TELEFONICA S A
Form 424B3
April 25, 2005
Table of Contents

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MERGER BY ABSORPTION PROPOSED YOUR VOTE IS VERY IMPORTANT

At meetings held on February 23, 2005, the Boards of Directors of Telefónica, S.A. and Terra Networks, S.A. approved a merger plan which provides for the merger of the two companies and prepared their respective balance sheets as of December 31, 2004, which we will refer to as the merger balance sheets and which will be submitted to their respective annual general shareholders meetings for their approval.

In the merger, Terra Networks will be merged into Telefónica with Telefónica being the surviving entity. If the merger is consummated the ordinary shares and ADSs of Terra Networks will cease to be traded on any exchange or quotation system, including the Spanish stock exchanges in the case of Terra Networks ordinary shares and the Nasdaq National Market in the case of Terra Networks ADSs.

If the merger is completed, holders of Terra Networks ordinary shares will receive 2 Telefónica ordinary shares for every 9 ordinary shares of Terra Networks they hold and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs they hold. Each Terra Networks ADS represents one Terra Networks ordinary share, and each Telefónica ADS represents three Telefónica ordinary shares.

Telefónica will deliver approximately 29,274,686 ordinary shares of Telefónica (including ordinary shares in the form of ADSs) to Terra Networks shareholders in the merger. The ordinary shares of Telefónica to be delivered to Terra Networks shareholders in the merger will represent approximately 0.6% of the outstanding ordinary shares of Telefónica after the merger.

Telefónica will not deliver fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any fractional ordinary shares or ADSs. Telefónica shareholders and ADS holders will continue to own their existing ordinary shares and ADSs after the merger.

We are asking shareholders and ADS holders of Telefónica to approve Telefónica s merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters.

We are asking shareholders and ADS holders of Terra Networks to approve Terra Networks merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters.

An English-language translation of the merger plan, deposited with the Madrid Commercial Registry, is attached as Annex A-1 to this joint information statement/prospectus.

We cannot complete the merger unless shareholders of both companies approve it.

This joint information statement/prospectus has been prepared for shareholders of Telefónica and Terra Networks residing in the United States and for holders of Telefónica and Terra Networks ADSs to provide information about the merger described herein which is to be voted on at the annual general shareholders meetings of Telefónica s and Terra Networks shareholders.

Under Spanish law, if a quorum is not obtained on the first date for which the meeting is called, the meeting is adjourned until the date and time specified in the meeting notice for the second call, if any. On the second call of a meeting, the quorum requirements are lower than those for the first call.

The dates, times and places of the annual general shareholders meeting on the first call or on the second call, if required, are:

For Telefónica shareholders:

First Call: May 30, 2005

Second Call: May 31, 2005

12:00 Noon, Local Time

Madrid, at IFEMA (Feria de Madrid), Campo de las Naciones, Parque Ferial Juan Carlos I, Pabellón 3

For Terra Networks shareholders:

First Call: June 2, 2005

12:00 Noon, Local Time

Barcelona, at Palau Sant Jordi, Barcelona 92 Room, Passeig Olímpic 5-7 de Barcelona

For Telefónica and Terra Networks shareholders, approval of the merger on the terms and conditions set forth in the merger plan, the merger balance sheets and related matters described herein requires a majority of the votes present or represented by proxy at the annual general shareholders meeting of Telefónica or Terra Networks, as the case may be, if a quorum of at least 50% is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% of the subscribed capital of Telefónica or Terra Networks, as the case may be, entitled to vote but at least 25% of the subscribed share capital entitled to vote. At February 23, 2005, Telefónica owned 75.87% of the outstanding Terra Networks ordinary shares and, accordingly, there will be only one call for the Terra Networks annual general shareholders meeting. Telefónica intends to vote its Terra Networks ordinary shares in favor of the merger.

