Article 1 of the By-Laws:

Article 1. Corporate name

The Company is named Telefónica, S.A. and shall be governed by these By-Laws and, as to matters not otherwise contemplated or provided for herein, by the Companies Act (Ley de Sociedades de Capital) and other legal provisions applicable thereto.

New text of paragraph 2 of Article 6 of the By-Laws:

2. Modifications to features of shares represented in book-entry form, once formalized in accordance with the provisions of the Companies Act (Ley de Sociedades de Capital) and the Securities Market Act (Ley del Mercado de Valores), shall be published in the Official Bulletin of the Commercial Registry (Boletín Oficial del Registro Mercantil) and in one of the newspapers of wider circulation in Madrid.

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New text of Article 7 of the By-Laws:

Article 7. Pending disbursements

- 1. Pending disbursements shall be paid within the period that is established, within legal limits, by the Board of Directors.*
- 2. In the case of arrears in the payment of pending disbursements, the delinquent shareholder shall be subject to the effects provided for under Law. In the event of a transfer of shares that have not been fully paid up, the transferee of any such shares and all prior transferors shall be jointly and severally liable.*

New text of Article 14 of the By-Laws:

Article 14. Powers of the Shareholders Acting at a General Shareholders Meeting

The shareholders acting at a General Shareholders Meeting shall decide on the matters assigned thereto by Law or these By-Laws and, in particular, regarding the following:

- 1) Appointment and removal of Directors.*
- 2) Appointment and removal of Auditors and liquidators.*
- 3) Commencement of claims for liability against Directors, liquidators or Auditors.*
- 4) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decisions regarding the allocation of profits/losses.*
- 5) Increase and reduction of share capital.*
- 6) Issuance of debentures.*

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7) *Amendment of the By-Laws.*

8) *Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.*

9) *The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.*

10) *The transformation of the Company into a holding company, through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.*

11) *The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.*

12) *Transactions the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.*

13) *Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.*

New text of paragraph 1 of Article 16 of the By-Laws:

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and on the Company's website (www.telefonica.com), as much in advance of the date set for the Meeting as is at a minimum required by Law. The notice published on the Company's website shall be accessible at least until the date of the Meeting. Furthermore, the Board of Directors may publish notices in other media, if it deems it appropriate in order to give broader publicity to the call to meeting.

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New text of paragraph 4 of Article 17 of the By-Laws:

4. Proxy representation must be granted in writing (in paper or electronic form) and specifically for each Meeting. A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

Without prejudice to the provisions of Section 187 of the Companies Act, a proxy must be granted pursuant to the provisions of Section 184.2 of such Act.

New text of paragraph 4 of Article 18 of the By-Laws:

4. In cases of increase or reduction in share capital, issuance of convertible debentures, merger, split-off, overall assignment of assets and liabilities and relocation of the Company's registered address abroad, the information required by Law in connection with such cases shall be made available.

New text of Article 31 bis of the By-Laws:

Article 31 bis. Audit and Control Committee

1. An Audit and Control Committee shall be created within the Board of Directors, which shall be composed of a minimum of three Directors and a maximum of five, to be appointed by the Board of Directors. All of the members of such Committee shall be external or non-executive Directors. At least one of them shall be an independent Director, who shall be appointed taking into account his knowledge and experience in accounting, auditing or both.

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2. *The Chairman of the Audit and Control Committee, which position shall be held by an independent Director in all cases, shall be appointed by the Committee itself from among its members and shall hold office for four years, and may be re-elected after the passage of one year from ceasing to act as such.*

3. *The Audit and Control Committee shall have the following powers, at a minimum:*

(i) To report, through its Chairman, to the shareholders at the General Shareholders Meeting regarding matters raised therein by the shareholders in connection with the matters for which the Committee is responsible.

(ii) To propose to the Board of Directors, for subsequent submission to the shareholders at the General Shareholders Meeting, the appointment of the Auditor referred to in Section 264 of the Companies Act, as well as, if appropriate, the terms and conditions for hiring such Auditor, the scope of its professional duties and the revocation of its appointment or its re-appointment.

(iii) To supervise the effectiveness of the Company's internal control system, the internal audit and the risk management systems as well as to discuss with the Auditor the significant weaknesses in the internal control system detected during the audit.

(iv) To supervise the process of preparation and submission of regulated financial information.

(v) To establish and maintain appropriate relations with the Auditor in order to receive, for review by the Committee, information on all matters that could jeopardize the independence thereof, as well as any other matters relating to the audit procedure, and such other communications as may be provided for in auditing legislation and in technical auditing regulations.

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In any event, the Audit and Control Committee must receive annually written confirmation from the Auditor of its independence vis-à-vis the entity or entities directly or indirectly related thereto, as well as information regarding additional services of any kind provided to such entities by the Auditor, or by the persons or entities related thereto pursuant to Law 19/1988, of July 12, on Auditing of Financial Statements.

(vi) To issue on an annual basis, prior to the issuance of the audit report, a report stating an opinion regarding the independence of the Auditor. This report must in all cases include an opinion on the provision of the additional services referred to in paragraph V above.

(vii) Any other powers granted under the Regulations of the Board of Directors.

New text of Article 36 of the By-Laws:

Article 36. Grounds for dissolution

The Company shall be dissolved upon any of the grounds set forth in the Companies Act.

III.2 Addition of a new paragraph 5 to Article 16 of the By-Laws.

It is resolved to add a new paragraph 5 to Article 16 of the By-Laws, with the following text:

5. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

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III.3 Addition of a new Article 26 bis to the By-Laws.

It is resolved to add a new Article 26 bis to the By-Laws, with the following text:

Article 26 bis. Director conflict of interest

1.- The Directors shall notify the Board of Directors of any situation of direct or indirect conflict with the interest of the Company that may affect them. The Director involved shall abstain from voting on resolutions or decisions relating to the transaction affected by the conflict.

Directors shall also provide notice, both regarding themselves and persons related thereto, of (a) direct or indirect interests held by them, and (b) positions they hold or duties they perform at any company effectively in competition with the Company.

The conflict of interest situations set forth in the preceding paragraphs shall be included in the annual report.

2.- Directors may not carry out, on their own behalf or on behalf of others, activities that may entail effective competition with the Company, except with the express authorization of the Company by means of a resolution of the shareholders at a General Shareholders Meeting, for which purpose they shall provide the notice set forth in paragraph 1 of this article.

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For the purposes of this paragraph and the previous one, the following shall not be deemed to be in a situation of effective competition with the Company, even if they have the same or a similar or complementary corporate purpose: (i) companies controlled by the Company (within the meaning of Article 42 of the Commercial Code) and (ii) companies with which Telefónica, S.A. maintains a strategic alliance. Neither shall proprietary Directors of competitor companies appointed at the request of the Company or as a result of the equity interest held by the Company in such competitor companies be deemed to be in breach of the prohibition on competition.

* * *

Madrid, April 8, 2011

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Telefónica, S.A.

REPORT OF THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A. RELATING TO THE PROPOSAL FOR AMENDMENT OF ARTICLES 5, 8.1, 11, 13.1 AND 14.1 OF THE REGULATIONS FOR THE GENERAL SHAREHOLDERS MEETING, WHICH REPORT SHALL BE SUBMITTED FOR APPROVAL OF THE SHAREHOLDERS AT THE 2011 ORDINARY GENERAL SHAREHOLDERS MEETING (ITEM IV OF THE AGENDA).

1. PURPOSE OF THE REPORT

The Agenda for the Ordinary General Shareholders Meeting of Telefónica, S.A., called to be held on May 17/18, 2011, on first and second call, respectively, includes in item IV a proposal relating to the amendment of Articles 5, 8.1, 11, 13.1 and 14.1 of the Regulations for the General Shareholders Meeting of the Company.

In this regard, the Board of Directors of Telefónica, S.A. issues this Report for the purpose of explaining the proposed amendments to the Regulations, also including the full text thereof.

2. RATIONALE FOR THE PROPOSAL

The purpose of the majority of the amendments proposed to the shareholders at the Ordinary General Shareholders Meeting of Telefónica, S.A. is conforming the Company's Regulations for the General Shareholders Meeting to the latest legislative developments relating to stock companies and listed corporations, in particular: (i) the restated text of the Companies Act (*Ley de Sociedades de Capital*) (the **Companies Act**) approved by Royal Legislative Decree 1/2010, of July 2; and (ii) Royal Decree-law 13/2010, of December 3, regarding tax, labor and liberalizing actions for the promotion of investment and job creation (**RDL 13/2010**), all consistently with the proposed amendments to the By-Laws under item III of the Agenda.

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Most of these amendments are based on the corresponding amendments to the By-Laws submitted to the shareholders at this General Shareholders Meeting under item III of the Agenda and, therefore, are also justified by the need to maintain due internal coherence within the corporate regulations and the corporate governance system of Telefónica, S.A.

For the purpose of voting, and without prejudice to the provision of an individual rationale for each of the amendments proposed, such amendments have been grouped into two blocks: those amendments relating to mere adaptations to legislative developments and the amendment of Article 14.1 of the Regulations for the General Shareholders Meeting, which does not entail a mere adjustment to the law but the introduction of improvements into the Regulations (due, in turn, to the inclusion of a new equivalent rule in the By-Laws, thus providing the necessary By-Law coverage).

Each of the amendments to the Regulations proposed to the shareholders at the General Shareholders Meeting is set forth and explained below.

Proposal for amendment of Article 5 of the Regulations for the General Shareholders Meeting:

It is proposed to amend Article 5 of the Regulations for the General Shareholders Meeting to adjust the enumeration of powers of the shareholders at the General Shareholders Meeting to the text of Section 160 of the Companies Law, in line with the proposed amendment to Article 14 of the By-Laws.

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Current text

Article 5. Powers of the shareholders at the General Shareholders Meeting

The shareholders acting at the General Shareholders Meeting shall have the power to deliberate upon and adopt resolutions on all such matters as legal provisions and the By-Laws reserve for decision thereat and, in general, on all matters which fall within the scope of powers assigned by Law to the shareholders and are submitted at the General Shareholders Meeting at the behest of the Board of Directors and of the shareholders themselves, in such instances and in such manner as are provided in the Law and the By-Laws. In particular, the shareholders shall decide the following matters:

- a) Appointment and removal of Directors.*
- b) Appointment of Auditors.*
- c) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decision regarding the allocation of profits/losses.*
- d) Increase or reduction of share capital.*
- e) Issuance of Debentures.*
- f) Amendment of the By-Laws.*
- g) Dissolution, merger, split-off and transformation of the Company.*
- h) The transformation of the Company into a holding company, through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.*
- i) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.*
- j) Transactions the effect of which is tantamount to liquidating the Company.*
- k) Any other matter that the Board of Directors resolves*

New proposed text

Article 5. Powers of the shareholders at the General Shareholders Meeting

The shareholders acting at the General Shareholders Meeting shall have the power to deliberate upon and adopt resolutions on all such matters as legal provisions and the By-Laws reserve for decision thereat and, in general, on all matters which fall within the scope of powers assigned by Law to the shareholders and are submitted at the General Shareholders Meeting at the behest of the Board of Directors and of the shareholders themselves, in such instances and in such manner as are provided in the Law and the By-Laws. In particular, the shareholders shall decide the following matters:

- a) Appointment and removal of Directors.*
- b) Appointment and removal of Auditors and liquidators.*
- c) Commencement of claims for liability against the Directors, liquidators or Auditors*
- d) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decision regarding the allocation of profits/losses.*
- ~~e~~) Increase or reduction of share capital.*
- ~~e~~f) Issuance of ~~d~~ebentures.*
- ~~f~~g) Amendment of the By-Laws.*
- ~~g~~h) Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.*
- i) The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.*
- ~~h~~j) The transformation of the Company into a holding company, through subsidiarization or by entrusting*

to submit to the shareholders at a General Shareholders Meeting.

subsidiaries with the conduct of core activities theretofore carried out by the Company itself.

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Current text

New proposed text

ik) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.

jl) Transactions the effect of which is tantamount to liquidating the Company, and, especially, the approval of the final balance sheet upon liquidation.

km) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.

Proposal for amendment of Article 8.1 of the Regulations for the General Shareholders Meeting:

It is proposed to amend paragraph 1 of Article 8 of the Regulations for the General Shareholders Meeting to conform it to the new text of Section 137 of the Companies Act as amended by paragraph 2 of Section 6 of RDL 13/2010, in line with the proposed amendment to Article 16.1 of the By-Laws.

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Proposal for amendment of Article 11 of the Regulations for the General Shareholders Meeting:

It is proposed to amend Article 11 of the Regulations for the General Shareholders Meeting to include the new provision relating to the Electronic Shareholders Forum contained in Section 528.2 of the Companies Act, for which purpose it is proposed to amend the title of the article and to add a new paragraph 2.

Current text

Article 11. Suggestions made by the shareholders

Without prejudice to the shareholders right, in such cases and under such terms as are provided in the Law, to have certain matters included in the Agenda for the Meeting that they request be called, the shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders Meeting and the powers of the shareholders thereat

New proposed text

Article 11. Electronic Shareholders Forum and suggestions made by the shareholders

1. Without prejudice to the shareholders right, in such cases and under such terms as are provided in the Law, to have certain matters included in the Agenda for the Meeting that they request be called, the shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders Meeting and the powers of the shareholders thereat.

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Current text

New proposed text

2. On occasion of the call to meeting and until each General Shareholders Meeting is held, the Company shall place into operation on its website (www.telefonica.com) an Electronic Shareholders Forum, which shall be accessible, with appropriate safeguards, by both individual shareholders and by any voluntary associations they may create as provided by law, in order to facilitate their communication prior to a General Shareholders Meeting being held. Proposed resolutions sought to be presented as a supplement to the agenda notified in the call to meeting may be published in the Forum, together with requests for adherence to such proposals, initiatives to reach the percentage sufficient to exercise a minority right provided by Law as well as proxy offers or solicitations. The Board of Directors may further develop the above-mentioned rules and establish the procedures, terms and other conditions for the operation of the Electronic Shareholders Forum.

Proposal for amendment of Article 13.1 of the Regulations for the General Shareholders Meeting:

It is proposed to amend paragraph 1 of Article 13 of the Regulations for the General Shareholders Meeting to replace the reference to the *Ley de Sociedades Anónimas* by a reference to the *Ley de Sociedades de Capital*.

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Current text

1. Every shareholder having the right to attend the General Shareholders Meeting may be represented thereat by another person, even if not a shareholder. The proxy must be granted specifically for each Meeting, either by using the proxy-granting form printed on the attendance card or in any other manner permitted by the Law, without prejudice to the provisions of Section 108 of the Companies Act (Ley de Sociedades Anónimas) regarding cases of proxies granted to family relatives and general proxies.

The documents setting forth the proxies or powers of attorney for the General Shareholders Meeting shall contain instructions regarding the direction of the vote. If no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda.

If there are no voting instructions because the shareholders acting at the General Shareholders Meeting are to decide matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the Meeting, the proxy-holder shall vote in such direction as he deems most appropriate, taking into account the interest of the Company and that of the shareholder granting the proxy. The same rule shall apply when the relevant proposal or proposals submitted to the shareholders at the Meeting have not been made by the Board of Directors.

New proposed text

1. Every shareholder having the right to attend the General Shareholders Meeting may be represented thereat by another person, even if not a shareholder. The proxy must be granted specifically for each Meeting, either by using the proxy-granting form printed on the attendance card or in any other manner permitted by the Law, without prejudice to the provisions of ~~Section 108 of~~ the Companies Act (Ley de Sociedades Anónimas de Capital) regarding cases of proxies granted to family relatives and general proxies.

The documents setting forth the proxies or powers of attorney for the General Shareholders Meeting shall contain instructions regarding the direction of the vote. If no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda.

If there are no voting instructions because the shareholders acting at the General Shareholders Meeting are to decide matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the Meeting, the proxy-holder shall vote in such direction as he deems most appropriate, taking into account the interest of the Company and that of the shareholder granting the proxy. The same rule shall apply when the relevant proposal or proposals submitted to the shareholders at the Meeting have not been made by the Board of Directors.

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Current text

If the document setting forth the proxy or power of attorney does not state the specific person or persons to whom the shareholder grants the proxy, such proxy shall be deemed granted in favor of any of the following: the Chairman of the Board of Directors of the Company, or the person that stands in for him as Chairman of the General Shareholders Meeting, or such person as is appointed by the Board of Directors, with notice of such appointment being given in advance in the official notice of the call to meeting.

In cases in which a public proxy solicitation has been carried out, the Director who obtains such proxy shall be subject to the voting restriction established in Section 114 of the Securities Market Act [Ley del Mercado de Valores] in connection with conflict of interest situations.

A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

Proposal for amendment of Article 14.1 of the Regulations for the General Shareholders Meeting:

It is proposed to amend paragraph 1 of Article 14 of the Regulations for the General Shareholders Meeting to conform it to the proposed amendment to Article 16 of the By-Laws, which provides for the possibility that the General Shareholders Meeting be held outside of the locality of the registered address (which may be any other location within Spain) if so determined by the Board of Directors, pursuant to Section 175 of the Companies Act.

New proposed text

If the document setting forth the proxy or power of attorney does not state the specific person or persons to whom the shareholder grants the proxy, such proxy shall be deemed granted in favor of any of the following: the Chairman of the Board of Directors of the Company, or the person that stands in for him as Chairman of the General Shareholders Meeting, or such person as is appointed by the Board of Directors, with notice of such appointment being given in advance in the official notice of the call to meeting.

In cases in which a public proxy solicitation has been carried out, the Director who obtains such proxy shall be subject to the voting restriction established in Section ~~114 of the Securities Market Act [Ley del Mercado de Valores]~~ in connection with 514 of the Companies Law for conflict of interest situations.

A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice.

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Current text

New proposed text

1. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice.

1. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

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

The resolutions that the Board of Directors submits for approval of the shareholders at the General Shareholders Meeting relating to this item on the Agenda are set forth below:

IV.1 Amendment of Articles 5, 8.1, 11 and 13.1 of the Regulations for the General Shareholders Meeting for conformance thereof to the latest legislative developments.

It is resolved to amend the above-mentioned articles of the Regulations, which shall henceforth read as follows:

New text of Article 5 of the Regulations for the General Shareholders Meeting:

Article 5. Powers of the shareholders at the General Shareholders Meeting

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The shareholders acting at the General Shareholders Meeting shall have the power to deliberate upon and adopt resolutions on all such matters as legal provisions and the By-Laws reserve for decision thereat and, in general, on all matters which fall within the scope of powers assigned by Law to the shareholders and are submitted at the General Shareholders Meeting at the behest of the Board of Directors and of the shareholders themselves, in such instances and in such manner as are provided in the Law and the By-Laws. In particular, the shareholders shall decide the following matters:

- a) Appointment and removal of Directors.*
- b) Appointment and removal of auditors and liquidators.*
- c) Commencement of claims for liability against the Directors, liquidators or Auditors.*
- d) Review of corporate management and approval, if appropriate, of the financial statements for the prior fiscal year and decision regarding the allocation of profits/losses.*
- e) Increase or reduction of share capital.*
- f) Issuance of debentures.*
- g) Amendment of the By-Laws.*
- h) Dissolution, merger, split-off, overall assignment of assets and liabilities, relocation of the registered address abroad and transformation of the Company.*
- i) The elimination of or establishment of restrictions upon pre-emptive rights, without prejudice to the possible delegation of these powers to the Directors as provided by law.*

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j) The transformation of the Company into a holding company, through subsidiarization or by entrusting subsidiaries with the conduct of core activities theretofore carried out by the Company itself.

k) The acquisition or disposition of essential operating assets, when this entails an effective amendment of the corporate purpose.

l) Transactions the effect of which is tantamount to liquidating the Company and, especially, the approval of the final balance sheet upon liquidation.

m) Any other matter that the Board of Directors resolves to submit to the shareholders at a General Shareholders Meeting.

New text of paragraph 1 of Article 8 of the Regulations for the General Shareholders Meeting:

1. The General Shareholders Meeting shall be called through a notice published in the Official Bulletin of the Commercial Registry and on the Company's website (www.telefonica.com), as much in advance of the date set for the Meeting as is at a minimum required by Law. The notice published on the Company's website shall be accessible at least until the date of the Meeting. Furthermore, the Board of Directors may publish notices in other media, if it deems it appropriate in order to give broader publicity to the call to meeting.

The call to the General Shareholders Meeting shall also be reported to the National Securities Market Commission and to such Market Supervisory Authorities as may be appropriate.

New text of Article 11 of the Regulations for the General Shareholders Meeting:

Article 11. Electronic Shareholders Forum and suggestions made by the shareholders

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1. Without prejudice to the shareholders' right, in such cases and under such terms as are provided in the Law, to have certain matters included in the Agenda for the Meeting that they request be called, the shareholders may at all times and after providing evidence of their status as such, make suggestions through the Shareholder Service [Servicio de Atención al Accionista] regarding the organization and operation of the General Shareholders' Meeting and the powers of the shareholders thereat.

2. On occasion of the call to meeting and until each General Shareholders' Meeting is held, the Company shall place into operation on its website (www.telefonica.com) an Electronic Shareholders' Forum, which shall be accessible, with appropriate safeguards, by both individual shareholders and by any voluntary associations they may create as provided by law, in order to facilitate their communication prior to a General Shareholders' Meeting being held. Proposed resolutions sought to be presented as a supplement to the agenda notified in the call to meeting may be published in the Forum, together with requests for adherence to such proposals, initiatives to reach the percentage sufficient to exercise a minority right provided by Law as well as proxy offers or solicitations. The Board of Directors may further develop the above-mentioned rules and establish the procedures, terms and other conditions for the operation of the Electronic Shareholders' Forum.

New text of paragraph 1 of Article 13 of the Regulations for the General Shareholders' Meeting:

1. Every shareholder having the right to attend the General Shareholders' Meeting may be represented thereat by another person, even if not a shareholder. The proxy must be granted specifically for each Meeting, either by using the proxy-granting form printed on the attendance card or in any other manner permitted by the Law, without prejudice to the provisions of the Companies Act (Ley de Sociedades de Capital) regarding cases of proxies granted to family relatives and general proxies.

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The documents setting forth the proxies or powers of attorney for the General Shareholders Meeting shall contain instructions regarding the direction of the vote. If no express instructions are given, it shall be understood that the proxy-holder must vote in favor of the proposed resolutions put forward by the Board of Directors regarding the matters on the agenda.