The holders of at least 300 ordinary shares of Telefónica and at least 25 ordinary shares of Terra Networks, or holders who join a group of shareholders who hold in the aggregate at least the required number of ordinary shares, will be allowed to attend and vote at the annual general shareholders meeting if those holders are recorded on the applicable book-entry registry of shareholders on May 25, 2005, and May 28, 2005, five days prior to the date of Telefónica and Terra Networks annual general shareholders meetings, respectively. Shareholders holding fewer ordinary shares may vote by proxy. The holders of ADSs representing ordinary shares of Telefónica and Terra Networks will be allowed to vote by proxy in accordance with the procedures set forth in their respective ADS deposit agreements, which are described below, if those holders are recorded on the ADS depositaries registries on April 22, 2005.

The principal market on which Telefónica ordinary shares trade is the Spanish stock exchanges, where they trade under the symbol TEF . Telefónica ADSs, each representing three ordinary shares, are listed on the New York Stock Exchange under the symbol TEF . The principal market on which Terra Networks ordinary shares trade is the Spanish stock exchanges, where they trade under the symbol TRR . Terra Networks ADSs, each representing one ordinary share, are traded on the Nasdaq National Market under the symbol TRRA .

This joint information statement/prospectus provides detailed information about the proposed merger and important information about the Telefónica ordinary shares and ADSs to be offered to Terra Networks shareholders and ADS holders pursuant to the merger. You are encouraged to read everything in this document, including the list of risk factors relating to the merger that begins on page II-1.

César Alierta Izuel
Executive Chairman
Telefónica, S.A.

Joaquín Faura Batlle
Executive Chairman
Terra Networks, S.A.

Joint information statement/prospectus dated April 25, 2005, and first mailed to shareholders on April 25, 2005.

Table of Contents

Information Incorporated by Reference

This joint information statement/prospectus incorporates by reference business and financial information about Telefónica and Terra Networks that is not included in or delivered in this joint information statement/prospectus. We may also incorporate by reference some of the reports on Form 6-K that we or Terra Networks furnishes to the SEC between the date of this joint information statement/prospectus and the date of the annual general shareholders meetings. You may obtain documents incorporated by reference in this joint information statement/prospectus without charge by requesting them in writing or by telephone from the appropriate party at the following address:

Georgeson Shareholder

17 State Street, 10th Floor

New York, NY 10004

Toll Free: (877) 278-4794

Banks & Brokers: (212) 440-9800

To obtain timely delivery of these documents, you must request them no later than May 24, 2005. For a list of those documents that are incorporated by reference into this joint information statement/prospectus, see Part Eight Additional Information for Shareholders Where You Can Find More Information.

Table of Contents

TELEFÓNICA, S.A.

Annual General Shareholders Meeting

The Board of Directors of Telefónica, S.A. has resolved to call the annual general shareholders meeting of the company, to be held in Madrid, at IFEMA (Feria de Madrid), Campo de las Naciones, Parque Ferial Juan Carlos I, Pabellón 3 on May 30, 2005 at 12:00 Noon on first call and on May 31, 2005 at 12:00 Noon on second call in the same place, if the necessary legal quorum is not reached on the first call.

The purpose of this call is to submit to the consideration and approval of the annual general shareholders meeting the items stated in the Agenda below.

AGENDA

I. Examination and approval, if applicable, of the Annual Accounts and Management Report of Telefónica, S.A. and its consolidated group of companies, as well as the proposal for the application of the results of Telefónica, S.A., and that of the management of the company s Board of Directors, all for the 2004 financial year.

II. Shareholder remuneration: A) distribution of dividends with a charge to the additional paid-in capital reserve and B) extraordinary non-cash distribution of additional paid-in capital.

III. Examination and approval, as the case may be, of the merger plan between Telefónica, S.A. and Terra Networks, S.A. and approval, as the Merger Balance Sheet, of Telefónica, S.A. s Balance Sheet closed as of December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by absorption (*absorción*) of Terra Networks, S.A. by Telefónica, S.A. with the dissolution without liquidation of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares as a result of the merger. Delegation of powers.