If there are no voting instructions because the shareholders acting at the General Shareholders Meeting are to decide matters that are not included in the agenda and are thus unknown on the date that the proxy is granted but which may be submitted to a vote at the Meeting, the proxy-holder shall vote in such direction as he deems most appropriate, taking into account the interest of the Company and that of the shareholder granting the proxy. The same rule shall apply when the relevant proposal or proposals submitted to the shareholders at the Meeting have not been made by the Board of Directors.

If the document setting forth the proxy or power of attorney does not state the specific person or persons to whom the shareholder grants the proxy, such proxy shall be deemed granted in favor of any of the following: the Chairman of the Board of Directors of the Company, or the person that stands in for him as Chairman of the General Shareholders Meeting, or such person as is appointed by the Board of Directors, with notice of such appointment being given in advance in the official notice of the call to meeting.

In cases in which a public proxy solicitation has been carried out, the Director who obtains such proxy shall be subject to the voting restriction established in Section 514 of the Companies Law for conflict of interest situations.

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A proxy is always revocable. Attendance at the Meeting by the shareholder granting the proxy, whether in person or through distance voting, entails the revocation of any proxy, whatever the date thereof. A proxy shall likewise be rendered void as a result of the disposition of shares of which the Company has notice .

IV.2 Amendment of Article 14.1 of the Regulations for the General Shareholders Meeting.

It is resolved to amend paragraph 1 of Article 14 of the Regulations for the General Shareholders Meeting, which shall henceforth read as follows:

1. The General Shareholders Meeting shall be held at the place set forth in the notice of the call to meeting, within the area where the Company has its registered office, on the date and at the time also set forth in such notice. However, when the Board of Directors deems it appropriate in order to facilitate the conduct of the meeting, it may resolve that the Meeting be held in any other place within Spain by so providing in the call to meeting.

* * *

Madrid, April 8, 2011

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Telefónica, S.A.

REPORT OF THE BOARD OF DIRECTORS OF TELEFÓNICA, S.A. REGARDING THE PROPOSED AUTHORIZATION TO THE BOARD OF DIRECTORS TO INCREASE THE SHARE CAPITAL AND EXCLUDE PRE-EMPTIVE RIGHTS, WHICH WILL BE SUBMITTED FOR APPROVAL BY THE SHAREHOLDERS AT THE ANNUAL GENERAL SHAREHOLDERS MEETING (ITEM VI ON THE AGENDA).

1. PURPOSE OF THIS REPORT

The Agenda for the Annual General Shareholders Meeting of Telefónica, S.A., called for May 17 and 18, 2011, on first and second call, respectively, includes in item VI thereof a proposal regarding authorizing the Board of Directors to increase the Company's share capital up to the maximum limit established by Law, with the resulting amendment of Article 5 of the By-Laws regarding the amount of share capital and the number of shares into which it is divided, and also delegating the power to exclude pre-emptive rights with respect to the issuances of shares under such authorization when the interests of the Company so require.

This Report is prepared in compliance with the provisions of Sections 286, 297.1.b) and 506 of the Companies Act (*Ley de Sociedades de Capital*) (the "Companies Act") approved by Royal Legislative Decree 1/2010, of July 2, in order to provide a rationale for such proposed authorization to the Board of Directors to increase the share capital, including the delegation of the power to exclude pre-emptive rights, and which is submitted for approval of the shareholders acting at the General Shareholders Meeting.

2. RATIONALE FOR THE PROPOSAL

Section 297.1.b) of the Companies Act gives authority to the shareholders at a General Shareholders Meeting to delegate to the Board of Directors 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 shareholders, and while meeting the requirements provided for amending the By-Laws. The law provides that such increases may not in any event 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.

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The Board of Directors believes that the proposed amendment submitted for approval of the shareholders at the General Shareholders Meeting is justified by the appropriateness of the mechanism provided for by current corporate law allowing for the approval of one or more increases in share capital without a subsequent call to and holding of a new General Shareholders Meeting, but within the limits, terms and conditions approved by the shareholders. This is intended to give the Company's management decision-making body 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 large companies are currently operating.

Pursuant to Section 297.1 b) of the Companies Act, the proposal contemplates that payment of the shares issued be made in the form of cash contributions, and expressly provides for the possibility of an incomplete subscription for shares issued, pursuant to the provisions of Section 311 of such Act. In addition, the proposed resolution submitted at the General Shareholders Meeting includes an authorization to the Board of Directors to take all steps required for the new shares covered by the capital increase to be admitted to trading on the Stock Exchanges on which the Company's shares are listed.

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The proposal is completed with an authorization to the Board of Directors such that it may in turn delegate such delegable powers as have been received from the shareholders acting at the General Shareholders Meeting. Furthermore, pursuant to the provisions of Section 506 of the current Companies Act, the delegation to the Board of Directors to increase share capital contained in the proposal to which this Report refers includes the grant to the Directors of the power to exclude pre-emptive rights, subject to the provisions of the above-mentioned Section 506 of the Act as to the requirements, conditions and formalities established therein and in related provisions of the Act. The Board of Directors believes that this power to exclude pre-emptive rights as a supplement to the power to increase capital is justified for various reasons. 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 Directors are 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 addition, the exclusion of pre-emptive rights causes lesser distortion of trading in the Company's shares during the time of issuance, which tends to be shorter than an issuance with rights. 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.

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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 Auditor's report required by Section 308 of the Companies Act must be prepared. 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.

3. PROPOSED RESOLUTION SUBMITTED FOR APPROVAL BY THE SHAREHOLDERS AT THE ANNUAL GENERAL SHAREHOLDERS MEETING ITEM VI ON THE AGENDA

The resolution that the Board of Directors submits for approval by the shareholders acting at the General Shareholders Meeting in connection with this item on the Agenda reads as follows:

VI. Authorization granted to the Board of Directors to increase the share capital pursuant to the terms and conditions of Section 297.1.b) of the Companies Act, over a maximum period of five years, delegating the power to exclude pre-emptive rights pursuant to Section 506 of the Companies Act.

To authorize the Board of Directors, as broadly as necessary under the law, in order that, under Section 297.1.b) of the Companies Act, it may increase the share capital on one or more occasions and at any time, within the term of five years as from the date of this General Shareholders Meeting, by up to the maximum amount of 2,281,998,242.50 euros, equal to one-half of the Company's current capital. Capital increases pursuant to this authorization shall be made through the issuance and placement into circulation of new shares with or without a premium the consideration for which shall consist of cash contributions. For each increase, the Board of Directors shall determine whether the new shares to be issued are common, preferred, redeemable, non-voting or any other type permitted by Law. The Board of Directors may also determine, to the extent not otherwise provided, the terms and conditions applicable to the capital increases and the characteristics of the shares, expressly providing for the possibility of an incomplete subscription, as well as freely offer new unsubscribed shares during the period or periods for exercise of pre-emptive rights. The Board of Directors may also establish 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 relating to capital and number of shares.

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Telefónica, S.A.

Likewise, with respect to capital increases made pursuant to this authorization, the Board of Directors is authorized to totally or partially exclude pre-emptive rights as permitted by Section 506 of the Companies Act.

Whenever appropriate, the Company shall make application for listing on Spanish or foreign, official or unofficial, organized or other secondary markets of the shares issued by the Company pursuant to this delegation of powers, and the Board of Directors is authorized to conduct all formalities and take all actions that may be necessary for admission to listing with the appropriate authorities of the various Spanish or foreign securities markets on which the shares of the Company are listed.

Under the provisions of Section 249.2 of the Companies Act, the Board of Directors is expressly authorized, in turn, to delegate the powers granted in this resolution.

* * *

Madrid, April 8, 2011

Table of Contents**DISCLOSURES REQUIRED UNDER ARTICLE 116 BIS OF THE SPANISH SECURITIES MARKET LAW**

The information required under Article 116.bis of the Spanish Securities Market Law is detailed below:

a.- Capital structure.

At December 31, 2010, the share capital of Telefónica was 4,563,996,485 euros, represented by 4,563,996,485 fully paid ordinary shares of a single series, par value of 1 euro each, all recorded under the book-entry system.

At that date they were admitted to trading on the Spanish electronic trading system (the Continuous Markets) where they form part of the Ibex 35 index, on the four Spanish stock exchanges (Madrid, Barcelona, Valencia and Bilbao) and on the New York, London, Tokyo, Buenos Aires, Sao Paulo and Lima stock exchanges.

All shares are ordinary, of a single series and confer the same rights and obligations on their shareholders.

At the time of writing, there were no securities in issue that are convertible into Telefónica shares.

b.- Restrictions on the transfer of securities.

Nothing in the Company Bylaws imposes any restriction or limitation on the free transfer of Telefónica shares.

c.- Significant shareholdings.

The table below lists shareholders who, at December 31, 2010, to the best of the Company's knowledge, had significant direct or indirect shareholdings in the Company as defined in Royal Decree 1362/2007 implementing the Spanish Securities Markets Law 24/1998 as it relates to the need for transparent information on issuers whose securities are listed for trading in an official secondary market or other regulated market of the European Union:

	Total		Direct shareholding		Indirect holding	
	%	Shares	%	Shares	%	Shares
BBVA ⁽¹⁾	6.279	286,574,224	6.273	286,317,371	0.006	256,853
la Caixa ⁽²⁾	5.050	230,469,182	0.024	1,117,990	5.025	229,351,192
Blackrock, Inc. ⁽³⁾	3.884	177,257,649			3.884	177,257,649

(1) Based on the information contained in Banco Bilbao Vizcaya Argentaria, S.A.'s 2010 Annual Report on Corporate Governance at December 31, 2010.

(2) Based on information provided by Caja de Ahorros y Pensiones de Barcelona, la Caixa as at December 31, 2010 for the 2010 Annual Report on Corporate Governance. The 5.025% indirect shareholding in Telefónica is owned by Criteria CaixaCorp, S.A.

(3) According to notification sent to the Spanish national securities commission, the CNMV, dated February 4, 2010.

d.- Restrictions on voting rights.

According to Article 21 of the Company's bylaws, no shareholder can exercise votes in respect of more than 10 per cent of the total shares with voting rights outstanding at any time, irrespective of the number of shares they may own. This restriction on the maximum number of votes that each shareholder can cast refers solely to shares owned by the shareholder concerned and cast on their own behalf. It does not include additional votes cast on behalf of other shareholders who may have appointed them as proxy, who are themselves likewise restricted by the 10 per cent voting ceiling.

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The 10 per cent limit described above also applies to the number of votes that can be cast either jointly or separately by two or more legal entity shareholders belonging to the same corporate group and to the number of votes that may be cast altogether by an individual or legal entity shareholder and any entity or entities that they directly or indirectly control and which are also shareholders.

e.- Agreements between shareholders.

In accordance with the provisions of 112, section 2 of the Securities Market Act 24/1988, of July 28, (currently replaced by the section 2 of the article 518 of the revised text of the Spanish Corporation Law approved by Royal Legislative Decree 1/2010, of July 2) on October 22, 2009, the Company notified the Spanish national securities commission, the CNMV, in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per this article. By virtue of these clauses, Telefónica may not, while the strategic alliance agreement is in force, offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertook not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica's voting share capital (excluding intragroup transfers). This undertaking is without effect, the aforementioned period of one year having expired.

At the same time, both parties also assumed similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

The mutual share exchange agreement, which includes the shareholder agreement, was filed with the Madrid Mercantile Registry on November 24, 2009.

f.- Rules governing the appointment and replacement of Directors and the amendment of the Company's Bylaws.

Appointment, reappointment and ratification.

Telefónica's By-Laws state that the Board of Directors shall have between five and twenty Directors who are appointed by shareholders at the Shareholders' Meeting. The Board of Directors may, in accordance with the revised text of the Spanish Corporation Law and the Company Bylaws, provisionally co-opt Directors to fill any vacant seats.

The appointment of Directors to Telefónica is as a general rule submitted for approval to the Shareholders' Meeting. Only in certain circumstances, when seats fall vacant after the conclusion of the General Meeting is it therefore necessary to co-opt Directors onto the Board in accordance with the revised text of the Spanish Corporation Law. Any such co-opted appointment is then ratified at the next Shareholders' Meeting.

Also, in all cases, proposals to appoint Directors must follow the procedures set out in the Company's Board of Directors' Regulations and be preceded by the appropriate favorable report by the Nominating, Compensation and Corporate Governance Committee and in the case of independent Directors, by the corresponding proposal by the committee.

Therefore, in exercise of the powers delegated to it, the Nominating, Compensation and Corporate Governance Committee must report, based on criteria of objectivity and the best interests of the Company, on proposals to appoint, re-appoint or remove Company Directors, taking into account the skills, knowledge and experience required of candidates to fill the vacancies.

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As a result, in accordance with its Regulations, the Board of Directors, exercising the rights to co-opt and propose appointments to the Shareholders Meeting, shall ensure that external or non-executive Directors are in an ample majority over the executive Directors. Similarly, it shall ensure that independent Directors make up at least one third of the total Board members.

In all circumstances, where a Director is proposed to the Shareholders Meeting for reappointment or ratification, the report of the Nominating, Compensation and Corporate Governance Committee, or in the case of independent Directors the proposal of this committee, shall include an assessment of the Director's past work and diligence in the discharge of their duties during their period in office.

Also, both the Board of Directors and the Nominating, Compensation and Corporate Governance Committee shall ensure, in fulfilling their respective duties, that all those proposed for appointment as Directors should be persons of acknowledged solvency, competence and experience who are willing to devote the time and effort necessary to the discharge of their functions, with particular attention paid to the selection of independent Directors.

Directors are appointed for a period of five years, renewable for one or more subsequent five-year periods.

As with appointments, proposals for the reappointment of Directors must be preceded by the corresponding report by the Nominating, Compensation and Corporate Governance Committee, and in the case of independent Directors by the corresponding proposal by the Committee.

Termination of appointment or removal

Directors' appointments shall end at the expirations of the period for which they were appointed or when shareholders at the General Shareholders Meeting so decide in exercise of their powers under the law.

Also, in accordance with Article 12 of the Board Regulations, Directors must submit their resignation to the Board of Directors and formalize their resignation in the following circumstances:

- a) If they leave the executive post by virtue of which they sat on the Board or when the reasons for which they were appointed cease to apply.
- b) If their circumstances become incompatible with their continued service on the Board or prohibit them from serving on the Board for one of the reasons specified under Spanish law.
- c) If they are severely reprimanded by the Nominating, Compensation and Corporate Governance Committee for failure to fulfill any of their duties as Director.
- d) If their continued presence on the Board could affect the credibility or reputation of the Company in the markets or otherwise threaten the Company's interests.

The Board of Directors shall not propose the termination of the appointment of any independent Director before the expirations of their statutory term, except in the event of just cause, recognized by the Board on the basis of a prior report submitted by the Nominating, Compensation and Corporate Governance Committee. Just cause shall be specifically understood to include cases where the Director has failed to fulfill their duties as Board member.

The Board may also propose the termination of the appointment of independent Directors in the case of Takeover Bids, mergers or other similar corporate transactions that represent a change in the structure of the Company's capital.

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Amendments to the Company Bylaws.

The procedure for amending the Bylaws is governed by Article 285 of the revised text of the Spanish Corporation Law and requires any change to be approved by shareholders at the Shareholders Meeting with the majorities stated in Articles 194 and 201 of the same law. Article 14 of Telefónica's Bylaws upholds this principle.

g.- Powers of Directors and, specifically, powers to issue or buy back shares.

Powers of Directors.

The Chairman of the Company, as Executive Chairman, is delegated all powers by the Board of Directors except where such delegation is prohibited by Law, by the Company Bylaws or by the Regulations of the Board of Directors, whose Article 5.4 establishes the powers reserved to the Board of Directors. Specifically, the Board of Directors reserves the powers, inter alia, to: (i) approve the general policies and strategies of the Company; (ii) evaluate the performance of the Board of Directors, its Committees and the Chairman; (iii) appoint Senior Executives, as well as the remuneration of Directors and Senior Executives; and (iv) decide strategic investments.

Meanwhile, the Chief Operating Officer has been delegated all the Board's powers to conduct the business and act as the senior executive for all areas of the Company's business, except where such delegation is prohibited by law, by the Company Bylaws, or by the Regulations of the Board of Directors.

In addition, the other Executive Directors are delegated the usual powers of representation and administration appropriate to the nature and needs of their roles.

Powers to issue shares.

At the Ordinary Shareholders Meeting of Telefónica on June 21, 2006, the Board of Directors was authorized under Article 297.1.b) of the revised text of the Spanish Corporation Law (previously Article 153.1.b) of the defunct Spanish Corporation Law), to increase the Company's capital by up to 2,460 million euros, equivalent to half the Company's subscribed and paid share capital at that date, one or several times within a maximum of five years of that date. The Board of Directors has not exercised these delegated powers to date.

Also, at the General Shareholders Meeting of June 2, 2010, the Board of Directors was authorized to issue bonds exchangeable for or convertible into shares in the Company, this power being exercisable one or several times within a maximum of five years of that date. The Board of Directors has not exercised this power to date.

Powers to buy back shares.

At the General Shareholders Meeting of Telefónica of June 2, 2010, the Board of Directors was authorized buy back its own shares either directly or via companies belonging to the Group. This authorization was granted for 5 years from that date and includes the specific limitation that at no point may the nominal value of treasury shares acquired, added to those already held by Telefónica and those held by any of the subsidiaries that it controls, exceed the maximum legal percentage at any time (currently 10% of Telefónica's share capital).

h.- Significant agreements outstanding that would come into force, be amended or expire in the event of a change of control following a Takeover Bid.

The Company has no significant agreements outstanding that would come into force, be amended or expire in the event of a change of control following a Takeover Bid.

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i.- Agreements between the Company and its Directors, managers or employees that provide for compensation in the event of resignation or unfair dismissal or if the employment relationship should be terminated because of a Takeover Bid.

In general, the contracts of Executive Directors and some members of the Company's executives team include a clause giving them the right to receive the economic compensation indicated below in the event that their employment relationship is ended for reasons attributable to the Company and/or due to objective reasons such as a change of control in the Company. However, if the employment relationship is terminated for a breach attributable to the executive Director or executive, he/she will not be entitled to any compensation whatsoever. That notwithstanding, in certain cases the severance benefit to be received by the Executive Director or Executive, according to their contract, does not meet these general criteria, but rather are based on other circumstances of a personal or professional nature or on the time when the contract was signed. The agreed economic compensation for the termination of the employment relationship, where applicable, consists of a maximum of three times salary plus another year based on length of service at the Company. The annual salary on which the indemnity is based is the Director's last fixed salary and the arithmetical mean of the sum of the last two variable payments received by contract.

Meanwhile, contracts that tie employees to the Company under a common employment relationship do not include indemnity clauses for the termination of their employment. In these cases, the employee is entitled to any indemnity set forth in prevailing labor legislation. This notwithstanding, contracts of some Company employees, depending on their level and seniority, as well as their personal, professional circumstances and when they signed their contracts, establish by contract, in some cases, their right to receive compensation in the same circumstances as in the preceding paragraph, generally consisting of a year and a half of salary. The annual salary on which the indemnity is based is the last fixed salary and the average amount of the last two annual variable payments received by contract.

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Audit Report
TELEFÓNICA, S.A. AND SUBSIDIARIES
Consolidated Financial Statements and
Consolidated Management Report
for the year ended
December 31, 2010

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Translation of a report and consolidated financial statements originally issued in Spanish. In the event of discrepancy, the Spanish-language version prevails (See Note 25)

AUDIT REPORT ON THE CONSOLIDATED FINANCIAL STATEMENTS

To the Shareholders of
Telefónica, S.A.

We have audited the consolidated financial statements of Telefónica, S.A. (the Parent Company) and its subsidiaries (the Group), which comprise the consolidated statement of financial position at December 31, 2010, the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity, the consolidated statement of cash flows, and the notes thereto for the year then ended. As indicated in Note 2 to the accompanying consolidated financial statements, the Parent Company's Directors are responsible for the preparation of the Group's consolidated financial statements in accordance with International Financial Reporting Standards, as adopted by the European Union, and other provisions in the regulatory framework applicable to the Group. Our responsibility is to express an opinion on the aforementioned consolidated financial statements taken as a whole, based upon work performed in accordance with the regulatory audit standards in Spain, which require the examination, through the performance of selective tests, of the evidence supporting the consolidated financial statements and the evaluation of whether their presentation, the accounting principles and criteria applied and the estimates made are in agreement with the applicable regulatory framework for financial information.

In our opinion, the accompanying 2010 consolidated financial statements give a true and fair view, in all material respects, of the consolidated equity and consolidated financial position of Telefónica, S.A. and subsidiaries at December 31, 2010, and the consolidated results of operations and consolidated cash flows for the year then ended, in conformity with International Financial Reporting Standards, as adopted by the European Union, and other applicable provisions in the regulatory framework for financial information.

The accompanying 2010 consolidated management report contains such explanations as the Directors of Telefónica, S.A. consider appropriate concerning the situation of the Group, the evolution of its business and other matters; however, it is not an integral part of the consolidated financial statements. We have checked that the accounting information included in the aforementioned consolidated management report agrees with the 2010 consolidated financial statements. Our work as auditors is limited to verifying the consolidated management report in accordance with the scope mentioned in this paragraph, and does not include the review of information other than that obtained from the accounting records of Telefónica, S.A. and its subsidiaries.

ERNST & YOUNG, S.L.

/s/ José Luis Perelli Alonso
José Luis Perelli Alonso

April 14, 2011

Domicilio Social: Pl. Pablo Ruiz Picasso, 1. 28020 Madrid

Inscrita en el Registro Mercantil de Madrid al

Tomo 12749, Libro 0, Folio 215, Sección 8ª,

Hoja M-23123, Inscripción 116. C.I.F. B-78970506

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**TELEFÓNICA, S.A. AND SUBSIDIARIES
COMPOSING THE TELEFÓNICA GROUP
CONSOLIDATED FINANCIAL STATEMENTS (CONSOLIDATED
ANNUAL ACCOUNTS) AND CONSOLIDATED MANAGEMENT
REPORT FOR THE YEAR ENDED DECEMBER 31, 2010**

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TELEFÓNICA GROUP
CONSOLIDATED STATEMENT OF FINANCIAL POSITION AT DECEMBER 31
(MILLIONS OF EUROS)

ASSETS	NOTE	2010	2009
A) NON-CURRENT ASSETS		108,721	84,311
Intangible assets	(Note 6)	25,026	15,846
Goodwill	(Note 7)	29,582	19,566
Property, plant and equipment	(Note 8)	35,797	31,999
Investment properties		5	5
Investments in associates	(Note 9)	5,212	4,936
Non-current financial assets	(Note 13)	7,406	5,988
Deferred tax assets	(Note 17)	5,693	5,971
B) CURRENT ASSETS		21,054	23,830
Inventories		1,028	934
Trade and other receivables	(Note 11)	12,426	10,622
Current financial assets	(Note 13)	1,574	1,906
Tax receivables	(Note 17)	1,331	1,246
Cash and cash equivalents	(Note 13)	4,220	9,113
Non-current assets held for sale		475	9
TOTAL ASSETS (A + B)		129,775	108,141
EQUITY AND LIABILITIES	NOTE	2010	2009
A) EQUITY		31,684	24,274
Equity attributable to equity holders of the parent		24,452	21,734
Non-controlling interests	(Note 12)	7,232	2,540
B) NON-CURRENT LIABILITIES		64,599	56,931
Non-current interest-bearing debt	(Note 13)	51,356	47,607
Non-current trade and other payables	(Note 14)	2,304	1,249
Deferred tax liabilities	(Note 17)	6,074	3,082
Non-current provisions	(Note 15)	4,865	4,993
C) CURRENT LIABILITIES		33,492	26,936

Current interest-bearing debt	(Note 13)	9,744	9,184
Current trade and other payables	(Note 14)	19,251	14,023
Current tax payables	(Note 17)	2,822	2,766
Provisions	(Note 15)	1,675	963
TOTAL EQUITY AND LIABILITIES (A+B+C)		129,775	108,141

The accompanying Notes 1 to 25 and Appendices I to VI are an integral part of these consolidated statements of financial position.

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**TELEFÓNICA GROUP
CONSOLIDATED INCOME STATEMENTS FOR THE YEARS ENDED DECEMBER 31
(MILLIONS OF EUROS)**

INCOME STATEMENT	NOTE	2010	2009	2008
Revenue from operations	(Note 19)	60,737	56,731	57,946
Other income	(Note 19)	5,869	1,645	1,865
Supplies		(17,606)	(16,717)	(17,818)
Personnel expenses		(8,409)	(6,775)	(6,762)
Other expenses	(Note 19)	(14,814)	(12,281)	(12,312)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION (OIBDA)		25,777	22,603	22,919
Depreciation and amortization	(Note 19)	(9,303)	(8,956)	(9,046)
OPERATING INCOME		16,474	13,647	13,873
Share of profit (loss) of associates	(Note 9)	76	47	(161)
Finance income		792	814	827
Exchange gains		3,508	3,085	6,189
Finance costs		(3,329)	(3,581)	(3,648)
Exchange losses		(3,620)	(3,625)	(6,165)
Net financial expense	(Note 16)	(2,649)	(3,307)	(2,797)
PROFIT BEFORE TAX FROM CONTINUING OPERATIONS		13,901	10,387	10,915
Corporate income tax	(Note 17)	(3,829)	(2,450)	(3,089)
PROFIT FOR THE YEAR FROM CONTINUING OPERATIONS		10,072	7,937	7,826
Profit after tax from discontinued operations	(Note 18)			

PROFIT FOR THE YEAR		10,072	7,937	7,826
Non-controlling interests	(Note 12)	95	(161)	(234)
PROFIT FOR THE YEAR ATTRIBUTABLE TO EQUITY HOLDERS OF THE PARENT		10,167	7,776	7,592
Basic and diluted earnings per share from continuing operations attributable to equity holders of the parent (euros)	(Note 19)	2.25	1.71	1.63
Basic and diluted earnings per share attributable to equity holders of the parent (euros)	(Note 19)	2.25	1.71	1.63

The accompanying Notes 1 to 25 and Appendices I to VI are an integral part of these consolidated income statements

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CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME (MILLIONS OF EUROS)	Year ended December 31		
	2010	2009	2008
Profit for the year	10,072	7,937	7,826
Other comprehensive income			
(Losses) gains on measurement of available-for-sale investments	(61)	638	(1,167)
Reclassification of losses (gains) included in the income statement	202	(4)	(142)
Income tax impact	(57)	(105)	281
	84	529	(1,028)
(Losses) gains on hedges	(291)	(794)	1,302
Reclassification of losses (gains) included in the income statement	73	(77)	50
Income tax impact	62	262	(402)
	(156)	(609)	950
Translation differences	820	1,982	(4,051)
Actuarial gains (losses) and impact of limit on assets for defined benefit pension plans (Note 15)	(94)	(189)	(182)
Income tax impact	35	53	55
	(59)	(136)	(127)
Share of (loss) income recognized directly in equity of associates	(84)	233	(59)
Income tax impact	23	2	(13)
	(61)	235	(72)
Total other comprehensive income	628	2,001	(4,328)
Total comprehensive income recognized in the year	10,700	9,938	3,498
Attributable to:			
Equity holders of the parent	10,409	9,418	3,612
Non-controlling interests	291	520	(114)
	10,700	9,938	3,498

The accompanying Notes 1 to 25 and Appendices I to VI are an integral part of these consolidated statements of comprehensive income

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STATEMENT OF CHANGES IN EQUITY	Attributable to equity holders of the parent Available-for-										
	Share capital	Share premium	Legal reserves	Revaluation reserve	Treasury shares	Retained earnings	sale investments	Hedge associations	Equity of Translation differences	Total	
December 31, 2009	4,564	460	984	157	(527)	16,685	(39)	804	19	(1,373)	21,121
Income (loss)						10,167 (55)	84	(156)	(61)	430	10,000
Income						10,112	84	(156)	(61)	430	10,000
(2)						(5,872)					(5,872)
ary shares						(849)					(849)
als of non-controlling interests and business											
						(16)					(16)
December 31, 2010	4,564	460	984	141	(1,376)	19,971	45	648	(42)	(943)	24,000
December 31, 2008	4,705	460	984	172	(2,179)	16,069	(566)	1,413	(216)	(3,611)	17,000
Income (loss)						7,776 (136)	527	(609)	235	1,625	7,000
Income						7,640	527	(609)	235	1,625	9,000
(2)						(4,557)					(4,557)
ent to 01/01/09 (Note 2)										613	613
ary shares						(656)					(656)
als of non-controlling interests											
(12)	(141)					2,308 (300)					2,000
December 31, 2009	4,564	460	984	157	(527)	16,685	(39)	804	19	(1,373)	21,121
December 31, 2007	4,773	522	984	180	(232)	13,025	457	463	(144)	97	20,000
Income (loss)						7,592 (127)	(1,023)	950	(72)	(3,708)	7,000
Income						7,465	(1,023)	950	(72)	(3,708)	3,000
(2)						(4,165)					(4,165)
ary shares		1,074				(3,151) (232)					(2,077)
als of non-controlling interests											
(12)	(68)	(1,136)				1,204					1,000

(8)

(24)

December 31, 2008

4,705 460 984 172 (2,179) 16,069 (566) 1,413 (216) (3,611) 17

The accompanying Notes 1 to 25 and Appendices I to VI are an integral part of these consolidated statements of changes in equity.

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TELEFÓNICA GROUP
CONSOLIDATED STATEMENT OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31
(MILLIONS OF EUROS)

	NOTE	2010	2009	2008
Cash flows from operating activities				
Cash received from customers		72,867	67,358	69,060
Cash paid to suppliers and employees		(51,561)	(46,198)	(48,500)
Dividends received		136	100	113
Net interest and other financial expenses paid		(2,154)	(2,170)	(2,894)
Taxes paid		(2,616)	(2,942)	(1,413)
Net cash from operating activities	(Note 23)	16,672	16,148	16,366
Cash flows from investing activities				
Proceeds on disposals of property, plant and equipment and intangible assets		315	242	276
Payments on investments in property, plant and equipment and intangible assets		(8,944)	(7,593)	(7,889)
Proceeds on disposals of companies, net of cash and cash equivalents disposed		552	34	686
Payments on investments in companies, net of cash and cash equivalents acquired		(5,744)	(48)	(2,178)
Proceeds on financial investments not included under cash equivalents		173	6	31
Payments made on financial investments not included under cash equivalents		(1,599)	(1,411)	(114)
Interest (paid) received on cash surpluses not included under cash equivalents		(621)	(548)	76
Government grants received		7	18	11
Net cash used in investing activities	(Note 23)	(15,861)	(9,300)	(9,101)
Cash flows from financing activities				
Dividends paid	(Note 12)	(6,249)	(4,838)	(4,440)
Transactions with equity holders		(883)	(947)	(2,241)
Proceeds on issue of debentures and bonds	(Note 13)	6,131	8,617	1,317
Proceeds on loans, borrowings and promissory notes		9,189	2,330	3,693

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Cancellation of debentures and bonds	(Note 13)	(5,482)	(1,949)	(1,167)
Repayments of loans, borrowings and promissory notes		(7,954)	(5,494)	(4,927)
Net cash flow used in financing activities	(Note 23)	(5,248)	(2,281)	(7,765)
Effect of foreign exchange rate changes on collections and payments		(463)	269	(302)
Effect of changes in consolidation methods and other non-monetary effects		7		14
Net increase (decrease) in cash and cash equivalents during the period		(4,893)	4,836	(788)
CASH AND CASH EQUIVALENTS AT JANUARY 1		9,113	4,277	5,065
CASH AND CASH EQUIVALENTS AT DECEMBER 31	(Note 13)	4,220	9,113	4,277
RECONCILIATION OF CASH AND CASH EQUIVALENTS WITH THE STATEMENT OF FINANCIAL POSITION				
BALANCE AT JANUARY 1		9,113	4,277	5,065
Cash on hand and at banks		3,830	3,236	2,820
Other cash equivalents		5,283	1,041	2,245
BALANCE AT DECEMBER 31	(Note 13)	4,220	9,113	4,277
Cash on hand and at banks		3,226	3,830	3,236
Other cash equivalents		994	5,283	1,041

The accompanying Notes 1 to 25 and Appendices I to VI are an integral part of these consolidated statements of cash flow

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**TELEFÓNICA, S.A. AND SUBSIDIARIES COMPOSING THE
TELEFÓNICA GROUP**
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (CONSOLIDATED
ANNUAL ACCOUNTS) FOR THE YEAR ENDED DECEMBER 31, 2010**

(1) BACKGROUND AND GENERAL INFORMATION

Telefónica Group organizational structure

Telefónica, S.A. and its subsidiaries and investees make up an integrated group of companies (the Telefónica Group or the Group) operating mainly in the telecommunications, media and contact center industries.

The parent company of this Group is Telefónica, S.A. (also Telefónica or the Company), a public limited company incorporated on April 19, 1924 for an indefinite period. Its registered office is at calle Gran Vía 28, Madrid (Spain).

Appendix V lists the subsidiaries, associates and investees in which the Telefónica Group has direct or indirect holdings, their corporate purpose, country, functional currency, share capital, the Telefónica Group s effective shareholding and their method of consolidation.

Corporate structure of the Group

Telefónica s basic corporate purpose, pursuant to Article 4 of its Bylaws, is the provision of all manner of public or private telecommunications services, including ancillary or complementary telecommunications services or related services. All the business activities that constitute this stated corporate purpose may be performed either in Spain or abroad and wholly or partially by the Company, either through shareholdings or equity interests in other companies or legal entities with an identical or a similar corporate purpose.

The Telefónica Group follows a regional, integrated management model through three business areas defined by the geographical markets in which it operates, and with an integrated view of the wireline and wireless businesses:

Telefónica Spain

Telefónica Latin America

Telefónica Europe

The business activities carried out by most of the Telefónica Group companies are regulated by broad ranging legislation, pursuant to which permits, concessions or licenses must be obtained in certain circumstances to provide the various services.

In addition, certain wireline and wireless telephony services are provided under regulated rate and price systems.

A more detailed segmentation of the activities carried out by the Group is provided in Note 4.

Table of Contents**(2) BASIS OF PRESENTATION OF THE CONSOLIDATED FINANCIAL STATEMENTS**

The accompanying consolidated financial statements were prepared from the accounting records of Telefónica, S.A. and of each of the companies comprising the Telefónica Group, whose individual financial statements were prepared in accordance with the generally accepted accounting principles prevailing in the various countries in which they are located, and for purposes of these consolidated financial statements are presented in accordance with the International Financial Reporting Standards (IFRS) adopted by the European Union, which for the purposes of the Telefónica Group are not different from those issued by the International Accounting Standards Board (IASB), to give a true and fair view of the consolidated equity and financial position at December 31, 2010, and of the consolidated results of operations, changes in consolidated equity and the consolidated cash flows obtained and used in the year then ended. The figures in these consolidated financial statements are expressed in millions of euros, unless otherwise indicated, and therefore may be rounded. The euro is the Group's reporting currency.

The accompanying consolidated financial statements for the year ended December 31, 2010 were prepared by the Company's Board of Directors at its meeting on February 23, 2011 for submission for approval at the General Shareholders Meeting, which is expected to occur without modification.

Note 3 contains a description of the most significant accounting policies used to prepare these consolidated financial statements.

For comparative purposes, the accompanying financial statements for 2010 include the consolidated statement of financial position at December 31, 2009 and the consolidated income statement, the consolidated statement of comprehensive income, the consolidated statement of changes in equity and the consolidated statement of cash flows, and the notes thereto for the years ended December 31, 2009 and, on a voluntary basis, 2008.

Comparative information and main changes in the consolidation scope

The main changes in the consolidation scope affecting comparability of the consolidated information for 2010 and 2009 (see Appendix I for a more detailed explanation of the changes in consolidation scope in both years and the main transactions in 2008) are as follows:

2010***a) Acquisition of 50% of Brasilcel, N.V.***

On July 28, 2010, Telefónica and Portugal Telecom, SGPS, S.A. (Portugal Telecom) signed an agreement for the acquisition by Telefónica, S.A. of 50% of the share capital of Brasilcel, N.V. (Brasilcel) owned by Portugal Telecom. Brasilcel owned, approximately, 60% of Vivo Participações, S.A. This transaction was completed on September 27, 2010, terminating the joint venture agreements entered into by Telefónica and Portugal Telecom in 2002 (Note 21b).

Vivo Participações, S.A. has been changed from the proportionate to full consolidation method within the scope of consolidation as of the transaction completion date.

Additionally, in accordance with IFRS 3 (see Note 3.c), the Group remeasured the previously held 50% investment in Brasilcel, generating a capital gain of 3,797 million euros, recognized under Other income in the accompanying consolidated income statement (Note 19).

The main impacts of this transaction are explained in Note 5.

Table of Contents***b) Acquisition of HanseNet Telekommunikation GmbH***

On December 3, 2009, Telefónica's subsidiary in Germany, Telefónica Deutschland GmbH (Telefónica Deutschland), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH (HanseNet). The transaction was completed on February 16, 2010, the date on which the Telefónica Group completed the acquisition of 100% of the shares of HanseNet. The amount initially paid out was approximately 913 million euros, which included 638 million euros of refinanced debt, and an acquisition cost in the amount of 275 million euros, which was ultimately reduced by 40 million euros upon completion of the transaction (Note 5).

The company has been included in the Telefónica Group's consolidation scope under the full consolidation method.

c) Reduction of stake in Portugal Telecom

In June 2010, the Telefónica Group reduced its ownership interest in Portugal Telecom by 7.98%, resulting in cash inflow of 631 million euros from the sale of the ownership interests. In addition, Telefónica entered into three equity swap contracts on the share trading price of Portugal Telecom shares with a number of financial institutions, subject to net settlement, which grant Telefónica the economic returns. The investment is no longer reflected in the scope of consolidation through the equity method of accounting (Note 9).

d) Acquisition of DTS Distribuidora de Televisión Digital, S.A.

On December 28, 2010, the Telefónica Group completed the acquisition of a 22% stake in DTS Distribuidora de Televisión Digital, S.A., the provider of the pay-TV services offered by the PRISA Group. The acquisition cost amounted to 488 million euros, of which 228 million euros were used to repay the outstanding balance on the subordinated loan between Telefónica de Contenidos, S.A.U. and Sogecable, S.A. This company has been included within the scope of consolidation through the equity method of accounting (Note 9).

e) Devaluation of the Venezuelan bolivar

Regarding the devaluation of the Venezuelan bolivar on January 8, 2010, the two main factors to consider with respect to the Telefónica Group's 2010 financial statements are:

The decrease in the Telefónica Group's net assets in Venezuela as a result of the new exchange rate, with a balancing entry in translation differences under equity of the Group, which generated an effect of approximately 1,810 million euros at the date of devaluation.

The translation of results and cash flows from Venezuela at the new devalued closing exchange rate.

2009***a) Classification of Venezuela as a hyperinflationary economy***

Throughout 2009 and in the early part of 2010, a number of factors arose in the Venezuelan economy that led the Telefónica Group to reconsider the treatment it follows with respect to the translation of the financial statements of investees, as well as the recovery of its financial investments in that country. These factors include the level of inflation reached in 2009 and the cumulative inflation rate over the last three years, the restrictions to the official foreign exchange market and, finally, the devaluation of the bolivar on January 8, 2010.

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As a result, in accordance with IFRS, Venezuela was considered a hyperinflationary economy in 2009. The main implications of this were as follows:

Adjustment of the historical cost of non-monetary assets and liabilities and the various items of equity of these companies from their date of acquisition or inclusion in the consolidated statement of financial position to the end of the year for the changes in purchasing power of the currency caused by inflation.

The cumulative impact of the accounting restatement to adjust for the effects of hyperinflation for years prior to 2009 is shown in translation differences at the beginning of the 2009 financial year.

Adjustment of the income statement to reflect the financial loss caused by the impact of inflation in the year on net monetary assets (loss of purchasing power).

The various components in the income statement and statement of cash flows have been adjusted for the inflation index since their generation, with a balancing entry in financial results and offsetting reconciling item in the statement of cash flows, respectively.

All components of the financial statements of the Venezuelan companies have been translated at the closing exchange rate.

The main effects on the Telefónica Group's consolidated financial statements for 2009 derived from the above are as follows:

	Millions of euros
Revenue	267
OIBDA	64
Net loss	(548)
Translation differences	1,224
Impact on equity	676

b) Tax amortization of goodwill

In December 2007, the European Commission opened an investigation involving the Kingdom of Spain with respect to the potential consideration as state aid of the tax deduction for the tax basis amortization of the goodwill generated on certain foreign investments under the provisions of article 12.5 of the revised Spanish corporate income tax law (TRLIS). This investigation led to widespread uncertainties regarding the scope of the European Commission's decision on the future for, among others, the Telefónica Group.

In this regard, the Company deemed it necessary to recognize a liability as the deduction was applied in the consolidated financial statements until the investigation was concluded.

In December 2009, the text of the European Commission's decision regarding the investigation was released, which deemed the deduction as state aid. Investments made prior to December 21, 2007 (as is the case for the Telefónica Group's investments in O2 Group companies, the operators acquired from BellSouth, Colombia Telecomunicaciones, S.A., ESP and Telefónica O2 Czech Republic, a.s.) were not affected by this decision. As a result of this decision, and considering the corporate structure of these investments, the consolidated income statement of the Telefónica Group for the year ended December 31, 2009 reflects a lower income tax expense due to the reversal of this liability in an amount of 591 million euros.

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c) Share exchange between Telefónica and China Unicom Limited, and signing of strategic alliance agreement

On September 6, 2009, Telefónica and the Chinese telecommunications company, China Unicom (Hong Kong) Limited (China Unicom) entered into a wide strategic alliance which includes, among others, the areas of: the joint procurement of infrastructure and client equipment; common development of mobile service platforms; joint provision of services to multinational customers; roaming; research and development; co-operation and sharing of best practices and technical, operational and management know-how; joint development of strategic initiatives in the area of the network evolution and joint participation in international alliances; and exchange of senior management.

In addition, on the same date, Telefónica and China Unicom executed a mutual share exchange agreement, which was implemented on October 21, 2009 through the subscription by Telefónica, through its wholly owned subsidiary Telefónica Internacional, S.A.U., of 693,912,264 newly issued shares of China Unicom, satisfied by a contribution in kind to China Unicom of 40,730,735 shares of Telefónica, S.A. (see Note 12).

Following the completion of the transaction, the Telefónica Group increased its share of China Unicom s voting share capital from 5.38% to 8.06% and obtained the right to appoint a member to its board of directors, while China Unicom became owner of approximately 0.87% of Telefónica s voting share capital at that date. Subsequently, after the capital reduction carried out by China Unicom, the Telefónica Group reached a shareholding equivalent to 8.37% of the company s voting share capital.

The investment in China Unicom was included in the consolidation scope through the equity method of accounting.

On January 23, 2011, Telefónica and China Unicom broadened their Strategic Alliance Agreement (see Note 24 Events after the reporting period).

Key performance indicators

The Group uses a series of indicators in its decision-making which it considers provide a better indication of its performance. These indicators, different from accounting measures, are as follows:

Operating income before depreciation and amortization (OIBDA)

Operating income before depreciation and amortization (OIBDA) is calculated by excluding depreciation and amortization from operating income to eliminate the impact of investments in fixed assets that cannot be directly controlled by management in the short term. OIBDA is considered to be more important for investors as it provides a gauge of segment operating performance and profitability using the same measures utilized by management. This metric also allows for comparisons with other companies in the telecommunications sector without consideration of their asset structure.

OIBDA is used to track the performance of the business and to establish operating and strategic targets. OIBDA is a commonly reported measure and is widely used among analysts, investors and other interested parties in the telecommunications industry, although not a measure explicitly defined in IFRS, and therefore, may not be comparable to similar indicators used by other companies. OIBDA should not be considered as an alternative to operating income as a measurement of our operating results or as an alternative to cash flows from operating activities as a measurement of our liquidity.