IV. Appointment of Directors.

V. Designation of the Accounts Auditor for Telefónica, S.A. and its consolidated group of companies, under the provisions of article 42 of the Spanish Commerce Code (Código de Comercio) and article 204 of the Spanish Corporations Act (Ley de Sociedades Anónimas).

VI. Authorization for the acquisition of treasury stock, directly or through group companies.

VII. Reduction of share capital through the amortization of treasury stock, with the exclusion of the right to opposition by creditors, through the redrafting of the article in the bylaws that refers to the share capital.

VIII. Delegation of powers to formalize, construe, correct and execute the resolutions adopted by the annual general shareholders meeting.

Table of Contents

TERRA NETWORKS, S.A.

Annual General Shareholders Meeting

The Board of Directors of Terra Networks, S.A. has resolved to call the annual general shareholders meeting of the company, to be held in Barcelona, at Palau Sant Jordi, Barcelona 92 Room, Passeig Olímpic 5-7 de Barcelona on June 2, 2005 at 12:00 Noon on the first, and only, call.

The purpose of this call is to submit to the consideration and approval of the annual general shareholders meeting the items stated in the Agenda below.

AGENDA

I. Examination and, if appropriate, approval of the financial statements and management report, both of Terra Networks, S.A. (parent company) and of its consolidated group, as well as the proposed distribution of income and the conduct of business by its Board of Directors, all in relation to 2004.

II. Reappointment, ratification and, if appropriate, appointment of Directors.

III. Shareholders remuneration: distribution of dividends with a charge to the additional paid-in capital reserve.

IV. Designation of auditor for Terra Networks, S.A. and its consolidated group of companies.

V. Examination and approval, if applicable, of the merger plan of Telefónica, S.A. and Terra Networks, S.A. and approval, as the merger balance sheet, of Terra Networks, S.A. s balance sheet closed on December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by means of the absorption (*absorción*) of the latter by the former with the extinction of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares. Delegation of powers.

VI. To consent to and approve, as far as necessary, the resolutions to be adopted by the annual shareholders meeting of Telefónica, S.A. under items IV and VII of the Agenda for the Meeting relating to: (i) appointment of Directors and (ii) capital reduction by means of the retirement of treasury stock, with the exclusion of the right of creditors to object, rewording the Article in the corporate bylaws relating to capital stock.

VII. Delegation of powers to formalize, interpret, rectify and implement the resolutions adopted by the shareholders meeting.

Table of Contents

TABLE OF CONTENTS

Table of Contents

The contents of Telefónica s and Terra Networks World Wide Web sites are not part of this joint information statement/prospectus.

Table of Contents

Glossary

The terms below are used as follows throughout this joint information statement/prospectus:

Telefónica means Telefónica, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires. In addition, references to we , us and our are to Telefónica, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires.

Terra Networks means Terra Networks, S.A. and its consolidated subsidiaries, unless otherwise indicated or the context otherwise requires.

Telefónica s Consolidated Financial Statements means Telefónica s audited consolidated financial statements at December 31, 2004 and 2003 and for the three years ended December 31, 2004, as included in Telefónica s 2004 Form 20-F.

Terra Networks Consolidated Financial Statements means Terra Networks audited consolidated financial statements at December 31, 2004 and 2003 and for the three years ended December 31, 2004, as included in Terra Networks 2004 Form 20-F.

Telefónica Merger Balance Sheets means the Spanish statutory audited balance sheets of Telefónica, S.A. at December 31, 2004, included in Annex A-2.

Terra Networks Merger Balance Sheets means the Spanish statutory audited balance sheets of Terra Networks, S.A. at December 31, 2004, included in Annex A-3.

Telefónica s 2004 Form 20-F means Telefónica s annual report on Form 20-F for the year ended December 31, 2004, as filed with the Securities and Exchange Commission on April 18, 2005, as amended on April 22, 2005, and incorporated by reference into this joint information statement/prospectus.