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The following table presents the reconciliation of OIBDA to operating income for the Telefónica Group for the years ended December 31, 2010, 2009 and 2008:

Millions of euros	2010	2009	2008
OIBDA	25,777	22,603	22,919
Depreciation and amortization	(9,303)	(8,956)	(9,046)
OPERATING INCOME	16,474	13,647	13,873

The following table presents the reconciliation of OIBDA to operating income for each business segment for the years ended December 31, 2010, 2009 and 2008:

	2010				
Millions of euros	Telefónica	Telefónica	Telefónica	Other and	Total
OIBDA	Spain	Latin America	Europe	eliminations	Group
OIBDA	8,520	13,782	4,014	(539)	25,777
Depreciation and amortization	(2,009)	(4,061)	(3,091)	(142)	(9,303)
OPERATING INCOME	6,511	9,721	923	(681)	16,474

	2009				
Millions of euros	Telefónica	Telefónica	Telefónica	Other and	Total
OIBDA	Spain	Latin America	Europe	eliminations	Group
OIBDA	9,757	9,143	3,910	(207)	22,603
Depreciation and amortization	(2,140)	(3,793)	(2,895)	(128)	(8,956)
OPERATING INCOME	7,617	5,350	1,015	(335)	13,647

	2008				
Millions of euros	Telefónica	Telefónica	Telefónica	Other and	Total
OIBDA	Spain	Latin America	Europe	eliminations	Group
OIBDA	10,285	8,445	4,180	9	22,919
Depreciation and amortization	(2,239)	(3,645)	(3,035)	(127)	(9,046)
OPERATING INCOME	8,046	4,800	1,145	(118)	13,873

Table of Contents**Debt indicators**

The following table presents the reconciliation between the Telefónica Group's gross financial debt, net financial debt and net debt at December 31, 2010, 2009 and 2008:

<i>Millions of euros</i>	31/12/2010	31/12/2009	31/12/2008
Gross financial debt	61,100	56,791	53,188
Other non-current payables (e.g. bills payable)	1,718	515	477
Other current payables (deferred payment for the acquisition of Brasilcel, N.V.)	1,977		
Cash and cash equivalents	(4,220)	(9,113)	(4,277)
Non-current financial investments	(3,408)	(2,736)	(4,439)
Current financial investments	(1,574)	(1,906)	(2,216)
Net financial debt	55,593	43,551	42,733
Commitments related to financial guarantees		71	365
Net commitments related to workforce reduction	1,710	2,261	2,687
Net debt	57,303	45,883	45,785

The Company calculates financial debt from gross consolidated financial debt by including other payables (e.g. bills payable), the deferred payment for the acquisition of 50% of Brasilcel for 1,977 million euros, and the unpaid portion of equity investments, in an amount of 1,718 million euros, and subtracting 4,220 million euros of cash and cash equivalents and 4,982 million euros of temporary financial investments and certain investments in financial assets with a maturity of beyond one year from the relevant consolidated statement of financial position under Non-current financial assets. After adjustment for these items, net financial debt rose to 55,593 million euros, an increase of 27.7% from 2009 (43,551 million euros).

(3) ACCOUNTING POLICIES

The principal accounting policies used in preparing the accompanying consolidated financial statements are as follows:

a) Translation methodology

The financial statements of the Group's foreign subsidiaries were translated to euros at the year-end exchange rates, except for:

1. Capital and reserves, which were translated at historical exchange rates.
2. Income statements, which were translated at the average exchange rates for the year.
3. Statements of cash flow, which were translated at the average exchange rate for the year.

Goodwill and statement of financial position items remeasured to fair value when a stake is acquired in a foreign operation are recognized as assets and liabilities of the company acquired and therefore translated at the closing exchange rate.

The exchange rate differences arising from the application of this method are included in Translation differences under Equity attributable to equity holders of the parent in the accompanying consolidated statements of financial position, net of the portion of said differences attributable to non-controlling interests, which is shown under Non-controlling interests. When the Company loses control of a foreign subsidiary, either through total or partial sale or dilution of its interest, the entire cumulative translation difference since January 1, 2008 (the IFRS transition date) applicable to such operation is recognized in income together with any gain or loss from the loss of control. Transactions in the stock of subsidiaries that do not result in loss of control are recognized within equity, with a reallocation of the related cumulative translation difference. All other transactions resulting in the total or partial sale

of the Company's interest in an entity not controlled by the Company will result in a proportionate recognition of the related cumulative translation difference in income.

The financial statements of Group companies whose functional currency is the currency of a hyperinflationary economy are adjusted for inflation in accordance with the procedure described in the following paragraph prior to their translation to euros. Once restated, all the items of the financial statements are converted to euros using the closing exchange rate. Amounts shown for prior years for comparative purposes are not modified.

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To determine the existence of hyperinflation, the Group assesses the qualitative characteristics of the economic environment of the country, such as the trends in inflation rates over the previous three years. The financial statements of companies whose functional currency is the currency of a hyperinflationary economy are adjusted to reflect the changes in purchasing power of the local currency, such that all items in the statement of financial position not expressed in current terms (non-monetary items) are restated by applying a general price index at the financial statement closing date, and all income and expense, profit and loss are restated monthly by applying appropriate adjustment factors. The difference between initial and adjusted amounts is taken to profit or loss.

In that regard, as indicated in Note 2, Venezuela has been classified as a hyperinflationary economy in 2010 and 2009. The inflation rates used to prepare the restated financial information are those published by the Central Bank of Venezuela. On an annual basis, these rates are 27.18% and 25.06% for 2010 and 2009, respectively.

b) Foreign currency transactions

Monetary transactions denominated in foreign currencies are translated to euros at the exchange rates prevailing on the transaction date, and are adjusted at year end to the exchange rates then prevailing.

All realized and unrealized exchange gains or losses are taken to the income statement for the year, with the exception of gains or losses arising from specific-purpose financing of investments in foreign investees designated as hedges of foreign currency risk to which these investments are exposed (see Note 3 i), and exchange gains or losses on intra-group loans considered part of the net investment in a foreign operation, which are included under Other comprehensive income.

c) Goodwill

For acquisitions occurring after January 1, 2010, the effective date of Revised IFRS 3, *Business combinations*, goodwill represents the excess of acquisition cost over the fair values of identifiable assets acquired and liabilities assumed at the acquisition date. Cost of acquisition is the sum of the fair value of consideration delivered and the value attributed to existing non-controlling interests. For each business combination, the company determines the value of non-controlling interests at either their fair value or their proportional part of the net identifiable assets acquired. After initial measurement, goodwill is carried at cost, less any accumulated impairment losses. Whenever an equity interest is held in the acquiree prior to the business combination (business combinations achieved in stages), the carrying value of such previously held equity interest is remeasured at its acquisition-date fair value and the resulting gain or loss, if any, is recognized in profit or loss.

For acquisitions after January 1, 2004, the IFRS transition date, and prior to January 1, 2010, the effective date of Revised IFRS 3, *Business combinations*, goodwill represents the excess of the acquisition cost over the acquirer's interest, at the acquisition date, in the fair values of identifiable assets, liabilities and contingent liabilities acquired from a subsidiary or joint venture. After initial measurement, goodwill is carried at cost, less any accumulated impairment losses.

In the transition to IFRS, Telefónica availed itself of the exemption allowing it not to restate business combinations taking place before January 1, 2004. As a result, the accompanying consolidated statements of financial position include goodwill net of amortization deducted until December 31, 2003, arising before the IFRS transition date, from the positive consolidation difference between the amounts paid to acquire shares of consolidated subsidiaries, and their carrying amounts plus increases in the fair value of assets and liabilities recognized in equity.

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In all cases, goodwill is recognized as an asset denominated in the currency of the company acquired. Goodwill is tested for impairment annually or more frequently if there are certain events or changes indicating the possibility that the carrying amount may not be fully recoverable.

The potential impairment loss is determined by assessing the recoverable amount of the cash generating unit (or group of cash-generating units) to which the goodwill relates when originated. If this recoverable amount is less than the carrying amount, an irreversible impairment loss is recognized in income (see Note 3 f).

d) Intangible assets

Intangible assets are stated at acquisition or production cost, less any accumulated amortization or any accumulated impairment losses.

The useful lives of intangible assets are assessed individually to be either finite or indefinite. Intangible assets with finite lives are amortized systematically over the useful economic life and assessed for impairment whenever events or changes indicate that their carrying amount may not be recoverable. Intangible assets with indefinite useful lives are not amortized, but are tested for impairment annually, or more frequently in the event of indications that their carrying amount may not be recoverable (see Note 3 f).

Management reassesses the indefinite useful life classification of these assets on an annual basis.

Amortization methods and schedules are revised annually at year end and, where appropriate, adjusted prospectively.

Research and development costs

Research costs are expensed as incurred. Costs incurred in developing new products to be marketed or used for the Group's own network, and whose future economic viability is reasonably certain, are capitalized and amortized on a straight-line basis over the period during which the related project is expected to generate economic benefits, starting upon its completion.

Recoverability is considered to be reasonably assured when the Group can demonstrate the technical feasibility of completing the intangible asset, whether it will be available for use or sale, its intention to complete and its ability to use or sell the asset and how the asset will generate future economic benefits.

As long as intangible assets developed internally are not in use, the associated capitalized development costs are tested for impairment annually or more frequently if there are indications that the carrying amount may not be fully recoverable. Costs incurred in connection with projects that are not economically viable are charged to the consolidated income statement for the year in which this circumstance becomes known.

Service concession arrangements and licenses

These arrangements relate to the acquisition cost of the licenses granted to the Telefónica Group by various public authorities to provide telecommunications services and to the value assigned to licenses held by certain companies at the time they were included in the Telefónica Group.

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These concessions are amortized on a straight-line basis over the duration of related licenses from the moment commercial exploitation commences.

Customer base

This primarily represents the allocation of acquisition costs attributable to customers acquired in business combinations, as well as the acquisition value of this type of assets in a third-party acquisition entailing consideration. Amortization is on a straight-line basis over the estimated period of the customer relationship.

Software

Software is stated at cost and amortized on a straight-line basis over its useful life, generally estimated to be between three and five years.

e) Property, plant and equipment

Property, plant and equipment is stated at cost less any accumulated depreciation and any accumulated impairment in value. Land is not depreciated.

Cost includes external and internal costs comprising warehouse materials used, direct labor used in installation work and the allocable portion of the indirect costs required for the related investment. The latter two items are recorded as revenues under Other income Own work capitalized. Cost includes, where appropriate, the initial estimate of decommissioning, retirement and site reconditioning costs when the Group is under obligation to incur such costs due to the use of the asset.

Interest and other financial expenses incurred and directly attributable to the acquisition or construction of qualifying assets are capitalized. Qualifying assets at the Telefónica Group are those assets that require a period of at least 18 months to bring the assets to their intended use or sale.

The costs of expansion, modernization or improvement leading to increased productivity, capacity or efficiency or to a lengthening of the useful lives of assets are capitalized when recognition requirements are met.

Upkeep and maintenance expenses are expensed as incurred.

The Telefónica Group assesses the need to write down, if appropriate, the carrying amount of each item of property, plant and equipment to its recoverable amount, whenever there are indications that the assets carrying amount exceeds the higher of its fair value less costs to sell or its value in use. The impairment provision is not maintained if the factors giving rise to the impairment disappear (see Note 3 f).

The Group's subsidiaries depreciate their property, plant and equipment, net of their residual values, once they are in full working condition using the straight-line method based on the assets' estimated useful lives, calculated in accordance with technical studies which are revised periodically based on technological advances and the rate of dismantling, as follows:

	Years of estimated useful life
Buildings	25 40

Plant and machinery	10	15
Telephone installations, networks and subscriber equipment	5	20
Furniture, tools and other items	2	10

Assets estimated residual values and methods and depreciation periods are reviewed, and adjusted if appropriate, prospectively at each financial year end.

Table of Contents**f) Impairment of non-current assets**

Non-current assets, including property, plant and equipment, goodwill and intangible assets are evaluated at each reporting date for indications of impairment losses. Wherever such indications exist, or in the case of assets which are subject to an annual impairment test, recoverable amount is estimated. An asset's recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows deriving from the use of the asset or its cash generating unit, as applicable, are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. When the carrying amount of an asset exceeds its recoverable amount, the asset is considered to be impaired. In this case, the carrying amount is written down to recoverable amount and the resulting loss is taken to the income statement. Future depreciation or amortization charges are adjusted for the asset's new carrying amount over its remaining useful life. Each asset is assessed individually for impairment, unless the asset does not generate cash inflows that are largely independent of those from other assets (or cash generating units).

The Group bases the calculation of impairment on the business plans of the various cash generating units to which the assets are allocated. These business plans generally cover a period of three to five years. For periods subsequent to the term of the strategic plan, an expected constant or decreasing growth rate is applied to the projections based on these plans. The growth rates used in 2010 and 2009 are as follows:

Rates	2010	2009
Businesses in Spain	0.91%-1.10%	0.88%-0.94%
Businesses in Latin America	1.66%-2.56%	1.21%-3.25%
Businesses in Europe	1.28%-1.46%	1.00%-2.00%

The main variables used by management to determine recoverable amounts are ARPU (average revenues per user), customer acquisition and retention costs, share of net adds in accesses, market shares, investments in non-current assets, growth rates and discount rates.

Discount rates are adjusted for country and specific business risks. The following ranges of rates were used in 2010 and 2009:

Rates	2010	2009
Businesses in Spain	7.8%-8.6%	6.8%-7.3%
Businesses in Latin America	7.2%-17.3%	8.6%-19.4%
Businesses in Europe	6.3%-10.9%	6.3%-8.5%

When there are new events or changes in circumstances that indicate that a previously recognized impairment loss no longer exists or has been decreased, a new estimate of the asset's recoverable amount is made. A previously recognized impairment loss is reversed only if there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If that is the case, the carrying amount of the asset is increased to its recoverable amount. The reversal is limited to the net carrying amount that would have been determined had no impairment loss been recognized for the asset in prior years. Such reversal is recognized in profit or loss and the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount. Impairment losses relating to goodwill cannot be reversed in future periods.

Table of Contents***g) Lease payments***

The determination of whether an arrangement is, or contains a lease is based on the substance of the agreement and requires an assessment of whether the fulfillment of the arrangement is dependent on the use of a specific asset and the agreement conveys a right to the Telefónica Group to the use of the asset.

Leases where the lessor does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognized as an expense in the income statement on a straight-line basis over the lease term.

Leases are classified as finance leases when the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the leased item to the Group. These are classified at the inception of the lease, in accordance with its nature and the associated liability, at the lower of the present value of the minimum lease payments or the fair value of the leased property. Lease payments are apportioned between the finance costs and reduction of the principal of lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance costs are reflected in the income statement over the lease term.

h) Investments in associates

The Telefónica Group's investments in companies over which it exercises significant influence but does not control or jointly control with third parties are accounted for using the equity method. The Group evaluates whether it exercises significant influence not only on the basis of its percentage ownership but also on the existence of qualitative factors such representation on the board of directors of the investee, its participation in decision-making processes, interchange of managerial personnel and access to technical information. The carrying amount of investments in associates includes related goodwill and the consolidated income statement reflects the share of profit or loss from operations of the associate. If the associate recognizes any gains or losses directly in equity, the Group also recognizes the corresponding portion of these gains or losses directly in its own equity.

The Group assesses the existence of indicators of impairment of the investment in each associate at each reporting date in order to recognize any required valuation adjustments. To do so, the recoverable value of the investment as a whole is determined as described in Note 3f.

i) Financial assets and liabilities***Financial investments***

All normal purchases and sales of financial assets are recognized in the statement of financial position on the trade date, i.e. the date that the Company commits to purchase or sell the asset. The Telefónica Group classifies its financial instruments into four categories for initial recognition purposes: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. When appropriate, the Company re-evaluates the designation at each financial year end.

Financial assets held for trading, i.e., investments made with the aim of realizing short-term returns as a result of price changes, are included in the category *financial assets at fair value through profit or loss* and presented as current assets. Derivatives are classified as held for trading unless they are designated as effective hedging instruments. The Group also classifies certain financial instruments under this category when doing so eliminates or mitigates measurement or recognition inconsistencies that could arise from the application of other criteria for measuring assets and liabilities or for recognizing gains and losses on

different bases. Also in this category are financial assets for which an investment and disposal strategy has been designed based on their fair value. Financial instruments included in this category are recorded at fair value and are remeasured at subsequent reporting dates at fair value, with any realized or unrealized gains or losses recognized in the income statement.

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Financial assets with fixed maturities that the Group has the positive intention and ability legal and financial to hold until maturity are classified as *held-to-maturity* and presented as *Current assets* or *Non-current assets*, depending on the time left until settlement. Financial assets falling into this category are measured at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the investments are settlement or impaired, as well as through the amortization process.

Financial assets which the Group intends to hold for an unspecified period of time and could be sold at any time to meet specific liquidity requirements or in response to interest-rate movements are classified as *available-for-sale*. These investments are recorded under *Non-current assets*, unless it is probable and feasible that they will be sold within 12 months. Financial assets in this category are measured at fair value. Gains or losses arising from changes in fair value are recognized in equity at each financial year end until the investment is derecognized or determined to be impaired, at which time the cumulative gain or loss previously reported in equity is recognized in profit or loss. Dividends from *available-for-sale* investments are recognized in the income statement when the Group has the right to receive the dividend. Fair value is determined in accordance with the following criteria:

1. Listed securities on active markets:

Fair value is considered to be quoted market prices or other valuation references available at the closing date.

2. Unlisted securities:

Fair value is determined using valuation techniques such as discounted cash flow analysis, option valuation models, or by reference to arms length market transactions. When fair value cannot be reliably determined, these investments are carried at cost.

Loans and receivables include financial assets with fixed or determinable payments that are not quoted in an active market and do not fall into any of the previous categories. These assets are carried at amortized cost using the effective interest rate method. Gains and losses are recognized in the income statement when the loans and receivables are derecognized or impaired, as well as through the amortization process. Trade receivables are recognized at the original invoice amount. A valuation adjustment is recorded when there is objective evidence of customer collection risk. The amount of the valuation adjustment is calculated as the difference between the carrying amount of the doubtful trade receivables and their recoverable amount. As a general rule, current trade receivables are not discounted.

The Group assesses at each reporting date whether a financial asset is impaired. If there is objective evidence that an impairment loss on a financial asset carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses that have not been incurred) discounted at the financial asset's original effective interest rate.

For equity instruments included in *available-for-sale* financial assets, the Company assesses individually for each security whether there is any objective evidence that an asset is impaired as a result of one or more events indicating that the carrying amount of the security will not be recovered. If there is objective evidence that an *available-for-sale* financial instrument is impaired, the cumulative loss recognized in equity, measured as the difference between the acquisition cost (net of any principal payments and amortization made) and the fair value at that date, less any impairment loss on that investment previously recognized in the income statement.

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Financial assets are only fully or partially derecognized when:

1. The rights to receive cash flows from the asset have expired.
2. An obligation to pay the cash flows received from the asset to a third party has been assumed.
3. The rights to receive cash flows from the asset have been transferred to a third party and all the risks and rewards of the asset have been substantially transferred.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and at banks, demand deposits and other highly liquid investments with an original maturity of three months or less. These items are stated at historical cost, which does not differ significantly from realizable value.

For the purpose of the consolidated statement of cash flows, cash and cash equivalents are shown net of any outstanding bank overdrafts.

Preferred stock

Preferred shares are classified as a liability or equity instrument depending on the issuance terms. A preferred share issue is considered equity only when the issuer is not obliged to give cash or another financial instrument in the form of either principle repayment or dividend payment, whereas it is recorded as a financial liability on the statement of financial position whenever the Telefónica Group does not have the right to avoid cash payments.

Issues and interest-bearing debt

These debts are recognized initially at the fair value of the consideration received less directly attributable transaction costs. After initial recognition, these financial liabilities are measured at amortized cost using the effective interest rate method. Any difference between the cash received (net of transaction costs) and the repayment value is recognized in the income statement over the life of the debt. Interest-bearing debt is considered non-current when its maturity is over 12 months or the Telefónica Group has full discretion to defer settlement for at least another 12 months from the reporting date.

Financial liabilities are derecognized when the obligation under the liability is discharged, cancelled or expires. Where an existing financial liability is replaced by another from the same lender under substantially different terms, such an exchange is treated as a derecognition of the original liability and the recognition of a new liability, and the difference between the respective carrying amounts is recognized in the income statement.

Derivative financial instruments and hedge accounting

Derivative financial instruments are initially recognized at fair value, normally equivalent to cost. Their carrying amounts are subsequently remeasured at fair value. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. They are classified as current or non-current depending on whether they fall due within less than or after one year, respectively. Derivatives that meet all the criteria for consideration as long-term hedging instruments are recorded as non-current assets or liabilities, depending on their positive or negative values.

The accounting treatment of any gain or loss resulting from changes in the fair value of a derivative depends on whether the derivative in question meets all the criteria for hedge accounting and, if appropriate, on the nature of the hedge.

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The Group designates certain derivatives as:

1. Fair value hedges, when hedging the exposure to changes in the fair value of a recognized asset or liability; or
2. Cash flow hedges, when hedging exposure to variability in cash flows that is either attributable to a particular risk associated with a recognized asset or liability or a forecast transaction; or
3. Hedges of a *net investment in a foreign operation*.

A hedge of the foreign currency risk in a firm commitment is accounted for as either a fair value or a cash flow hedge. Changes in fair value of derivatives that qualify as fair value hedges are recognized in the income statement, together with changes in the fair value of the hedged asset or liability attributable to the risk being hedged.

Changes in the fair value of derivatives that qualify and have been assigned to hedge cash flows, which are highly effective, are recognized in equity. The portion considered ineffective is taken directly to the income statement. Fair value changes from hedges that relate to firm commitments or forecast transactions that result in the recognition of non-financial assets or liabilities are included in the initial measurement of those assets or liabilities. Otherwise, changes in fair value previously recognized in equity are recognized in the income statement in the period in which the hedged transaction affects profit or loss.

An instrument designed to hedge foreign currency exposure from a net investment in a foreign operation is accounted for in a similar manner to cash flow hedges.

The application of the Company's corporate risk-management policies could result in financial risk-hedging transactions that make economic sense, yet do not comply with the criteria and effectiveness tests required by accounting policies to be treated as hedges. Alternatively, the Group may opt not to apply hedge accounting criteria in certain instances. In these cases, gains or losses resulting from changes in the fair value of derivatives are taken directly to the income statement. Transactions used to reduce the exchange rate risk relating to the income contributed by foreign subsidiaries are not treated as hedging transactions.

From inception, the Group formally documents the hedging relationship between the derivative and the hedged item, as well as the associated risk management objectives and strategies. The documentation includes identification of the hedge instrument, the hedged item or transaction and the nature of the risk being hedged. In addition, it states how it will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk. Hedge effectiveness is assessed, prospectively and retrospectively, both at the inception of the hedge relationship and on a systematic basis throughout the life of the hedge.

Hedge accounting is discontinued whenever the hedging instrument expires or is sold, terminated or settled, the hedge no longer meets the criteria for hedge accounting or the Company revokes the designation. In these instances, gains or losses accumulated in equity are not taken to the income statement until the forecast transaction or commitment affects profit or loss. However, if the hedged transaction is no longer expected to occur, the cumulative gains or losses recognized directly in equity are taken immediately to the income statement.

The fair value of the derivative portfolio includes estimates based on calculations using observable market data, as well as specific pricing and risk-management tools commonly used by financial entities.

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j) Inventories

Materials stored for use in investment projects and inventories for consumption and replacement are valued at the lower of weighted average cost and net realizable value.

When the cash flows associated with the purchase of inventory are effectively hedged, the corresponding gains and losses accumulated in equity become part of the cost of the inventories acquired.

Obsolete, defective or slow-moving inventories have been written down to estimated net realizable value. The recoverable amount of inventory is calculated based on inventory age and turnover.

k) Treasury share instruments

Treasury shares are stated at cost and deducted from equity. Any gain or loss obtained on the purchase, sale, issue or cancellation of treasury shares is recognized directly in equity.

Call options on treasury shares to be settled through physical delivery of a fixed number of _____ shares at a fixed price are considered treasury share instruments. They are valued at the amount of premium paid and are presented as a reduction of equity. If the call options are exercised upon maturity, the amount previously recognized is reclassified as treasury shares together with the price paid. If the options are not exercised upon maturity, the amount is recognized directly in equity.

l) Provisions

Pensions and other employee obligations

Provisions required to cover the accrued liability for defined-benefit pension plans are determined using the projected unit credit actuarial valuation method. The calculation is based on demographic and financial assumptions for each country considering the macroeconomic environment. The discount rates are determined based on market yield curves. Plan assets are measured at fair value. Actuarial gains and losses on post-employment defined-benefit plans are recognized immediately in equity.

For defined-contribution pension plans, the obligations are limited to the payment of the contributions, which are taken to the income statement as accrued.

Provisions for post-employment benefits (e.g. early retirement or other) are calculated individually based on the terms agreed with the employees. In some cases, these may require actuarial valuations based on both demographic and financial assumptions.

Other provisions

Provisions are recognized when the Group has a present obligation (legal or constructive), as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. When the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognized as a separate asset, but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money is material, provisions are discounted, and the corresponding increase in the provision due to the passage of time is recognized as a finance cost.

m) Share-based payments

The Group has compensation systems linked to the market value of its shares, providing employees share options. Compensation plans are cash-settled in certain cases, while equity-settled in others.

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For cash-settled share-based transactions, the total cost of the rights granted is recognized as an expense in the income statement over the vesting period with recognition of a corresponding liability (Performance period). The total cost of the options is measured initially at fair value at the grant date using statistical techniques, taking into account the terms and conditions established in each share option plan. At each subsequent reporting date, the Group reviews its estimate of fair value and the number of options it expects to be settled, remeasuring the liability, with any changes in fair value recognized in the income statement.

For equity-settled share option plans, fair value at the grant date is measured by applying statistical techniques or using benchmark securities. The cost is recognized, together with a corresponding increase in equity, over the vesting period. At each subsequent reporting date, the Company reviews its estimate of the number of options it expects to vest, with a corresponding adjustment to equity.

n) Corporate income tax

This heading in the accompanying consolidated income statement includes all the expenses and credits arising from the corporate income tax levied on the Spanish Group companies and similar taxes applicable to the Group's foreign operations.

The income tax expense of each year includes both current and deferred taxes, where applicable.

Current tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the taxation authorities. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted by the reporting date.

Deferred taxes are calculated based on a statement of financial position analysis of the temporary differences generated as a result of the difference between the tax bases of assets and liabilities and their respective carrying amounts.

The main temporary differences arise due to discrepancies between the tax bases and carrying amounts of plant, property and equipment, intangible assets, and non-deductible provisions, as well as differences in the fair value and tax bases of net assets acquired from a subsidiary, associate or joint venture.

Furthermore, deferred taxes arise from unused tax credits and tax loss carryforwards.

The Group determines deferred tax assets and liabilities by applying the tax rates that will be effective when the corresponding asset is received or the liability is settled, based on tax rates and tax laws that are enacted (or substantively enacted) at the reporting date.

Deferred income tax assets and liabilities are not discounted to present value and are classified as non-current, irrespective of the date of their reversal.

The carrying amount of deferred income tax assets is reviewed at each reporting date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilized. Unrecognized deferred income tax assets are reassessed at each reporting date and are recognized to the extent that it has become probable that future taxable profit will allow the deferred tax asset to be recovered.

Deferred tax liabilities on investments in subsidiaries, branches, associates and joint ventures are not recognized if the parent company is in a position to control the timing of the reversal and if the reversal is

unlikely to take place in the foreseeable future.

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Deferred income tax relating to items directly recognized in equity is recognized in equity. Deferred tax assets and liabilities arising from the initial recognition of the purchase price allocation of business combinations impact the amount of goodwill. However, subsequent changes in tax assets acquired in a business combination are recognized as an adjustment to profit or loss.

Deferred tax assets and liabilities are offset if a legally enforceable right exists to set off current tax assets against current tax liabilities and the deferred taxes relate to the same taxable entity and the same taxation authority.

o) *Revenue and expenses*

Revenue and expenses are recognized on the income statement based on an accruals basis; i.e. when the goods or services represented by them take place, regardless of when actual payment or collection occurs.

The Telefónica Group principally obtains revenues from providing the following telecommunications services: traffic, connection fees, regular (normally monthly) network usage fees, interconnection, network and equipment leasing, handset sales and other services such as pay-TV and value-added services (e.g. text or data messaging) and maintenance. Products and services may be sold separately or in promotional packages (bundled).

Revenues from calls carried on Telefónica's networks (traffic) entail an initial call establishment fee plus a variable call rate, based on call length, distance and type of service. Both wireline and wireless traffic is recognized as revenue as service is provided. For prepaid calls, the amount of unused traffic generates a deferred revenue recognized in Trade and other payables on the statement of financial position. Prepaid cards generally expire within 12 months and any deferred revenue from prepaid traffic is taken directly to the income statement when the card expires as the Group has no obligation to provide service after this date.

Revenue from traffic sales and services at a fixed rate over a specified period of time (flat rate) are recognized on a straight-line basis over the period of time covered by the rate paid by the customer.

Connection fees arising when customers connect to the Group's network are deferred and taken to the income statement throughout the average estimated customer relationship period, which varies by type of service. All related costs, except those related to network enlargement expenses, administrative expenses and overhead, are recognized in the income statement as incurred.

Installment fees are taken to the income statement on a straight-line basis over the related period. Equipment leases and other services are taken to profit or loss as they are consumed.

Interconnection fees from wireline-wireless and wireless-wireline calls and other customer services are recognized in the period in which the calls are made.

Revenues from handset and equipment sales are recognized once the sale is considered complete, i.e., generally when delivered to the end customer.

In the wireless telephony business there are loyalty campaigns whereby customers obtain points for the telephone traffic they generate. The amount assigned to points awarded is recognized as deferred income until the points are exchanged and recognized as sales or services according to the product or service chosen by the customer. This exchange can be for discounts on the purchase of handsets, traffic or other types of services depending on the number of points earned and the type of contract involved. The accompanying

consolidated statements of financial position include the related deferred revenue, based on an estimate of the value of the points accumulated at year end, under Trade and other payables.

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Bundle packages, which include different elements, are sold in the wireline, wireless and internet businesses. They are assessed to determine whether it is necessary to separate the separately identifiable elements and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values (i.e. the fair value of each element relative to the total fair value of the package).

As connection or initial activation fees, or upfront non-refundable fees, cannot be separately identifiable as elements in these types of packages, any revenues received from customer for these items are allocated to the remaining elements. However, amounts contingent upon delivery of undelivered elements are not allocated to delivered elements.

All expenses related to mixed promotional packages are taken to the income statement as incurred.

p) Use of estimates, assumptions and judgments

The key assumptions concerning the future and other relevant sources of uncertainty in estimates at the reporting date that could have a significant impact on the consolidated financial statements within the next financial year are discussed below.

A significant change in the facts and circumstances on which these estimates and related judgments are based could have a material impact on the Group's results and financial position.

Property, plant and equipment, intangible assets and goodwill

The accounting treatment of investments in property, plant and equipment and intangible assets entails the use of estimates to determine the useful life for depreciation and amortization purposes and to assess fair value at their acquisition dates for assets acquired in business combinations.

Determining useful life requires making estimates in connection with future technological developments and alternative uses for assets. There is a significant element of judgment involved in making technological development assumptions, since the timing and scope of future technological advances are difficult to predict.

When an item of property, plant and equipment or an intangible asset is considered to be impaired, the impairment loss is recognized in the income statement for the period. The decision to recognize an impairment loss involves estimates of the timing and amount of the impairment, as well as analysis of the reasons for the potential loss. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

The Telefónica Group evaluates its cash-generating units' performance regularly to identify potential goodwill impairments. Determining the recoverable amount of the cash-generating units to which goodwill is allocated also entails the use of assumptions and estimates and requires a significant element of judgment.

Deferred income taxes

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings. The ability to recover these taxes depends ultimately on the Group's ability to generate taxable earnings over the period for which the deferred tax assets remain deductible. This analysis is based on the estimated schedule for reversing deferred tax liabilities, as well as estimates of taxable earnings, which are sourced from internal

projections and are continuously updated to reflect the latest trends.

The recognition of tax assets and liabilities depends on a series of factors, including estimates as to the timing and realization of deferred tax assets and the projected tax payment schedule.

Actual Group company income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances.

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Provisions

Provisions are recognized when the Group has a present obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. This obligation may be legal or constructive, deriving from inter alia regulations, contracts, normal practices or public commitments that lead third parties to reasonably expect that the Group will assume certain responsibilities. The amount of the provision is determined based on the best estimate of the outflow of resources required to settle the obligation, bearing in mind all available information at the statement of financial position date, including the opinions of independent experts such as legal counsel or consultants.

Given the uncertainties inherent in the estimates used to determine the amount of provisions, actual outflows of resources may differ from the amounts recognized originally on the basis of the estimates.

Revenue recognition

Connection fees

Connection fees, generated when customers connect to the Group's network, are deferred and recognized as revenue over the average estimated customer relationship period.

The estimate of the average estimated customer relationship period is based on the recent history of customer churn. Potential changes in estimates could lead to changes in both the amount and timing of the future recognition of revenues.

Bundled offers

Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values.

Determining fair values for each identified element requires estimates that are complex due to the nature of the business.

A change in estimates of fair values could affect the apportionment of revenue among the elements and, as a result, the date of recognition of revenues.

q) Consolidation methods

The consolidation methods applied are as follows:

Full consolidation method for companies over which the Company controls either by exercising effective control or by virtue of agreements with the other shareholders.

Proportionate consolidation method for companies which are jointly controlled with third parties (joint ventures). Similar items are grouped together such that the corresponding proportion of these companies overall assets, liabilities, expenses and revenues and cash flows are integrated on a line by line basis into the consolidated financial statements.

Equity method for companies in which there is significant influence, but not control or joint control with third parties.

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In certain circumstances, some of the Group's investees may require a qualified majority to adopt certain resolutions. This, together with other factors, is taken into account when selecting the consolidation method.

All material accounts and transactions between the consolidated companies were eliminated on consolidation. The returns generated on transactions involving capitalizable goods or services by subsidiaries with other Telefónica Group companies were eliminated on consolidation.

The financial statements of the consolidated companies have the same financial year end as the parent company's individual financial statements and are prepared using the same accounting policies. In the case of Group companies whose accounting and valuation methods differed from those of the Telefónica Group, adjustments were made on consolidation in order to present the consolidated financial statements on a uniform basis.

The consolidated income statement and consolidated statement of cash flows include the revenues and expenses and cash flows of companies that are no longer in the Group up to the date on which the related holding was sold or the company was liquidated, and those of the new companies included in the Group from the date on which the holding was acquired or the company was incorporated through year end.

Revenue and expenses associated with discontinued operations are presented in a separate line on the consolidated income statement. Discontinued operations are those with identifiable operations and cash flows (for both operating and management purposes) and that represent a line of business or geographic unit which has been disposed of or is available for sale.

The share of non-controlling interests in the equity and results of the fully consolidated subsidiaries is presented under "Non-controlling interests" on the consolidated statement of financial position and income statement, respectively.

r) *Acquisitions and disposals of non-controlling interests*

Changes in investments in subsidiaries without loss of control:

Prior to January 1, 2010, the effective date of IAS 27 (Amended) *Consolidated and separate financial statements*, the Telefónica Group treated increases in equity investments of companies already controlled by the Group via purchases of non-controlling interests by recognizing any difference between the acquisition price and the carrying amount of the minority interest's participation as goodwill. In transactions involving the sale of investments in subsidiaries in which the Group retained control, the Telefónica Group derecognized the carrying amount of the shareholding sold, including any related goodwill. The difference between this amount and the sale price was recognized as a gain or loss in the consolidated income statement.

Effective January 1, 2010, any increase or decrease in the percentage of ownership interests in subsidiaries that does not result in a loss of control is accounted for as a transaction with owners in their capacity as owners, which means that as of the aforementioned date, these transactions do not give rise to goodwill or generate profit or loss; any difference between the carrying amount of the non-controlling interests and the fair value of the consideration received or paid, as applicable, is recognized in equity.

Table of Contents*Commitments to acquire non-controlling interests (put options):*

Put options granted to non-controlling interests of subsidiaries are measured at the exercise price and classified as a financial liability, with a deduction from non-controlling interests on the consolidated statement of financial position at each reporting date. Prior to January 1, 2010, the effective date of IAS 27 (Amended) *Consolidated and separate financial statements*, where the exercise price exceeded the balance of non-controlling interests, the difference was recognized as an increase in the goodwill of the subsidiary. At each reporting date, the difference was adjusted based on the exercise price of the options and the carrying amount of non-controlling interests. As of January 1, 2010, the effect of this adjustment is recognized in equity in line with the treatment of transactions with owners described in the previous paragraphs.

s) ***New IFRS and interpretations of the IFRS Interpretations Committee (IFRIC)***

The accounting policies applied in the preparation of the financial statements for the year ended December 31, 2010 are consistent with those used in the preparation of the Group's consolidated annual financial statements for the year ended December 31, 2009, except for the adoption of new standards, amendments to standards and interpretations published by the International Accounting Standards Board (IASB) and the IFRS Interpretations Committee (IFRIC), and adopted by the European Union, effective as of January 1, 2010, noted below:

Revised IFRS 3, *Business Combinations*

The revised version of IFRS 3 introduces significant changes in the accounting for business combinations. The main impacts are as follows:

To allow a choice on a transaction-by-transaction basis for the measurement of non-controlling interests either at fair value or at the non-controlling interests' share of the fair value of the identifiable net assets of the acquiree.

To change the recognition and subsequent accounting requirements for contingent consideration. Under the revised standard, contingent consideration is measured at fair value at the acquisition date; subsequent adjustments to the consideration are recognized against goodwill only to the extent that they arise from better information about the fair value at the acquisition date, and they occur within the measurement period (a maximum of 12 months from the acquisition date). All subsequent adjustments are recognized in profit or loss.

To require that acquisition-related costs be accounted for separately from the business combination, generally leading to those costs being recognized as an expense in profit or loss as incurred, whereas previously they were accounted for as part of the cost of the acquisition.

To require that in a business combination achieved in stages, the acquirer remeasure its previously held equity interest in the acquiree at its acquisition-date fair value and recognize the resulting gain or loss, if any, in profit or loss.

To require that in business combinations in which the acquisition date is prior to January 1, 2010, the acquirer recognizes changes in acquired deferred tax benefits of the acquiree as an adjustment to profit and loss.

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Its adoption has affected the accounting for business combination transactions that occurred in the current period (Note 5).

Amendment to IAS 27, Consolidated and Separate Financial Statements

IAS 27 (Amended) requires that a change in the ownership interest of a subsidiary without loss of control be accounted for as a transaction with owners in their capacity as owners. Therefore, such transactions will no longer give rise to goodwill, nor will they give rise to a gain or loss. Furthermore, the amendment changes the accounting for the loss of control of a subsidiary, meaning that any retained interest in the former subsidiary is remeasured at its fair value at the date control is lost, with any resulting gain or loss recognized in profit or loss.

The changes to IAS 27 (Amended) affect transactions with non-controlling interests and future transactions that result in the loss of control of subsidiaries on or after January 1, 2010.

Improvements to IFRS (April 2009)

This text introduces a number of improvements to IFRS in force primarily to eliminate inconsistencies and clarifying the wording of some of these standards. These improvements have not had a significant impact on the financial position or performance of the Telefónica Group.

Amendment to IFRS 2, Share-based Payment – Group Cash-settled Share-based Payment Transactions

The standard has been amended to clarify the accounting for group cash-settled share-based payment transactions. The amendment also supersedes IFRIC 8 and IFRIC 11. The adoption of this amendment did not have a significant impact on the financial position or performance of the Group.

Amendment of IAS 39, Financial Instruments: Recognition and Measurement – Eligible hedged items

The amendment clarifies two issues relating to hedge accounting: designation of inflation as a hedged risk in a hedging relationship, and designation of call options as hedging instruments to hedge financial or non-financial items. The adoption of this amendment did not have a significant impact on the financial position or performance of the Group.

IFRIC 17, Distributions of non-cash assets to owners

This interpretation provides guidance on accounting for dividends in kind, by clarifying when to recognize the dividend payable, the measurement requirements for this kind of dividend and how to account for the differences between the carrying amount of the assets distributed and the carrying amount of the payment obligation that can arise when the dividend in kind is settled. The application of this interpretation has not had a significant impact on the financial position or performance of the Group.

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New standards and IFRIC interpretations issued but not in effect as of December 31, 2010

At the date of preparation of the accompanying consolidated financial statements, the following IFRS, amendments and IFRIC interpretations had been published, but their application was not mandatory:

Standards and amendments		Mandatory application: annual periods beginning on or after
IFRS 9	<i>Financial Instruments</i>	January 1, 2013
Revised IAS 24	<i>Related Party Disclosures</i>	January 1, 2011
Amendments to IAS 32	<i>Classification of rights issues</i>	February 1, 2010
<i>Improvements to IFRS (May 2010)</i>		January 1, 2011 (*)
Amendments to IFRS 7	<i>Disclosures about transfers of financial assets</i>	July 1, 2011
Amendments to IAS 12	<i>Deferred tax: Recovery of underlying assets</i>	January 1, 2012

(*) The changes to IFRS 3 (2008) regarding the measurement of non-controlling interests and share-based payments, as well as the changes to IAS 27 (2008) and the amendment to IFRS 3 (2008) regarding contingent consideration arising in business combinations acquired prior to the effective date of the revised standards are effective for annual periods beginning on or after July 1, 2010.

Interpretations		Mandatory application: annual periods beginning on or after
IFRIC 19	<i>Extinguishing financial liabilities with equity instruments</i>	July 1, 2010
Amendments to IFRIC 14	<i>Prepayment of minimum funding requirements</i>	January 1, 2011

The Group is currently assessing the impact of the application of these standards, amendments and interpretations. Based on the analyses made to date, the Group estimates that their adoption will not have a significant impact on the consolidated financial statements in the initial period of application. However, the changes introduced by IFRS 9 will affect financial assets and future transactions with financial assets carried out on or after January 1, 2013.

(4) SEGMENT INFORMATION

Combining the wireline and wireless telephony services underscores the need to manage the business by region in order to offer customers the best integrated solutions and support wireless-wireline convergence.

To implement this management model, the Group has three large business areas: Telefónica Spain, Telefónica Europe and Telefónica Latin America, with each overseeing the integrated business. This forms the basis of the segment reporting in these consolidated financial statements.

Telefónica Spain oversees the wireline and wireless telephony, broadband, internet, data, broadband TV, value added services operations and their development in Spain.

Telefónica Latin America oversees the same operations in Latin America.

Telefónica Europe oversees the wireline, wireless, broadband, value added services and data operations in the UK, Germany, Ireland, the Czech Republic and the Slovak Republic.

The Telefónica Group is also involved in the media and contact center businesses through investments in Telefónica de Contenidos and Atento, included under Other and eliminations together with the consolidation adjustments and the remaining Group companies.

The segment reporting takes into account the impact of the purchase price allocation (PPA) to assets acquired and the liabilities assumed from the companies included in each segment. The assets and liabilities presented in each segment are those managed by the heads of each segment, irrespective of their legal structure.

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The Group manages its borrowing activities and tax implications centrally. Therefore, it does not disclose the related assets, liabilities, revenue and expenses breakdown by reportable segments.

In order to present the information by region, revenue and expenses arising from intra-group invoicing for the use of the trademark and management services have been eliminated from the operating results of each Group region, while centrally-managed projects have been incorporated at a regional level. These adjustments have no impact on the Group's consolidated results.

Inter-segment transactions are carried out at market prices.