Terra Networks 2004 Form 20-F means Terra Networks annual report on Form 20-F for the year ended December 31, 2004 as filed with the Securities and Exchange Commission and incorporated by reference into this joint information statement/prospectus.

Cautionary Statement Regarding

Forward-Looking Statements

This document contains statements that constitute forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933, as amended, Section 21E of the U.S. Securities Exchange Act of 1934, as amended, and the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this document can be identified in some instances, by the use of words such as expects , aims , hopes , anticipates , intends , believes and similar language or the negative thereof or by the forward-looking n of discussions of strategy, plans or intentions. These statements appear in a number of places in this document including, without limitation, certain statements made in Questions and Answers About the Merger, Summary, The Merger Background of the Merger, The Merger Our Reasons for the Merger, The Merger Other Expenses, Opinion of Morgan Stanley & Co. Limited, Opinion of Lehman Brothers Europe Limited, Opinion of Citigroup Global Markets Limited, Opinion of the Spanish Independent Expert, Information about Telefónica and Information about

Terra Networks. The sections of documents incorporated by reference which contain forward-looking statements include Operating and Financial Review and Prospects and Quantitative and Qualitative Disclosures About Market Risk in Telefónica s 2004 Form 20-F and Terra Networks 2004 Form 20-F. Other forward-looking statements contained herein or therein include statements regarding our intent, belief or current expectations with respect to, among other things:

- the effect on our results of operations of increased competition in the Spanish telecommunications market and our other principal markets;

- trends affecting our financial condition or results of operations;

Table of Contents

- acquisitions or investments which we may make in the future;
- our capital expenditures plan;
- supervision and regulation of the Spanish telecommunications sector and in other countries where we have significant operations;
- our strategic partnerships;
- the potential for growth and competition in current and anticipated areas of our business; and
- the adoption of International Financial Reporting Standards in preparing Telefónica, S.A. s consolidated financial statements beginning January 1, 2005.

Such forward-looking statements are not guarantees of future performance and involve numerous risks and uncertainties, and actual results may differ materially from those anticipated in the forward-looking statements as a result of various factors. The risks and uncertainties involved in our businesses that could affect the matters referred to in such forward-looking statements include but are not limited to:

- changes in general economic, business, or political conditions in the domestic or international markets in which we operate or have material investments that may affect demand for our services;
- changes in currency exchange rates and interest rates;
- the impact of current, pending or future legislation and regulation in Spain, other countries where we operate and the European Union;
- the impact of new pronouncements from the International Accounting Standards Board regarding International Financial Reporting Standards on Telefónica, S.A. s consolidated financial statements beginning January 1, 2005;
- the actions of existing and potential competitors in each of our markets; and
- the potential effects of technological changes.

Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of the date of this document. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date of this document, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

You should understand that the following important factors, in addition to those discussed above and elsewhere in this document and in the documents which are incorporated by reference, could affect the future results of Telefónica and Terra Networks, and of Telefónica after the closing of the merger, and could cause those results or other outcomes to differ materially from those expressed in our forward-looking statements:

- our ability to integrate the businesses of Telefónica and Terra Networks successfully after the merger;
- the challenges inherent in diverting management s focus and resources from other strategic opportunities and from operational matters during the integration process;
- the process of, or conditions imposed in connection with, obtaining regulatory approvals for the merger;
- the outcome of negotiations with partners and governments;
- the growth of free internet access in many core markets that may increase competition;
- the need to establish and maintain strategic relationships with content providers, e-commerce merchants and technology providers;
- declining prices for our services; and
- reliance on third-party content providers.

Table of Contents

Questions and Answers about the Merger

Q: When and where are the shareholders meetings?

A: Telefónica s annual general shareholders meeting will take place on May 30, 2005 or May 31, 2005, if a quorum is not obtained at the first call, in Madrid, Spain. Terra Networks annual general shareholders meeting will take place on June 2, 2005 in Barcelona, Spain. For the address of each meeting, see Part Four Information about the Meetings and Voting Matters Relating to the Meetings.