Key information for these segments is as follows:

	Telefónica	2010 Telefónica Latin America	Telefónica	Other and eliminations	Total Group
Millions of euros	Spain		Europe		
Revenue from operations	18,711	26,041	15,255	730	60,737
<i>External sales</i>	<i>18,301</i>	<i>25,828</i>	<i>15,198</i>	<i>1,410</i>	<i>60,737</i>
<i>Inter-segment sales</i>	<i>410</i>	<i>213</i>	<i>57</i>	<i>(680)</i>	
Other operating income and expenses	(10,191)	(12,259)	(11,241)	(1,269)	(34,960)
OIBDA	8,520	13,782	4,014	(539)	25,777
Depreciation and amortization	(2,009)	(4,061)	(3,091)	(142)	(9,303)
OPERATING INCOME	6,511	9,721	923	(681)	16,474
CAPITAL EXPENDITURE	2,021	5,535	3,072	216	10,844
INVESTMENTS IN ASSOCIATES	1	71		5,140	5,212
FIXED ASSETS	14,179	46,045	28,742	1,439	90,405
TOTAL ALLOCATED ASSETS	23,291	65,731	35,164	5,589	129,775
TOTAL ALLOCATED LIABILITIES	11,021	29,375	9,855	47,840	98,091

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	2009				
	Telefónica	Telefónica	Telefónica	Other and	Total
Millions of euros	Spain	Latin	Europe	eliminations	Group
Revenue from operations	19,703	22,983	13,533	512	56,731
<i>External sales</i>	<i>19,354</i>	<i>22,786</i>	<i>13,468</i>	<i>1,123</i>	<i>56,731</i>
<i>Inter-segment sales</i>	<i>349</i>	<i>197</i>	<i>65</i>	<i>(611)</i>	
Other operating income and expenses	(9,946)	(13,840)	(9,623)	(719)	(34,128)
OIBDA	9,757	9,143	3,910	(207)	22,603
Depreciation and amortization	(2,140)	(3,793)	(2,895)	(128)	(8,956)
OPERATING INCOME	7,617	5,350	1,015	(335)	13,647
CAPITAL EXPENDITURE	1,863	3,450	1,728	216	7,257
INVESTMENTS IN ASSOCIATES	3	152		4,781	4,936
FIXED ASSETS	14,082	25,016	26,962	1,351	67,411
TOTAL ALLOCATED ASSETS	26,156	42,377	32,097	7,511	108,141
TOTAL ALLOCATED LIABILITIES	13,363	22,862	6,435	41,207	83,867

	2008				
	Telefónica	Telefónica	Telefónica	Other and	Total
Millions of euros	Spain	Latin	Europe	eliminations	Group
Revenue from operations	20,838	22,174	14,309	625	57,946
<i>External sales</i>	<i>20,518</i>	<i>21,974</i>	<i>14,253</i>	<i>1,201</i>	<i>57,946</i>
<i>Inter-segment sales</i>	<i>320</i>	<i>200</i>	<i>56</i>	<i>(576)</i>	
Other operating income and expenses	(10,553)	(13,729)	(10,129)	(616)	(35,027)
OIBDA	10,285	8,445	4,180	9	22,919
Depreciation and amortization	(2,239)	(3,645)	(3,035)	(127)	(9,046)
OPERATING INCOME	8,046	4,800	1,145	(118)	13,873
CAPITAL EXPENDITURE	2,208	4,035	2,072	86	8,401
	99	107		2,571	2,777

INVESTMENTS IN
ASSOCIATES

FIXED ASSETS	14,372	21,959	27,265	1,193	64,789
TOTAL ALLOCATED ASSETS	32,273	37,942	32,726	(3,045)	99,896
TOTAL ALLOCATED LIABILITIES	20,754	21,998	6,420	31,162	80,334

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The composition of segment revenue from operations, detailed by the main countries in which the Group operates, is as follows:

Country	MILLIONS OF EUROS											
	2010				2009				2008			
	Wireline	Wireless	Other and eliminations	Total	Wireline	Wireless	Other and eliminations	Total	Wireline	Wireless	Other and eliminations	Total
Spain	11,397	8,550	(1,236)	18,711	12,167	8,965	(1,429)	19,703	12,581	9,684	(1,427)	20,838
Latin America				26,041				22,983				22,174
Brazil	6,843	4,959	(683)	11,119	5,766	3,036	(426)	8,376	6,085	2,932	(411)	8,606
Argentina	1,187	1,979	(93)	3,073	1,047	1,643	(81)	2,609	1,027	1,585	(85)	2,527
Chile	1,038	1,266	(107)	2,197	893	1,010	(72)	1,831	974	1,051	(89)	1,936
Peru	1,097	1,001	(138)	1,960	1,006	840	(130)	1,716	977	773	(123)	1,627
Columbia	700	872	(43)	1,529	615	685	(31)	1,269	710	815	(35)	1,490
Mexico	N/A	1,832		1,832	N/A	1,552		1,552	N/A	1,631		1,631
Venezuela	N/A	2,318		2,318	N/A	3,773		3,773	N/A	2,769		2,769
Remaining operators and inter-segment eliminations				2,013				1,857				1,588
Europe				15,255				13,533				14,309
UK	134	7,067		7,201	70	6,442		6,512	33	7,019		7,052
Germany	1,412	3,414		4,826	558	3,188		3,746	496	3,099		3,595
Czech Republic	960	1,237		2,197	1,015	1,248	(3)	2,260	1,183	1,388	10	2,581
Ireland	4	844		848	1	904		905	N/A	957		957
Remaining operators and inter-segment eliminations				183				110				124
Other and inter-segment eliminations				730				512				625
Total Group				60,737				56,731				57,946

(5) BUSINESS COMBINATIONS AND ACQUISITIONS OF NON-CONTROLLING INTERESTS**Business combinations****2010**

Acquisition of Brasilcel

As described in Note 2, on July 28, 2010, Telefónica and Portugal Telecom signed an agreement for the acquisition by Telefónica of 50% of the capital stock of Brasilcel (company then jointly owned by Telefónica and Portugal Telecom, which owned shares representing, approximately, 60% of the capital stock of Brazilian company Vivo Participações, S.A.). The acquisition price for the aforementioned capital stock of Brasilcel was 7,500 million euros, of which 4,500 million euros was paid at the closing of the transaction on September 27, 2010, 1,000 million euros on December 30, 2010, and the remaining 2,000 million euros deferred until October 31, 2011 (although Portugal Telecom may request for this last payment to be made on July 29, 2011, in which case the price of the acquisition and the closing payment would be reduced by 25 million euros).

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Furthermore, the aforementioned agreement established that Portugal Telecom waived its right to the declared dividend payable by Brasilcel of approximately 49 million euros.

Once the acquisition was consummated on September 27, 2010, in accordance with currently effective IFRS with respect to a business combination achieved in stages (see Note 3.c), the Telefónica Group remeasured the previously held 50% investment in Brasilcel, N.V. The difference between the carrying value of the investment at the date of acquisition and its fair value, equivalent to approximately 80% of the price paid to Portugal Telecom for 50% of Brasilcel, N.V., gave rise to a capital gain of 3,797 million euros. The remeasurement considered, among other factors, that the previously held 50% investment in Brasilcel, N.V., coupled with the additional percentage interest acquired, provides the Telefónica Group sole control of the Vivo Participações group. The aforementioned capital gain is recognized under *Other income* in the accompanying consolidated income statement

On December 21, 2010, the merger between Telefónica and Brasilcel was registered in the Madrid Mercantile Register, with the Company becoming a direct shareholder of the Brazilian consolidated group Vivo, with approximately 60% of its capital stock.

Pursuant to Brazilian legislation, on October 26, 2010, Telefónica announced a tender offer for the acquisition of voting shares of Vivo Participações, S.A. held by non-controlling interests, representing approximately 3.8% of its capital stock, for an amount equivalent to 80% of the price agreed in the Portugal Telecom acquisition previously described and subject to regulatory approval. This offer was approved by the Brazilian market regulator (C.V.M.) on February 11, 2011 (see Note 24).

Similarly, and in accordance with IFRS 3 (2008), the Group opted to record at fair value the non-controlling interests of Vivo Participações, S.A. corresponding to non-voting shares, determining such fair value based on a discounted cash flows valuation determined in accordance with the company's business plans.

In 2010, Telefónica proceeded to recognize and value the identifiable assets acquired and liabilities assumed at the date of acquisition.

These values were determined using various measurement methods for each type of asset and/or liability based on the best available information. The advice of experts has also been considered in addition to the various other considerations made in determining these fair values.

The methods and assumptions used to measure these fair values are as follows:

Licenses

The fair value of the licenses has been determined through the use of the Multi-period Excess Earnings Method (MEEM), which is based on a discounted cash flows analysis of the estimated future economic benefits attributable to the licenses, net of the elimination of charges related to contributing assets involved in the generation of such cash flows and excluding cash flows attributable to the customer base.

This method assumes that intangible assets rarely generate income on their own. Thus, cash flows attributable to the licenses are those remaining after the return on investment of all of the contributing assets required to generate the projected cash flows.

Table of Contents*Customer base*

The customer base has been measured using the MEEM, which is based on a discounted cash flow analysis of the estimated future economic benefits attributable to the customer base, net of the elimination of charges involved in its generation. An analysis of the average length of customer relationships, using the retirement rate method, was performed in order to estimate the remaining useful life of the customer base.

The objective of the analysis of useful lives is to estimate a survival curve that predicts future customer churn of our current customer base. The so-called Iowa curves were considered to approximate the survival curve of customers.

Trademark

The fair value of the trademark was calculated using the relief-from-royalty method. This method establishes that an asset's value is calculated by capitalizing the royalties saved by holding the intellectual property. In other words the trademark owner generates a gain in holding the intangible asset rather than paying royalties for its use. The royalties saving was calculated by applying a market royalty rate (expressed as a percentage of revenues) to future revenues expected to be generated from the sale of products and services associated with the intangible asset. A market royalty rate is the rate, normally expressed as a percentage of net revenues, that a knowledgeable, interested owner would charge a knowledgeable, interested user for the use of an asset in an arm's length transaction.

The provisional carrying amounts, fair values, goodwill and purchase consideration cost of the identifiable assets acquired and liabilities assumed in this transaction were the following:

Millions of euros (provisional data)	Brasilcel, N.V.	
	Carrying amount	Fair value
Intangible assets	3,466	8,401
Goodwill	932	N/A
Property, plant and equipment	2,586	2,586
Other non-current assets	1,921	1,953
Other current assets	3,101	3,101
Financial liabilities	(1,913)	(1,913)
Deferred tax liabilities	(828)	(2,506)
Other liabilities and current liabilities	(3,046)	(3,203)
Value of net assets	6,219	8,419
Purchase consideration cost		18,408
Goodwill (Note 7)		9,989

At the date of authorization for issue of these consolidated financial statements, the Group is finalizing the process of purchase price allocation and calculating the complete fair value of the identifiable assets acquired and liabilities assumed in the transaction. The conclusion of this process is pending the completion of the analysis of trends in the Brazilian wireline and wireless markets and its consideration with respect to the operations the Group is defining in these markets, which is expected to be carried out within a maximum of twelve months from the date of acquisition.

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The impact of this acquisition on cash and cash equivalents is as follows:

	Millions of euros
Cash and cash equivalents of the company acquired	401
Cash paid in the acquisition less declared dividend	5,448
Total net cash outflow	5,047

Of the amount of consideration agreed in the acquisition of Brasilcel (Vivo), 5,500 million euros was paid in 2010, while the remainder will be paid in 2011.

Had the acquisition occurred on January 1, 2010, the Telefónica Group's revenue from operations and OIBDA would have been approximately 2,400 million and 890 million euros higher, respectively.

Similarly, the contributions of the 50% investment in Brasilcel to revenue from operations and OIBDA since the date of its acquisition to December 31, 2010 were 875 million and 360 million euros, respectively.

Acquisition of HanseNet Telekommunikation GmbH (HanseNet)

On December 3, 2009, Telefónica's subsidiary in Germany, Telefónica Deutschland GmbH (Telefónica Deutschland), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH (HanseNet). The purchase and sale was subject to compliance with a series of conditions, including approval of the transaction by the pertinent competition authorities, which was obtained on January 29, 2010.

The transaction was completed on February 16, 2010, and having complied with the terms established in the agreement, the Telefónica Group completed the acquisition of 100% of the shares of HanseNet. The initial amount paid was approximately 913 million euros, which included 638 million euros of refinanced debt, leaving an acquisition cost of 275 million euros, which was finally reduced by 40 million euros at completion of the transaction.

Upon the acquisition of this shareholding, the purchase price was allocated to the identifiable assets acquired and the liabilities assumed using generally accepted valuation methods for each type of asset and/or liability, based on the best available information.

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The complete carrying amounts, fair values, goodwill and purchase consideration cost of the identifiable assets acquired and the liabilities assumed in this transaction at the date control was obtained are as follows:

Millions of euros	HanseNet	
	Carrying amount	Fair value
Intangible assets	277	309
Goodwill	461	N/A
Property, plant and equipment	514	531
Other assets	191	235
Financial liabilities	(657)	(665)
Deferred tax liabilities		(101)
Other liabilities and current liabilities	(303)	(356)
Value of net assets	483	(47)
Purchase Consideration cost		235
Goodwill (Note 7)		282

In addition, the impact of this acquisition on cash and cash equivalents was as follows:

	Millions of euros
Cash and cash equivalents of the company acquired	28
Cash paid in the acquisition	235
Total net cash outflow	207

The contributions to the Telefónica Group's revenue from operations and OIBDA from the consolidation of HanseNet in 2010 amounted to 786 million and 77 million euros, respectively.

2009

No significant business combinations were carried out in 2009 that had been completed as of December 31, 2009.

Acquisitions of non-controlling interests

There were no significant acquisitions of non-controlling interests in 2010 and 2009. The detail of transactions carried out in the year is provided in Appendix I.

Table of Contents**(6) INTANGIBLE ASSETS**

The composition of and movements in net intangible assets in 2010 and 2009 are as follows:

	Millions of euros							Balance at 12-31-10
	Balance at 12-31-09	Additions	Amortization	Disposals	Transfers and other	Translation differences and hyperinflation adjustments	Inclusion of Companies	
Development costs	162	104	(55)		(18)	2	11	206
Service concession arrangements and licenses	8,842	1,237	(836)		61	623	4,639	14,566
Software	2,948	945	(1,381)		558	134	322	3,526
Customer base	2,681		(563)		(141)	134	1,032	3,143
Other intangible assets	1,139	41	(309)	(18)	166	50	1,103	2,172
Prepayments on intangible assets	74	1,638			(324)	5	20	1,413
Net intangible assets	15,846	3,965	(3,144)	(18)	302	948	7,127	25,026

	Millions of euros							Balance at 12-31-09
	Balance at 12-31-08	Additions	Amortization	Disposals	Transfers and other	Translation differences and hyperinflation adjustments	Inclusion of Companies	
Development costs	175	84	(81)	(2)	(14)			162
Service concession arrangements and licenses	8,697	10	(786)		(8)	929		8,842
Software	2,394	964	(1,312)		772	130		2,948
Customer base	3,046		(512)		24	123		2,681
Other intangible assets	1,229	81	(170)	(1)	(51)	51		1,139
Prepayments on intangible assets	380	166			(479)	7		74

Net intangible assets	15,921	1,305	(2,861)	(3)	244	1,240	15,846
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The gross cost, accumulated amortization and impairment losses of intangible assets at December 31, 2010 and 2009 are as follows:

Millions of euros	Gross cost	Balance at December 31, 2010		Net intangible assets
		Accumulated amortization	Impairment losses	
Development costs	1,229	(1,023)		206
Service concession arrangements and licenses	20,438	(5,872)		14,566
Software	13,724	(10,172)	(26)	3,526
Customer base	6,481	(3,338)		3,143
Other intangible assets	3,445	(1,269)	(4)	2,172
Prepayments on intangible assets	1,413			1,413
Net intangible assets	46,730	(21,674)	(30)	25,026

Millions of euros	Gross cost	Balance at December 31, 2009		Net intangible assets
		Accumulated amortization	Impairment losses	
Development costs	1,613	(1,451)		162
Service concession arrangements and licenses	14,074	(5,232)		8,842
Software	11,175	(8,226)	(1)	2,948
Customer base	5,476	(2,795)		2,681
Other intangible assets	2,143	(973)	(31)	1,139
Prepayments on intangible assets	74			74
Net intangible assets	34,555	(18,677)	(32)	15,846

Inclusion of companies primarily consists of the incorporation into the Group of all of the assets of HanseNet, as well as the 50% interest in Vivo Participações, S.A. and the impact of the purchase price allocation process to the assets of Vivo Participações, S.A. (Note 5).

Additions of service concession arrangements and licenses in 2010 include the acquisition of the spectrum license in Mexico for 1,237 million euros in 2010, for the 1850-1910/1930-1990 MHz and 1710-1770/2110-2170 MHz frequencies. Telefónica México acquired eight additional blocks of radioelectric spectrum, equivalent to 140 MHz in the 1900 MHz auction and 60 MHz in the 1700 MHz auction. Payment of these licenses will be made in the next twenty years (Note 14).

Furthermore, in 2010 an advanced payment of 1,379 million euros has been made for the license for spectrum use in Germany, which is recognized as Additions of prepayments on intangible assets.

Details of the principal concessions and licenses with which the Group operates are provided in Appendix VI.

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Additions for 2010 and 2009 also include investments in software.

At December 31, 2010 and 2009, the Company carried intangible assets with indefinite useful lives of 108 and 111 million euros, respectively, related primarily to permanent licenses to operate wireless telecommunications services in Argentina.

Intangible assets are also subject to impairment tests whenever there are indications of a potential loss in value and, in any event, at the end of each year for intangible assets with indefinite useful lives. There was no significant impairment recognized in the consolidated financial statements for 2010 and 2009 as a result of these impairment tests.

Other intangible assets includes the amounts allocated to trademarks acquired in business combinations, of 2,339 million euros and 1,477 million euros at December 31, 2010 and 2009 (1,586 million euros and 901 million euros net of the related accumulated amortization).

Translation differences and hyperinflation adjustments reflects the impact of exchange rate movements on opening balances, as well as the impact of the monetary adjustments due to hyperinflation in Venezuela. The effect of exchange rates on movements in the year is included in the column corresponding to such movement.

(7) GOODWILL

The movement in this heading assigned to each Group segment was the following:

Millions of euros						
	Balance at 12-31-2009	Acquisitions	Disposals	Transfers	Translation differences and hyperinflation adjustments	Balance at 12-31-2010
2010						
Telefónica Spain	3,238	42				3,280
Telefónica Latin America	6,320	9,201		(350)	501	15,672
Telefónica Europe	9,810	397	(37)		251	10,421
Other	198				11	209
Total	19,566	9,640	(37)	(350)	763	29,582

Millions of euros						
	Balance at 12-31-2008	Acquisitions	Disposals		Translation differences and hyperinflation adjustments	Balance at 12-31-2009
2009						
Telefónica Spain	3,238					3,238
Telefónica Latin America	5,450		23	(209)	1,056	6,320
Telefónica Europe	9,452				358	9,810
Other	183		7		8	198
Total	18,323		30	(209)	1,422	19,566

Goodwill generated in the acquisition of foreign companies is treated as an asset denominated in the currency of the company acquired, and is therefore subject to exchange rate differences, which are included under Translation differences.

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The impairment tests carried out did not identify the need to recognize any material write-downs to goodwill at the 2010 and 2009 year ends as the recoverable amount, in all cases based on value in use, was higher than carrying amount.

In addition, sensitivity analyses were performed on changes reasonably expected to occur in the primary valuation variables, and the recoverable amount remained above the net carrying amount.

2010

Additions in 2010 include the goodwill of Vivo Participações, S.A. in the amount of 9,989 million euros which, net of the goodwill from the previously held investment, results in an addition to this line item of 9,200 million euros.

Similarly, the acquisitions of HanseNet and Jajah led to increases in goodwill of 282 million and 115 million euros, respectively, while the acquisition of Tuenti Technologies, S.L. led to an addition in goodwill of 42 million euros.

Disposals in 2010 comprise the divestment of Manx.

Fluctuations in exchange rates in the various countries in which the Group operates, combined with the hyperinflationary adjustment in Venezuela has led to an increase in goodwill of 763 million euros.

2009

The primary disposals in 2009 correspond to the measurement of the purchase commitment for non-controlling interests of Colombia Telecomunicaciones, S.A. ESP for 90 million euros (see Note 21) and the impact of the corporate restructuring carried out at the VIVO Group.

In addition, the favorable evolution of exchange rates applied to goodwill led to an increase in this line item of 709 million euros in 2009, and the impact of recognizing Venezuela as a hyperinflationary economy (see Note 2) led to an increase in goodwill of 713 million euros.

(8) PROPERTY, PLANT AND EQUIPMENT

The composition and movement of the items comprising net Property, plant and equipment in 2010 and 2009 were the following:

	Millions of euros								
	Balance at 12-31-09	Additions	Depreciation	Disposals	Transfers and other	Translation differences and hyperinflation adjustment	Inclusion of companies	Exclusion of companies	Balance at 12-31-10
Land and buildings	6,092	61	(538)	(40)	180	332	87	(22)	6,152
Plant and machinery	21,391	1,447	(4,869)	(57)	3,750	1,198	1,390	(44)	24,206
Furniture, tools and other items	1,660	448	(752)		339	77	178	(3)	1,947
Total PP&E in service	29,143	1,956	(6,159)	(97)	4,269	1,607	1,655	(69)	32,305
PP&E in progress	2,619	4,781		(3)	(4,370)	139	100	(7)	3,259
Advance payments on PP&E	10	3			(5)				8
Installation materials	227	139		(16)	(143)	18			225

Net PP&E	31,999	6,879	(6,159)	(116)	(249)	1,764	1,755	(76)	35,797
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	Millions of euros								
	Balance at 12-31-08	Additions	Depreciation	Disposals	Transfers and other	Translation differences and hyperinflation adjustments	Inclusion of companies	Exclusion of companies	Balance at 12-31-09
Land and buildings	7,031	34	(454)	(19)	(852)	352			6,092
Plant and machinery	19,250	1,356	(4,980)	(100)	4,607	1,254	4		21,391
Furniture, tools and other items	1,546	285	(661)	(6)	362	134			1,660
Total PP&E in service	27,827	1,675	(6,095)	(125)	4,117	1,740	4		29,143
PP&E in progress	2,485	3,973		(4)	(3,937)	102			2,619
Advance payments on PP&E	6	6			(2)				10
Installation materials	227	298		(3)	(297)	2			227
Net PP&E	30,545	5,952	(6,095)	(132)	(119)	1,844	4		31,999

The gross cost, accumulated depreciation and impairment losses of property, plant and equipment at December 31, 2010 and 2009 are as follows:

	Balance at December 31, 2010			Net PP&E
	Gross cost	Accumulated depreciation	Impairment losses	
Land and buildings	12,372	(6,216)	(4)	6,152
Plant and machinery	100,496	(76,266)	(24)	24,206
Furniture, tools and other items	7,406	(5,367)	(92)	1,947
Total PP&E in service	120,274	(87,849)	(120)	32,305
PP&E in progress	3,259			3,259
Advance payments on PP&E	8			8
Installation materials	256		(31)	225
Net PP&E	123,797	(87,849)	(151)	35,797

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	Balance at December 31, 2009			
	Gross cost	Accumulated depreciation	Impairment losses	Net PP&E
Land and buildings	11,560	(5,456)	(12)	6,092
Plant and machinery	87,017	(65,548)	(78)	21,391
Furniture, tools and other items	6,184	(4,534)	10	1,660
Total PP&E in service	104,761	(75,538)	(80)	29,143
PP&E in progress	2,619			2,619
Advance payments on PP&E	10			10
Installation materials	260		(33)	227
Net PP&E	107,650	(75,538)	(113)	31,999

Inclusion of companies primarily consists of the consolidation of the interest in HanseNet, as well as the additional 50% Vivo Participações, S.A. (see Note 5).