Q: What do I need to do now if I hold Telefónica or Terra Networks ordinary shares?

A: All holders of at least 300 Telefónica ordinary shares will be allowed to attend the Telefónica meeting and vote. All holders of at least 25 Terra Networks ordinary shares will be allowed to attend the Terra Networks meeting and vote.

Holders of fewer than 300 Telefónica ordinary shares or fewer than 25 Terra Networks ordinary shares may join other shareholders to form a group owning at least the minimum required ordinary shares and appoint a shareholder representative to vote their ordinary shares. In addition, holders of fewer than 300 Telefónica ordinary shares may also grant a proxy to a holder who already has sufficient ordinary shares to attend the meeting.

In order to attend the meetings, shareholders must request an admission ticket from the Spanish depositary for their ordinary shares.

Q: What do I need to do now if I hold Telefónica or Terra Networks ADSs?

A: If you hold Telefónica or Terra Networks ADSs representing Telefónica or Terra Networks ordinary shares and wish to vote, you must complete the voting instruction card provided by the relevant depositary. Please contact the relevant depositary for more information about these procedures.

Q: How many votes will I get for each ordinary share of Telefónica or Terra Networks?

A: Holders of Telefónica ordinary shares will be entitled to one vote for every ordinary share they own and that is represented at Telefónica s annual general shareholders meeting. Holders of Terra Networks ordinary shares will be entitled to one vote for every ordinary share they own and that is represented at Terra Networks annual general shareholders meeting.

However, each shareholder of Telefónica, including any affiliates of that shareholder, is limited to a maximum number of votes representing 10% of the paid-in capital of Telefónica entitled to vote.

Q: How many votes will I get for each Telefónica or Terra Networks ADS?

A: If you hold Telefónica or Terra Networks ADSs representing Telefónica or Terra Networks ordinary shares and you complete the voting instruction card and return it, in the case of the Telefónica ADSs, to the Telefónica depositary by May 27, 2005, and in the case of the Terra Networks ADSs, to the Terra Networks depositary by May 31, 2005, you will be entitled to three votes for each Telefónica ADS held and one vote for each Terra Networks ADS held.

Q: Can I vote by proxy?

A: Telefónica shareholders may vote by proxy by executing a written instrument in favor of another person, including a director of Telefónica. Terra Networks shareholders may vote by proxy by executing a written instrument in favor of another person, including a director of Terra Networks. A proxy may be appointed for only one single meeting, including the first and second calls relating to such meeting.

Table of Contents

Q: Will my depositary vote the ordinary shares represented by my ADSs for me?

A: If you own Terra Networks ADSs, the Terra Networks depositary will, subject to certain conditions, vote the ordinary shares represented by your ADSs in accordance with the Board of Directors recommendation unless you provide the Terra Networks depositary with instructions to the contrary.

If you own Telefónica ADSs, the Telefónica depositary will, subject to certain conditions, vote the ordinary shares represented by your ADSs in accordance with the Board of Directors recommendation unless you provide the Telefónica depositary with instructions to the contrary.

Q: What will I receive in the merger for my Terra Networks ordinary shares and ADSs?

A: Terra Networks shareholders will receive 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks, and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs.

Telefónica will not deliver any fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any ordinary shares or ADSs Terra Networks that do not entitle them to receive one ordinary share or ADS of Telefónica.

Q: What happens to my future dividends?

A: The merger plan describes that the holders of ordinary shares of Telefónica and Terra Networks will receive separate dividends prior to the merger as follows: (1) holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share as interim dividends with respect to the fiscal year ended December 31, 2004; (2) holders of Terra Networks ordinary shares and ADSs will receive 0.60 per Terra Networks ordinary share; and (3) holders of Telefónica ordinary shares and ADSs will receive a dividend of one Telefónica ordinary share for every 25 Telefónica ordinary shares already held. The dividends described under (2) and (3) above are subject to the final approval of the annual general shareholders meetings of the relevant company. The determination of the exchange ratio took into consideration the dividends that both companies are expected to distribute. Other than the dividends described in (1), (2) and (3) above, which will be paid prior to the merger, the holders of Telefónica ordinary shares and ADSs received in connection with the merger will be entitled to receive dividends on an equal basis with current holders of Telefónica ordinary shares and ADSs with respect to the year beginning January 1, 2005, including a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share payable on November 11, 2005, subject to final approval by the annual general shareholders meeting of Telefónica. To compare dividends paid by each of Telefónica and Terra Networks, see Part One Summary Summary Comparative per Ordinary Share Data.

Q: When do you expect the merger to be completed?

A: We are working towards completing the merger as quickly as possible. We hope to complete the merger within two months of the date of the annual general shareholders meetings.

Q: What do I have to do in order to exchange my ordinary shares of Terra Networks for ordinary shares in Telefónica?

A: Nothing. If the merger is approved, your Terra Networks ordinary shares will be automatically exchanged for ordinary shares of Telefónica.

Q: What do I have to do in order to exchange my Terra Networks ADSs for ADSs of Telefónica?

A: Nothing. If the merger is approved, the Terra Networks ordinary shares represented by your ADSs will be automatically exchanged for ordinary shares of Telefónica and ADSs representing Telefónica ordinary shares will be delivered to you.

Table of Contents

If you hold your Terra Networks ADSs in the form of ADR certificate(s), you must surrender your ADR certificate(s) for cancellation and obtain a new ADR certificate representing the Telefónica ADSs you are entitled to received in the merger.

Q: *Who do I call if I have questions about the meetings or the merger?*

A: Telefónica shareholders and ADS holders may call Telefónica s Shareholder Assistant Service, at 011-34-900-11-1004.

Terra Networks shareholders and ADS holders may call 011-34-900-50-0525.

Q: *If I own ADSs, how do I contact the depositary?*

A: If you own Telefónica ADSs, you should contact Citibank, N.A. at the address and number provided in the instructions to your voting card.

If you own Terra Networks ADSs, you should contact Citibank, N.A. at the address and number provided in the instructions to your voting card.

Table of Contents

Part One Summary

This summary highlights selected information from this joint information statement/prospectus and may not contain all of the information that is important to you. To understand the merger fully and for a more complete description of the legal terms of the merger, you should read this document and the documents we have referred you to carefully. See Part Eight Additional Information for Shareholders Where You Can Find More Information.

The Companies

Telefónica, S.A.

The registered offices of Telefónica are at Gran Vía, 28, 28013 Madrid, Spain; the telephone number of Telefónica s registered offices is 011-34-900-11-1004.

We are a diversified telecommunications group which provides a comprehensive range of services in Spain and Latin America through one of the world s largest and most modern telecommunications networks. We are also the leading provider of fixed line public voice telephone services, wireless communications services, Internet access services and data transmission services in Spain and one of the largest telecommunications operators in Latin America, with operations principally in Brazil, Argentina, Chile, Peru, Mexico, Colombia, Ecuador, Nicaragua, Panama, Uruguay, Venezuela, El Salvador and Guatemala.

Our group is organized according to seven principal lines of business: Spanish fixed line business, Latin American fixed line business, mobile business, directories business, Internet portal business, call centers and content and media business.

At December 31, 2004, we had approximately 43.2 million access lines in service and 74.4 million wireless subscribers. In addition, we have 0.4 million pay television subscribers. We had a total of approximately 118.1 million clients at December 31, 2004, more than half of which were in Latin America.

Terra Networks, S.A.

The registered offices of Terra Networks are at Calle Nicaragua, 54, 08029, Barcelona, Spain; the telephone number of Terra Networks registered offices is 011-34-93-493-2300. The main offices of Terra Networks are at Via de las Dos Castillas, 33, 28224, Pozuelo de Alarcón, Madrid, Spain; the telephone number of Terra Networks main offices is 011-34-91-452-3000.