Additions for 2010, totaling 6,879 million euros, reflect the Group's investment efforts made during the year.

Additions in Telefónica Spain amount to 1,500 million euros in 2010, compared to 1,276 million euros in 2009. Significant investments in the wireline business include those in broadband, with a localized roll-out of fiber optics, Imagenio and data services for large corporate customers, as well as the maintenance of the traditional business. Investment in the wireless business was primarily focused on the deployment of third generation technologies (3G). Telefónica Latin America's investments in 2010 and 2009 amounted to 3,948 million euros and 3,187 million euros, respectively. Investment in 2010 centered on driving wireline technologies, namely the transformation of the wireline business, especially in Telesp, while the wireless business continues to expand coverage and capacity of 3G and GSM networks.

Investment in Telefónica Europe in 2010 and 2009 amounted to 1,254 million euros and 1,356 million euros, respectively. Investments in 2010 have been focused on improving capacity and coverage of the mobile networks in the United Kingdom, including the recent refarming of 900MHz, as well as greater investments in the ADSL business in Germany and the Czech Republic.

Translation differences and hyperinflation adjustments reflects the impact of exchange rate movements on opening balances as well as the impact of the monetary adjustments due to hyperinflation in Venezuela. The effect of exchange rates on movements in the year is included in the column corresponding to such movement.

Telefónica Group companies have purchased insurance policies to reasonably cover the possible risks to which their property, plant and equipment used in operations are subject, with suitable limits and coverage. In addition, as part of its commercial activities and network roll-out, the Group maintains several property acquisition commitments. The timing of scheduled payments in this regard are disclosed in Note 19.

Property, plant and equipment deriving from finance leases amounted to 787 million euros at December 31, 2010 (691 million euros at December 31, 2009). The most significant finance leases are disclosed in Note 22.

The net amounts of Property, plant and equipment temporarily out of service at December 31, 2010 and 2009 were not significant.

Table of Contents**(9) ASSOCIATES AND JOINT VENTURES****Associates**

The breakdown of amounts recognized in the consolidated statements of financial position and consolidated income statements related to associates is as follows:

Description	Millions of euros	
	12-31-2010	12-31-2009
Investments in associates	5,212	4,936
Long-term loans to associates (Note 13)	604	3
Short-term loans to associates	43	15
Receivables from associates for current operations (Note 11)	84	262
Loans granted by associates (Note 14)	147	174
Payables to associates for current operations (Note 14)	46	113
Revenue from operations with associates	518	583
Work performed by associates and other operating expenses	906	904
Share of profit of associates	76	47

Transactions performed through Brasilcel group companies are shown at 50% until September 27, 2010.

The breakdown of the main associates and key financial highlights for the last 12-month periods available at the time of preparation of these consolidated financial statements are as follows:

December 31, 2010	%	Millions of euros					
		Total assets	Total liabilities	Operating income	Profit for the year	Carrying amount	Market value
COMPANY	holding						
Telco, S.p.A. (Italy) (*)	46.18%	6,554	3,356		63	2,055	N/A
DTS Distribuidora de Televisión Digital, S.A. (Spain)	22.00%	1,497	497	1,085	169	488	N/A
China Unicom (Hong Kong) Limited	8.37%	47,494	24,238	18,604	388	2,499	2,112
Hispasat, S.A. (Spain)	13.23%	945	448	179	72	65	N/A
Other						105	
TOTAL						5,212	

December 31, 2009	%	Millions of euros					
		Total assets	Total liabilities	Operating income	Profit for the year	Carrying amount	Market value
COMPANY	holding						
Telco, S.p.A. (Italy) (*)	46.18%	7,111	3,703		(39)	2,026	N/A
Portugal Telecom, S.G.P.S., S.A. (Portugal)	9.86%	14,948	12,965	6,674	516	458	764
China Unicom (Hong Kong) Limited	8.37%	37,397	16,203	21,490	3,687	2,301	1,815
Hispasat, S.A. (Spain)	13.23%	841	383	151	71	56	N/A
Other						95	
TOTAL						4,936	

(*) Through this company, Telefónica effectively has an indirect stake in Telecom Italia S.p.A. s voting shares at December 31, 2010 of approximately 10.47% (10.49% at December 31, 2009), representing 7.20% (7.21% at December 31, 2009) of the dividend rights.

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The detail of the movement in investments in associates in 2010 and 2009 was the following:

	Millions of euros
Investments in associates	
Balance at 12/31/08	2,777
Acquisitions	772
Disposals	(114)
Translation differences	103
Income	47
Dividends	(58)
Transfers and other	1,409
Balance at 12/31/09	4,936
Acquisitions	489
Disposals	(473)
Translation differences	321
Income	76
Dividends	(97)
Transfers and other	(40)
Balance at 12/31/10	5,212

Changes at December 31, 2010 and 2009 reflect the amounts from transactions detailed in the changes to the consolidation scope (see Appendix I and Note 2). The figure for 2010 includes the disposal of 472 million euros due to the de-consolidation of Portugal Telecom, as well as the addition of 488 million euros for the 22% stake in DTS Distribuidora de Televisión Digital, S.A. Translation differences mainly corresponds to the equity investment in China Unicom, which varied by approximately 259 million euros due to exchange-rate fluctuations.

Additions in 2009 reflected the inclusion in the consolidation scope of the equity investment in China Unicom Limited for 2,301 million euros. Of this amount, 1,467 million euros were transferred from Non-current financial assets Equity investments (see Note 13) following the acquisition of an additional 2.68% of this company.

Disposals in 2009 included the sale by Telefónica Móviles España, S.A.U., a wholly owned subsidiary of Telefónica, S.A., of its 32.18% stake in Moroccan operator Medi Telecom, S.A., along with outstanding loans to shareholders, for a total amount of 400 million euros. The net gain from this transaction before tax amounted to 220 million euros (see Note 19).

Joint ventures

On December 27, 2002, Telefónica Móviles, S.A. and PT Movéis Serviços de Telecomunicações, S.G.P.S., S.A. (PT Movéis) set up a 50/50 joint venture, Brasilcel, via the contribution of 100% of the groups direct and indirect shares in Brazilian cellular operators. This company was integrated in the consolidated financial statements of the Telefónica Group using proportionate consolidation.

As disclosed in Note 2, on September 27, 2010 these joint venture agreements were terminated, thereby having no impact since such date.

The contributions of Brasilcel to the Telefónica Group's 2009 and 2008 consolidated statements of financial position and 2010, 2009 and 2008 consolidated income statements are as follows:

	Millions of euros		
	2010	2009	2008
Current assets		1,170	1,234

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Non-current assets		5,617	4,616
Current liabilities		1,170	1,351
Non-current liabilities		1,505	1,212
Operating revenue	2,583(*)	2,743	2,662
Operating expenses	1,896(*)	2,046	2,063

(*) For the period from January 1, 2010 to September 27, 2010

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(10) RELATED PARTIES

Significant shareholders

The main transactions between Telefónica Group companies and significant shareholders of the Company are described below. All of these transactions were carried out at market prices.

Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries comprising the consolidated group:

Financing transactions arranged under market conditions, with approximately 682 million euros drawn down at December 31, 2010 (531 million euros at December 31, 2009).

Time deposits amounting to 260 million euros at December 31, 2010 (878 million euros at December 31, 2000).

Derivative transactions contracted under market conditions, for a total nominal amount of approximately 11,197 million euros at December 31, 2010 (7,824 million euros at December 31, 2009).

Guarantees granted by BBVA for approximately 922 million euros at December 31, 2010 (237 million euros at December 31, 2009).

Dividends and other benefits paid to BBVA in 2010 for 439 million euros (287 million euros in 2009).

Services, mainly telecommunications and telemarketing, rendered by Telefónica Group companies to the BBVA Group, under market conditions.

Caja de Ahorros y Pensiones de Barcelona (la Caixa), and subsidiaries comprising the consolidated group:

Financing transactions arranged under market conditions, with approximately 305 million euros drawn down at December 31, 2010 (643 million euros at December 31, 2009).

Time deposits amounting to 118 million euros at December 31, 2010 (1,293 million euros at December 31, 2009).

Derivative transactions arranged under market conditions, for a total nominal amount of approximately 800 million euros in 2010 and 2009.

Dividends and other benefits paid to la Caixa in 2010 for 298 million euros (260 million euros in 2009).

Guarantees granted for 47 million euros at December 31, 2010 (17 million euros in 2009).

Telecommunications services rendered by Telefónica Group companies to la Caixa group companies under market conditions.

Associates and joint ventures

The most significant balances and transactions with associates and joint ventures and their contributions to the consolidated statement of financial position and income statement are detailed in Note 9.

Table of Contents**Directors and senior executives**

During the financial year to which these accompanying annual consolidated financial statements refer, the directors and senior executives did not perform any transactions with Telefónica or any Telefónica Group company other than those in the Group's normal trading activity and business.

Compensation and other benefits paid to members of the Board of Directors and senior executives, as well as the detail of the equity interests and positions or duties held by the directors in companies engaging in an activity that is identical, similar or complementary to that of the Company are detailed in Note 21 of these consolidated financial statements.

(11) TRADE AND OTHER RECEIVABLES

The breakdown of this consolidated statement of financial position heading at December 31, 2010 and 2009 is as follows:

Millions of euros	Balance at 12-31-10	Balance at 12-31-09
Trade receivables	13,002	10,877
Receivables from associates (Note 9)	84	262
Other receivables	1,182	1,103
Allowance for uncollectibles	(3,098)	(2,589)
Short-term prepayments	1,256	969
Total	12,426	10,622

Public-sector net trade receivables in the countries in which the Group operates at December 31, 2010 and 2009 amounted to 696 million and 666 million euros, respectively.

The breakdown of trade receivables at December 31, 2010 and 2009 is as follows:

Millions of euros	12-31-2010	12-31-2009
Trade receivables billed	9,420	7,544
Trade receivables unbilled	3,582	3,333
Total	13,002	10,877

The movement in impairment losses in 2010 and 2009 is as follows:

	Millions of euros
Impairment losses at December 31, 2008	2,196
Allowances	1,209
Retirements/amount applied	(970)
Translation differences	154
Impairment losses at December 31, 2009	2,589
Allowances	1,123
Retirements/amount applied	(940)
Inclusion of companies	133
Exclusion of companies	(1)
Translation differences	194

Impairment losses at December 31, 2010

3,098

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The balance of trade receivables billed net of impairment losses at December 31, 2010 amounted to 6,361 million euros (4,955 million euros at December 31, 2009), of which 3,852 million euros were not yet due (2,981 million euros at December 31, 2009).

Of the amounts due, only net amounts of 260 million euros and 204 million euros are over 360 days at December 31, 2010 and 2009, respectively. They are mainly with the public sector.

(12) EQUITY***a) Share capital and share premium***

At December 31, 2010, Telefónica, S.A.'s share capital amounted to 4,563,996,485 euros and consisted of 4,563,996,485 fully paid ordinary shares of a single series, per value of 1 euro, all recorded by the book-entry system and traded on the Spanish electronic trading system (Continuous Market), where they form part of the Ibx 35 Index, on the four Spanish Stock Exchanges (Madrid, Barcelona, Valencia and Bilbao) and listed on the New York, London, Tokyo, Buenos Aires, Sao Paulo and Lima Stock Exchanges.

With respect to authorizations given regarding share capital, on June 21, 2006, authorization was given at the Annual Shareholders Meeting of Telefónica, S.A. for the Board of Directors, at its discretion and in accordance with the Company's needs, to increase the Company's capital, at one or several times, within a maximum period of five years from that date, under the terms of Article 153.1 b) of the former Spanish Corporation Law (Article 297.1.b) of the current Corporate Enterprises Act) up to a maximum increase of 2,460 million euros, equivalent to half of Telefónica, S.A.'s share capital at that date, by issuing and placing new ordinary shares, be they ordinary or of any other type permitted by the Law, with a fixed or variable premium, with or without pre-emptive subscription rights and, in all cases, in exchange for cash, and expressly considering the possibility that the new shares may not be fully subscribed in accordance with the terms of Article 161.1 of the former Spanish Corporation Law (Article 311.1 of the current Corporate Enterprises Act). The Board of Directors was also empowered to exclude, partially or fully, pre-emptive subscription rights under the terms of Article 159.2 of the former Spanish Corporation Law (article 506 of the current Corporate Enterprises Act) and related provisions.

In addition, at the June 2, 2010 Shareholders Meeting, authorization was given for the Board of Directors to issue fixed-income securities and preferred shares at one or several times within a maximum period of five years from that date. These securities may be in the form of debentures, bonds, promissory notes or any other kind of fixed-income security, plain or, in the case of debentures and bonds, convertible into shares of Telefónica, S.A. and/or exchangeable for shares of Telefónica, S.A., of any of the Group companies or of any other company. They may also be preferred shares. The total maximum amount of the securities issued agreed under this authorization is 25,000 million euros or the equivalent in another currency. For promissory notes, the outstanding balance of promissory notes issued under this authorization will be calculated for purposes of the aforementioned limit. As at December 31, 2010, the Board of Directors had exercised these powers, approving a program for the issuance of corporate promissory notes in 2011.

In addition, on June 2, 2010, shareholders voted to authorize the acquisition by the Board of Directors of treasury shares, up to the limits and pursuant to the terms and conditions established at the Shareholders Meeting, within a maximum period of five years from that date. However, it specified that in no circumstances could the par value of the shares acquired, added to that of the treasury shares already held by Telefónica, S.A. and by any of its controlled subsidiaries, exceed the maximum legal percentage at any time (currently 10% of Telefónica, S.A.'s share capital).

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Finally, on December 28, 2009, the deed of capital reduction formalizing the implementation by Telefónica, S.A.'s Board of Directors of the resolution adopted by the Shareholders Meeting on June 23, 2009, was executed. Capital was reduced through the cancellation of treasury shares previously acquired by Telefónica, S.A. as authorized by the Shareholders Meeting. As a result, 141,000,000 Telefónica, S.A. treasury shares were cancelled and the Company's share capital was reduced by a nominal amount of 141,000,000 euros. Article 5 of the Corporate Bylaws relating to the amount of share capital was amended accordingly to show 4,563,996,485 euros. At the same time, a reserve was established for cancelled shares as described in the *Other reserves* section of this Note. The cancelled shares were delisted on December 30, 2009.

Proposed distribution of profit attributable to equity holders of the parent

Telefónica generated 4,130 million euros of profit in 2010.

Accordingly, the Company's Board of Directors will submit the following proposed distribution of 2010 profit for approval at the Shareholders Meeting:

	Millions of euros
Total distributable profit	4,130
Interim dividend (paid in May 2010)	2,938
Goodwill reserve	2
Voluntary reserves	1,190
Total	4,130

b) Dividends**Dividends paid in 2010**

At its meeting of April 28, 2010, the Company's Board of Directors resolved to pay an interim dividend against 2010 profit of a fixed gross 0.65 euros per outstanding share carrying dividend rights. This dividend was paid in full on May 11, 2010, and the total amount paid was 2,938 million euros.

In addition, approval was given at the General Shareholders Meeting on June 2, 2010 to pay a gross 0.65 euros dividend per outstanding share with a charge to unrestricted reserves. This dividend was paid in full on November 8, 2010, and the total amount paid was 2,934 million euros.

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In accordance with Article 277 of the Corporate Enterprises Act, the following table presents the mandatory statement of accounts prepared to confirm the existence of sufficient liquidity to pay the dividend at the date of its approval.

	Millions of euros
Liquidity statement at April 28, 2010	
Profit generated from January 1 through March 31, 2010	5,029
Mandatory appropriation to reserves	
Distributable income	5,029
Proposed interim dividend (maximum amount)	2,967

Cash position at April 28, 2010

Funds available for distribution	
Cash and cash equivalents	4,271
Unused credit facilities	5,889
Proposed interim dividend (maximum amount)	(2,967)
Difference	7,193

The Telefónica Group manages its liquidity risks (see Note 16) in order to have cash available for the following year.

Dividends paid in 2009

At its meeting held on June 23, 2009, the Company's Board of Directors resolved to pay a dividend charged to unrestricted reserves for a fixed gross amount of 0.50 euros per outstanding share carrying dividend rights. This dividend was paid in full on November 11, 2009, and the total amount paid was 2,280 million euros.

In addition, in May 2009 an interim dividend against 2009 profit of a gross 0.50 euros per share was paid, entailing a total payment of 2,277 million euros.

Dividends paid in 2008

At its meeting held on April 22, 2008, the Company's Board of Directors agreed to pay an additional dividend charged against 2007 profit of a gross 0.40 euros per share. A total of 1,869 million euros was paid in May 2008.

In addition, in November 2008 an interim dividend against 2008 profit of a gross 0.50 euros per share was paid, entailing a total payment of 2,296 million euros.

c) Reserves**Legal reserve**

According to the text of the Corporate Enterprises Act, companies must transfer 10% of profit for the year to a legal reserve until this reserve reaches at least 20% of share capital. The legal reserve can be used to increase capital by the amount exceeding 10% of the increased share capital amount. Except for this purpose, until the legal reserve exceeds the limit of 20% of share capital, it can only be used to offset losses, if there are no other reserves available. At December 31, 2010, the Company had duly set aside this reserve.

Revaluation reserves

The balance of Revaluation reserves arose as a result of the revaluation made pursuant to Royal Decree-Law 7/1996 dated June 7.

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The revaluation reserve may be used, free of tax, to offset any losses incurred in the future and to increase capital. From January 1, 2007, it may be allocated to unrestricted reserves, provided that the capital gain has been realized. The capital gain will be deemed to have been realized in respect of the portion on which the depreciation has been recorded for accounting purposes or when the revalued assets have been transferred or derecognized. In this respect, an amount of 16 million euros in 2010 (15 million euros in 2009 and 8 million euros in 2008) corresponding to revaluation reserves subsequently considered unrestricted has been reclassified to Retained earnings.

Retained earnings

These reserves include undistributed profits of companies comprising the consolidated Group less interim dividends paid against profit for the year, actuarial gains and losses, and the impact of the asset ceiling on defined-benefit plans.

d) Translation differences

The translation differences relate mainly to the effect of exchange rate fluctuations on the net assets of the companies located abroad after the elimination of intra-group balances and transactions. They also include exchange rate differences resulting from intra-group monetary items considered part of the net investment in a foreign subsidiary, and the impact of the restatement of financial statements of companies in hyperinflationary economies (see Note 3.b). The Group took an exemption that allows all translation differences generated up to the IFRS transition date to be reset to zero, with the impact on prior years recognized as retained earnings.

The breakdown of the accumulated contribution of translation differences at December 31 is as follows:

Millions of euros	2010	2009	2008
Telefónica Latin America	1,208	1,052	(834)
Telefónica Europe	(2,363)	(2,524)	(2,793)
Other adjustments and intra-group eliminations	212	99	16
Total Telefónica Group	(943)	(1,373)	(3,611)

e) Treasury shares

At December 31, 2010, 2009 and 2008, Telefónica Group companies held the following shares in the Telefónica, S.A. parent company:

	Number of shares	Euros per share		Market value Millions of euros	%
		Acquisition price	Trading price		
<i>Treasury shares at 12/31/10</i>	55,204,942	17.01	16.97	937	1.20957%
<i>Treasury shares at 12/31/09</i>	6,329,530	16.81	19.52	124	0.13868%
<i>Treasury shares at 12/31/08</i>	125,561,011	16.68	15.85	1,990	2.66867%

Telefónica S.A. owns the treasury shares, except for 16,896 shares held by Telefónica Móviles Argentina, S.A.

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In 2010, 2009 and 2008 the following transactions involving treasury shares were carried out:

	Number of shares
Treasury shares at 12/31/07	64,471,368
Acquisitions	129,658,402
Disposals	(68,759)
Share cancellation	(68,500,000)
Treasury shares at 12/31/08	125,561,011
Acquisitions	65,809,222
Exchange of Telefónica, S.A. shares for China Unicom shares	(40,730,735)
Employee share option plan	(3,309,968)
Share cancellation	(141,000,000)
Treasury shares at 12/31/09	6,329,530
Acquisitions	52,650,000
Disposals	(810,151)
Employee share option plan (Note 20.a)	(2,964,437)
Treasury shares at 12/31/10	55,204,942

The amount paid to acquire treasury shares in 2010 was 897 million euros (1,005 million euros and 2,225 million euros in 2009 and 2008, respectively).

At December 31, 2010 and 2009, the Group held call options on 160 million and 150 million treasury shares, respectively, and at December 31, 2008, put options on 6 million treasury shares.