Terra Networks is a leading portal to Spanish- and Portuguese-speaking markets. Terra Networks offers a suite of Internet services in a variety of languages that provides users throughout our markets in Europe, Latin America and North America with:

- access to the Internet (in Spain and certain countries in Latin America);
- portal and network services that incorporate a wide variety of individually-tailored content for each market and featuring enhanced functionality;
- a range of online advertising, marketing and e-commerce opportunities;
- multiple solutions for our customers Internet needs, such as web design and hosting and communication; and
- consulting services such as web audit, web rationalization and web maintenance.

Through Terra Networks portals and network of websites and joint venture partnerships, it has one of the largest global footprints of any Internet portal or network, with portals in 27 countries. Terra Networks holds a

Table of Contents

leading position in the following markets: Spain, Latin America and the U.S. Hispanic market. Terra Networks is also a leading interactive services provider in Spain and Latin America, offering Internet access and local-language interactive content and services to more than 6 million pay customers in Spain, the United States, Brazil, Mexico, Peru, Chile and Central America.

Telefónica and Terra Networks Reasons for the Merger

Telefónica and Terra Networks believe that by combining Terra Networks Internet access and portal services with Telefónica s fixed-line telephony network and broadband services, the two companies can create more shareholder value than could be achieved by the companies on their own. This is the fundamental reason for the merger.

Telefónica and Terra Networks believe that the strategy of independently developing telecommunications and Internet businesses is no longer attractive, particularly in light of the recent growth in penetration of broadband technology in many of the markets in which the two companies operate. As a result of the success of broadband technology, a new market dynamic has developed in which Internet access and connection and telephony services offered in one integrated package is the business model that best serves customers increasing desire to obtain these services from one telecommunications provider.

For Telefónica and Terra Networks, the integration of Telefónica s telecommunications business, and in particular its fixed-line telephony network infrastructure, with the requisite technical and human capital to operate such network, and broadband capability, with Terra Networks Internet access and portal services, provides greater growth opportunities for the companies as an integrated unit than as independent operators. As an integrated telephony and Internet services provider, Telefónica will be able to provide a complete package of services in order to compete successfully with other integrated operators, such as cable companies.

In addition, after the merger, Telefónica and Terra Networks believe that:

- The two companies competitive position will be stronger as a result of an increased capability to compete with the integrated telephony, internet service and content packages offered by competitors;
- The two companies will be better positioned to develop new services that optimize the use of Terra Networks network or that require significant resources;
- The two companies will improve their ability to leverage each company s client relationships by creating global strategies based on client segment, rather than product line, reducing customer churn through the sale of packaged services and increasing cross-selling; and
- The two companies costs and expenses will decrease as a result of, among other measures, integrating their networks and platforms, eliminating duplicative marketing and advertising and reducing corporate overhead.

Telefónica and Terra Networks believe the combined company can be run more efficiently and can compete more effectively and use its capital more profitably than either company on its own. Of course, these benefits and the other benefits described above depend on our ability to obtain the necessary approvals for the merger, to integrate the businesses of Telefónica and Terra Networks successfully after the merger and on other uncertainties.

Merger Recommendations to Shareholders

To Telefónica Shareholders:

The Board of Directors of Telefónica has approved the merger plan, an English-language translation of which is attached as Annex A-1, and the holders of Telefónica ordinary shares and Telefónica ADSs are being invited to approve the merger on the terms and conditions set forth in the merger plan at the Telefónica annual

Table of Contents

general shareholders meeting. In accordance with Spanish law, Telefónica s Board of Directors has prepared a report to shareholders which explains certain legal and financial aspects of the merger. See Part Three The Merger Report of the Board of Directors of Telefónica for a description of such report. An English-language translation of the report is attached as Annex C-2 to this joint information statement/prospectus.