The Company also holds a derivative financial instrument on 25.64 million Telefónica shares, subject to net settlement.

f) Non-controlling interests

Non-controlling interests represents the share of non-controlling interests in the equity and income or loss for the year of fully consolidated Group companies. The movements in this heading of the 2010, 2009 and 2008 consolidated statement of financial position are as follows:

	Capital		Acquisitions of non-controlling interests and exclusion				Balance at
	Balance at	contributions and inclusion of companies	Profit/(loss) for the year	Change in translation differences	of companies	Dividends paid	
Millions of euros	12/31/09						12/31/10
Telefónica O2 Czech Republic, a.s.	1,044		88	57		(156)	1,033
Telefónica Chile, S.A.	22		3	3		(1)	23
Telesp Participações, S.A.	542		131	69		(105)	630

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Brasilcel (Holdings)	885	4,304	224	258		(171)	6	5,506
Fonditel Entidad Gestora de Fondos de Pensiones, S.A.	23		2			(3)		22
Iberbanda, S.A.	6		(4)					2
Colombia Telecomunicaciones, S.A., ESP			(540)				540	
Other	18	6	1	3	(3)	(4)	(5)	16
Total	2,540	4,310	(95)	390	(3)	(440)	530	7,232

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	Capital		Change in translation differences	Acquisitions of non-controlling interests and exclusion of		Dividends paid	Other movements	Balance at
	Balance at 12/31/08	contributions and inclusion of companies		Profit/(loss) for the year	of			
Millions of euros								
Telefónica O2 Czech Republic, a.s.	1,095		114	21		(186)		1,044
Telefónica Chile, S.A.	23	1	1	6	(8)	(1)		22
Telesp Participações, S.A.	385		101	118		(64)	2	542
Brasilcel (Holdings)	774		46	214	(108)	(41)		885
Fonditel Entidad Gestora de Fondos de Pensiones, S.A.	20		3					23
Iberbanda, S.A.	9		(3)					6
Colombia Telecomunicaciones, S.A., ESP			(104)				104	
Other	25		3	(2)	(7)	(3)	2	18
Total	2,331	1	161	357	(123)	(295)	108	2,540

	Capital		Change in translation differences	Acquisitions of non-controlling interests and exclusion of		Dividends paid	Other Movements	Balance at
	Balance at 12/31/07	contributions and inclusion of companies		Profit/(loss) for the year	of			
Millions of euros								
Telefónica O2 Czech Republic, a.s.	1,192		112	(12)		(197)		1,095
Telefónica Chile, S.A.	473		25	(72)	(397)	(7)	1	23
Telesp Participações, S.A.	464		127	(93)		(113)		385
Brasilcel (Holdings)	545	348	61	(163)		(12)	(5)	774
Fonditel Entidad Gestora de Fondos de Pensiones, S.A.	19		4			(2)	(1)	20
Iberbanda, S.A.	11	8	(10)					9
Colombia Telecomunicaciones, S.A., ESP			(89)				89	
Other	26		4	(3)	(1)	(2)	1	25
Total	2,730	356	234	(343)	(398)	(333)	85	2,331

2010

As disclosed in Note 5, the Group availed itself of the option to measure the non-controlling interests of Vivo Participações, S.A. at fair value at the date of acquisition (see Note 3.c) in the amount of 5,290 million euros, which has resulted in an increase in non-controlling interests of 4,304 million euros, net of the amount of the previously existing non-controlling interests.

Similarly, the activity in 2010 reflects the allocation to non-controlling interests of the losses incurred by Colombia Telecomunicaciones, S.A., ESP, as described in Note 17, in the amount of 414 million euros.

Other movements includes the impact of the agreement signed with the holders of non-controlling interests in Colombia Telecomunicaciones, S.A., ESP (see Notes 21.b and 3.r)

Also noteworthy was the impact of the dividends paid during the year by Brasilcel, N.V., Telefónica O2 Czech Republic, a.s. and Telesp Participações, S.A.

2009

The reorganization of Brasilcel Group companies in 2009 following the acquisition of the Telemig Group in 2008 decreased the balance of Non-controlling interests by 108 million euros.

Also noteworthy was the impact of the dividends paid during the year by Telefónica O2 Czech Republic, a.s. and Telesp Participações, S.A.

Table of Contents**2008**

The main variation in 2008 relates to the acquisition of Telefónica Chile, S.A.'s non-controlling interests, which decreased the balance of Non-controlling interests by 397 million euros, and to the acquisition of the Telemig Group companies, which increased the balance by 335 million euros.

Also noteworthy in 2008 was the movement caused by the dividends paid by Telefónica O2 Czech Republic, a.s. and Telesp Participações, S.A.

(13) FINANCIAL ASSETS AND LIABILITIES**1.- Financial assets**

The breakdown of financial assets of the Telefónica Group at December 31, 2010 and 2009 is as follows:

Millions of euros	Fair value through profit or loss		Available-	Hedges	December 31, 2010 Measurement hierarchy Level 2 (Other Level 3 Inputs directly not based observable on market)			Held-to-maturity cost investments	Total amount	Total carrying amount	Total fair value
	Held for trading	Fair value option			(Quoted market prices)	observable inputs)	data)				
Non-current financial assets	948	211	1,194	1,630	1,321	2,660	2	3,423	7,406	7,325	
Investments			597		482	113	2		597	597	
Long-term credits	12	211	597		816	4		2,118	2,938	2,838	
Deposits and guarantees								1,680	1,680	1,324	
Derivative instruments	936			1,630	23	2,543			2,566	2,566	
Impairment losses								(375)	(375)		
Current financial assets	272	160	309	201	554	363	25	4,604	248	5,794	5,794
Financial investments	272	160	309	201	554	363	25	384	248	1,574	1,574
Cash and cash equivalents								4,220	4,220	4,220	
Total financial assets	1,220	371	1,503	1,831	1,875	3,023	27	8,027	248	13,200	13,119

December 31, 2009

Millions of euros	Fair value through profit or loss				Measurement hierarchy			Amortized cost	Total carrying amount	Total fair value
					Level 1	Level 2 (Other inputs directly observable market data)	Level 3 (Inputs not based on observable market data)			
	Held for trading	Fair value option	Available-for-sale	Hedges	(Quoted prices)	(Observable market inputs)	(Observable market data)			
Non-current financial assets	930	233	1,248	1,572	1,508	2,475		2,005	5,988	5,988
Investments			654		570	84			654	654
Long-term credits	91	233	594		918			1,022	1,940	1,940
Deposits and guarantees								1,496	1,496	983
Derivative instruments	839			1,572	20	2,391			2,411	2,411
Impairment losses								(513)	(513)	
Current financial assets	859	134	237	59	769	520		9,730	11,019	11,019
Financial investments	859	134	237	59	769	520		617	1,906	1,906
Cash and cash equivalents								9,113	9,113	9,113
Total financial assets	1,789	367	1,485	1,631	2,277	2,995		11,735	17,007	17,007

The calculation of the fair values of the Telefónica Group's debt instruments required an estimate, for each currency and subsidiary, of a credit spread curve using the prices of the Group's bonds and credit derivatives.

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Derivatives are measured using the valuation techniques and models normally used in the market, based on money-market curves and volatility prices available in the market.

a) Non-current financial assets

The movement in items composing Non-current financial assets and the related impairment losses at December 31, 2010 and 2009 are as follows:

	Millions of euros						Total
	Investments	Long-term credits	financial assets	Deposits and guarantees	Long-term prepayments	Impairment losses	
Balance at 12/31/08	1,584	1,602	3,590	905	92	(397)	7,376
Acquisitions	3	921		842	35	(114)	1,687
Disposals	(33)	(503)	(1,118)	(364)	(26)		(2,044)
Inclusion of companies							
Translation differences	9	90	(38)	146	6	(2)	211
Fair value adjustments	565	(53)	(5)				507
Transfers	(1,474)	(221)	(18)	(33)	(3)		(1,749)
Balance at 12/31/09	654	1,836	2,411	1,496	104	(513)	5,988
Acquisitions	51	1,385	62	339	80	(79)	1,838
Disposals	(1)	(719)	(389)	(112)	(29)	243	(1,007)
Inclusion of companies	8	198	34	203	7	(7)	443
Translation differences	13	92	16	(186)	7	39	(19)
Fair value adjustments	(128)	60	444	34			410
Transfers		(81)	(12)	(94)	(2)	(58)	(247)
Balance at 12/31/10	597	2,771	2,566	1,680	167	(375)	7,406

Investments includes the fair value of investments in companies where Telefónica does not exercise significant control and for which there is no specific disposal plan for the short term (see Note 3.i).

Among these is the Telefónica Group's shareholding in Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) held since 2000 of 418 million euros (468 million euros at December 31, 2009), representing 0.98% of its share capital. In 2010, the Telefónica Group transferred 191 million euros of the value of the holding in BBVA, up to its fair value, from equity to net financial expense.

In 2009, the Telefónica Group's stake in China Unicom was transferred to Investments in associates following the share exchange described in Note 2. The amount transferred was 1,467 million euros.

Given the poor situation of financial markets, at year-end the Group assessed the securities in its portfolio of listed available-for-sale assets individually for impairment. The analysis did not uncover the need to recognize any additional impairment losses.

Long-term credits includes mainly the investment of the net level premium reserves of the Group's insurance companies, primarily in fixed-income securities, amounting to 931 million euros and 1,023 million euros at December 31, 2010 and 2009, respectively. It also includes the long-term loans to associates described in Note 9, especially the financing extended to Telco, S.p.A., totaling 600 million euros at December 31, 2010.

Derivative financial assets includes the fair value of economic hedges of assets or liabilities in the consolidated statement of financial position whose maturity is 12 months or greater, as part of the Group's financial risk-hedging strategy (see Note 16).

Deposits and guarantees consists mainly of balances to cover guarantees and stood at 1,680 million euros at December 31, 2010 (1,496 million euros at December 31, 2009). These deposits will decrease as the respective obligations they guarantee are reduced.

Table of Contents**b) Current financial assets**

This heading in the accompanying consolidated statement of financial position at December 31, 2010 and 2009 includes mainly the following items:

Investments in financial instruments recognized at fair value to cover commitments undertaken by the Group's insurance companies, amounting to 160 million euros at December 31, 2010 (140 million euros at December 31, 2009). The maturity schedule for these financial assets is established on the basis of payment projections for the commitments.

Derivative financial assets with a short-term maturity or not used to hedge non-current items in the consolidated statement of financial position, which amounted to 371 million euros (537 million euros in 2009). The variation in the balance between the two years was due to exchange- and interest-rate fluctuations (see Note 16).

Short-term deposits and guarantees amounting to 196 million euros at December 31, 2010 (470 million euros at December 31, 2009).

Current investments of cash surpluses which, given their characteristics, have not been classified as Cash and cash equivalents.

Current financial assets that are highly liquid and have maturities of three months or less from the date contracted are recorded under Cash and cash equivalents on the accompanying consolidated statement of financial position.

2.- Financial liabilities

The composition of this heading at December 31, 2010 and 2009 is as follows:

Millions of euros	Balance at 12/31/10	Balance at 12/31/09
Issues	39,692	35,843
Interest-bearing debt	21,408	20,948
Total	61,100	56,791
Total non-current	51,356	47,607
Total current	9,744	9,184

The maturity profile of these financial liabilities at December 31, 2010 is as follows:

<i>(Millions of euros)</i>	Maturity					Subsequent years	Total
	2011	2012	2013	2014	2015		
Debentures and bonds	4,029	1,933	5,399	5,100	3,809	15,723	35,993
Promissory notes & commercial paper	1,728						1,728
Other marketable debt securities		1,971					1,971
Loans and other payables	3,664	3,932	4,567	1,110	4,390	2,244	19,907
Derivative financial liabilities	323	195	93	109	226	555	1,501
TOTAL	9,744	8,031	10,059	6,319	8,425	18,522	61,100

The estimate of future interest that would accrue on these financial liabilities held by the Group at December 31, 2010 is as follows: 2,534 million euros in 2011, 2,323 million euros in 2012, 2,119 million euros in 2013, 1,815 million euros in 2014, 1,448 million euros in 2015 and 9,170 million euros in years after 2015. For variable rate financing, the Group mainly estimates future interest using the forward curve of the various currencies at December 31, 2010.

The amounts shown in this table take into account the fair value of derivatives classified as financial liabilities (i.e., those with a negative fair value) and exclude the fair value of derivatives classified as current financial assets, in the amount of 371 million euros, and those classified as non-current, in the amount of 2,566 million euros (i.e., those with a positive fair value).

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In addition, the amounts take into account the deferred payment for the acquisition of Brasilcel, N.V. for 1,977 million euros (see Note 5).

The composition of these financial liabilities, by category, at December 31, 2010 and 2009 is as follows:

Millions of euros	December 31, 2010							Total fair value	
	Measurement hierarchy								
	Level 2								
	Fair value through profit or loss	(Other directly observable inputs)			Level 3 (Inputs not based on observable market data)	Liabilities at	Total		
Held for trading	Fair value option	Hedges	Level 1 (Quoted prices)	market inputs)	based on observable market data)	amortized cost	carrying amount	Total fair value	
Issues						39,692	39,692	39,127	
Interest-bearing debt	695		806	210	1,291		19,907	21,408	19,777
Total financial liabilities	695		806	210	1,291		59,599	61,100	58,904

Millions of euros	December 31, 2009							Total fair value	
	Measurement hierarchy								
	Level 2								
	Fair value through profit or loss	(Other directly observable inputs)			Level 3 (Inputs not based on observable market data)	Liabilities at	Total		
Held for trading	Fair value option	Hedges	Level 1 (Quoted prices)	market inputs)	based on observable market data)	amortized cost	carrying amount	Total fair value	
Issues						35,843	35,843	37,890	
Interest-bearing debt	705		2,285	147	2,843		17,958	20,948	20,840
Total financial liabilities	705		2,285	147	2,843		53,801	56,791	58,730

Some of the financing arranged by various Telefónica Group companies is subject to compliance with certain financial covenants. All the covenants were being complied with at the date of these consolidated financial statements.

Table of Contents**a) Issues**

The movement in issues of debentures, bonds and other marketable debt securities in 2010 and 2009 is as follows:

Millions of euros	Domestic currency issues	Foreign currency issues	Short-term promissory notes and commercial paper	Other non- current marketable debt securities	Total
Balance at 12/31/08	13,631	12,799	1,595	2,054	30,079
New issues	5,750	2,855	105		8,710
Redemptions, conversions and exchanges	(1,152)	(802)	(909)		(2,863)
Changes in consolidation scope					-
Revaluation and other movements	(654)	535	82	(46)	(83)
Balance at 12/31/09	17,575	15,387	873	2,008	35,843
New issues	2,392	3,879	1,102		7,373
Redemptions, conversions and exchanges	(1,269)	(3,634)	(311)		(5,214)
Changes in consolidation scope		317			317
Revaluation and other movements	96	1,250	64	(37)	1,373
Balance at 12/31/10	18,794	17,199	1,728	1,971	39,692

Bonds and other marketable debt securities

Telefónica, S.A. has a full and unconditional guarantee on issues made by Telefónica Emisiones, S.A.U., Telefónica Finanzas México, S.A. de C.V and Telefónica Europe, B.V., all of which are, directly or indirectly, wholly owned subsidiaries of Telefónica, S.A.

Appendix II presents the characteristics of all outstanding debentures and bond issues at year-end 2010 and 2009, as well as the significant issues made in each year.

Promissory notes & commercial paper

At December 31, 2010, Telefónica Europe, B.V., had a program for issuance of commercial paper, guaranteed by Telefónica, S.A., for an amount of up to 2,000 million euros. The outstanding balance of commercial paper issued under this program at December 31, 2010 was 1,613 million euros, carrying an average interest rate of 0.82% (551 million euros at an average rate of 1.17% at December 31, 2009).

On December 13, 2010, Telefónica Móviles, S.A. (Peru) registered a commercial paper program for an equivalent of up to 150 million US dollars. At December 31, 2010, there was no outstanding balance under this program.

On December 20, 2010, Telefónica de Perú, S.A.A. registred a commercial paper program for an equivalent of up to 150 million US dollars. At December 31, 2010, there was no outstanding balance under this program.

Other marketable debt securities

This heading consists mainly of preferred shares issued by Telefónica Finance USA, LLC, with a redemption value of 2,000 million euros. These shares were issued in 2002 and have the following features:

Interest rate up to December 30, 2012 of 3-month Euribor, and maximum and minimum effective annual rates of 7% and 4.25%, respectively, and from then 3-month Euribor plus a 4% spread.

Interest is paid every three calendar months provided the Telefónica Group generates consolidated net income.

Table of Contents**b) Interest-bearing debt**

The detail of Interest-bearing debt is as follows:

Millions of euros	Balance at 12/31/10			Balance at 12/31/09		
	Current	Non-current	Total	Current	Non-current	Total
Loans and other payables	3,664	16,243	19,907	1,789	16,169	17,958
Derivative financial liabilities (Note 16)	323	1,178	1,501	1,432	1,558	2,990
Total	3,987	17,421	21,408	3,221	17,727	20,948

The average interest rate on outstanding loans and other payables at December 31, 2010 was 2.56% (3.58% in 2009). This percentage does not include the impact of hedges arranged by the Group.

The main financing transactions included under Interest-bearing debt outstanding at December 31, 2010 and 2009 and their nominal amounts are provided in Appendix IV.

Interest-bearing debt arranged in 2010 and 2009 mainly includes the following:

On February 12, 2010, Telefónica, S.A. entered into a long-term line of credit facility for an aggregate amount of 472 million US dollars at a fixed rate with the guaranty of the Swedish Export Credits Guarantee Board (EKN) for equipment and networks purchases from a supplier in this country. This credit facility is divided into three tranches: a tranche of 232 million US dollars maturing on November 30, 2018, another of 164 million US dollars maturing on April 30, 2019, and a third of 76 million US dollars maturing on November 30, 2019. At December 31, 2010, there was no outstanding principal amounts drawn under this credit facility.

On July 28, 2010, Telefónica, S.A. entered into a syndicated facility agreement (Facility Agreement) with several domestic and international financial entities in an aggregate amount of up to 8,000 million euros. The Facility Agreement is divided into two tranches: the first, a three-year loan facility in an aggregate amount of up to 5,000 million euros and the second, a five-year revolving credit facility, in an aggregate amount of up to 3,000 million euros. At December 31, 2010, the outstanding principal amount of this credit facility was 6,000 million euros.

The main repayments or maturities of bank interest-bearing debt in 2010 and 2009 are as follows:

During 2010, Telefónica, S.A. made several voluntary early repayments under its 6,000 million euros credit facility dated June 28, 2005 in an aggregate amount of 5,700 million euros and the limit amount was reduced to 650 million euros. At December 31, 2010, the outstanding principal amount was 300 million euros.

On July 6, 2009, the syndicated loan facility arranged by Telefónica, S.A. with a group of banks on July 6, 2004, for 3,000 million euros, matured as scheduled.

At December 31, 2010 the Telefónica Group had total undrawn credit lines from various sources amounting approximately 11,000 million euros (exceeding the 7,200 million euros available at December 31, 2009).

Table of Contents**Loans by currency**

The breakdown of loans by currency at December 31, 2010 and 2009, along with the equivalent value of foreign-currency loans in euros, are as follows:

Currency	Outstanding balance (in millions)			
	Currency		Euros	
	12/31/10	12/31/09	12/31/10	12/31/09
Euros	11,778	10,835	11,778	10,835
US dollars	2,580	2,498	1,931	1,734
Brazilian reais	3,633	3,114	1,632	1,242
Argentine pesos	1,080	603	203	110
Colombian pesos	8,176,727	7,675,200	3,197	2,610
Yen	16,882	17,258	155	130
Chilean peso	54,886	151,943	88	208
New soles	948	1,120	253	269
Pounds sterling	557	708	648	798
Czech crown	131	301	5	11
Other currencies			17	11
Total Group	N/A	N/A	19,907	17,958

(14) TRADE AND OTHER PAYABLES

The composition of Trade and other payables is as follows:

Millions of euros	12/31/10		12/31/09	
	Non-current	Current	Non-current	Current
Trade payables		9,038		6,963
Advances received on orders		83		115
Other payables	1,761	8,162	752	5,130
Deferred income	543	1,775	497	1,528
Payable to associates (Note 9)		193		287
Total	2,304	19,251	1,249	14,023

Deferred income principally includes the amount of connection fees not yet recognized in the income statement, customer loyalty programs, and advance payments received on prepay contracts.

Non-current Other payables mainly comprises the deferred portion of the payment for acquiring the license for spectrum use in Mexico, in the amount of 1,039 million euros (see Note 6).

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The detail of current Other payables at December 31, 2010 and 2009 is as follows:

Millions of euros	Balance at 12/31/10	Balance at 12/31/09
Dividends payable by Group companies	199	157
Payables to suppliers of property, plant and equipment, current	4,455	3,598
Accrued employee benefits	780	695
Deferred payment for Brasilcel, N.V. (Note 5)	1,977	
Other non-financial non-trade payables	751	680
Total	8,162	5,130

Information on deferred payments to suppliers of Spanish companies (Third additional provision, Information requirement of Law 15/2010 of July 5).

In order to comply with Law 15/2010, the Telefónica Group's Spanish companies have adapted their internal processes and settled 82 million euros during the first days of 2011, corresponding to the amounts pending to be adapted at the end of the year.

(15) PROVISIONS

The amounts of provisions in 2010 and 2009 are as follows:

Millions of euros	12/31/10			12/31/09		
	Current	Non-current	Total	Current	Non-current	Total
Employee benefits:	916	2,974	3,890	667	3,594	4,261
- Termination plans	898	1,858	2,756	652	2,418	3,070
- Post-employment defined benefit plans		829	829		911	911
- Other benefits	18	287	305	15	265	280
Other provisions	759	1,891	2,650	296	1,399	1,695
Total	1,675	4,865	6,540	963	4,993	5,956

Employee benefits

a) Termination plans

In the last few years, the Telefónica Group has carried out early retirement plans in order to adapt its cost structure to the prevailing environment in the markets where it operates, making certain strategic decisions relating to its size and organization.

In this respect, on July 29, 2003, the Ministry of Labor and Social Affairs approved a labor force reduction plan for Telefónica de España through various voluntary, universal and non-discriminatory programs, which were announced on July 30, 2003. The plan concluded on December 31, 2007, with 13,870 employees taking part for a total cost of 3,916 million euros. Provisions recorded for this plan at December 31, 2010 and 2009 amounted to 1,825 and 2,283 million euros, respectively.

Furthermore, the Group had recorded provisions totaling 931 million euros (787 million euros at December 31, 2009) for other planned adjustments to the workforce and plans prior to 2003.

The companies bound by these commitments calculated provisions required at 2010 and 2009 year-end using actuarial assumptions pursuant to current legislation, including the PERM/F-2000 C mortality tables and a variable interest rate based on market yield curves.

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The movement in provisions for post-employment plans in 2010 and 2009 is as follows:

Millions of euros	Total
Provisions for post-employment plans at 12/31/08	3,774
Additions	109
Retirements/amount applied	(1,021)
Transfers	59
Translation differences and accretion	149
Provisions for post-employment plans at 12/31/09	3,070
Additions	406
Retirements/amount applied	(813)
Transfers	(3)
Translation differences and accretion	96
Provisions for post-employment plans at 12/31/10	2,756

b) Post-employment defined benefit plans

The Group has a number of defined-benefit plans in the countries where it operates. The following tables present the main data of these plans:

12/31/10	Spain		Europe		Latin America		Total
Millions of euros	ITP	Survival	UK	Germany	Brazil	Other	Total
Obligation	424	208	918	57	272	13	1,892
Assets			(838)	(63)	(250)	(5)	(1,156)