To Terra Networks Shareholders:

The Board of Directors of Terra Networks has approved the merger plan, an English-language translation of which is attached as Annex A-1, and the holders of Terra Networks ordinary shares and Terra Networks ADSs are being invited to approve the merger plan at the Terra Networks annual general shareholders meeting. In accordance with Spanish law, Terra Networks Board of Directors has prepared a report to shareholders which explains certain legal and financial aspects of the merger. See Part Three The Merger Report of the Board of Directors of Terra Networks for a description of such report. An English-language translation of the report is attached as Annex C-3 to this joint information statement/prospectus.

The Merger

In the merger, Terra Networks will be merged into Telefónica with Telefónica being the surviving entity. If the merger is consummated the ordinary shares and ADSs of Terra Networks will cease to be traded on any exchange or quotation system, including the Spanish stock exchanges in the case of the Terra Networks ordinary shares and the Nasdaq National Market in the case of the Terra Networks ADSs.

The English-language translation of the merger plan is attached as Annex A-1 to this joint information statement/prospectus. We encourage you to read the merger plan because it is the document that governs the merger.

What Holders of Terra Networks Ordinary Shares and ADSs Will Receive

As a result of the merger, Terra Networks shareholders will receive 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks, and holders of Terra Networks ADSs will receive 2 Telefónica ADSs for every 27 Terra Networks ADSs.

Telefónica will not deliver any fractional ordinary shares or ADSs. Terra Networks shareholders and ADS holders will receive cash in lieu of any ordinary shares or ADSs of Terra Networks that do not entitle them to receive one ordinary share or ADS of Telefónica.

Comparative Per Ordinary Share and ADS Market Price Information

Telefónica and Terra Networks ordinary shares are both listed on the Automated Quotation System of the Spanish stock exchanges. On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, Telefónica ordinary shares closed at 14.46 and Terra Networks ordinary shares closed at 3.19. On April 21, 2005 Telefónica ordinary shares closed at 13.12 and Terra Networks ordinary shares closed at 3.32.

Telefónica ADSs are listed on the New York Stock Exchange. Terra Networks ADSs are traded on the Nasdaq National Market. On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, Telefónica ADSs closed at U.S.$55.91 and Terra Networks ADSs closed at U.S.$4.07. On April 21, 2005, Telefónica ADSs closed at U.S.$51.98 and Terra Networks ADSs closed at U.S.$4.29.

Listing of New Telefónica ADSs

The new Telefónica ADSs will be listed on the New York Stock Exchange under the ticker symbol TEF, subject to approval by the NYSE of Telefónica s application to list such ADSs.

Ownership of Telefónica After the Merger

Telefónica will deliver approximately 29,274,686 ordinary shares of Telefónica (including ordinary shares in the form of ADSs) to Terra Networks shareholders in the merger. The ordinary shares of Telefónica to be delivered to Terra Networks shareholders in the merger will represent approximately 0.6% of the outstanding ordinary shares of Telefónica after the merger.

Shareholder Vote Required to Approve the Merger Proposals

For Telefónica shareholders: Approval of the merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of the annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Telefónica entitled to vote is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%.

For Terra Networks shareholders: Approval of the merger balance sheets, the merger on the terms and conditions set forth in the merger plan and related matters requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of the annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Terra Networks entitled to vote is obtained or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%.

At February 23, 2005, Telefónica owned 75.87% of the outstanding Terra Network ordinary shares. Telefónica intends to vote its Terra Networks ordinary shares in favor of the merger.

Appraisal Rights

The holders of Telefónica and Terra Networks ordinary shares and ADSs do not have any right to an appraisal of the value of their ordinary shares in connection with the merger. However, an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the share exchange ratio is justified. See Part Three The Merger Report of the Spanish Independent Expert for a description of such report. An English-language translation of this report is attached as Annex C-1 to this joint information statement/prospectus.

Board of Directors of Telefónica After the Merger

Following the merger, the Board of Directors of Telefónica will remain unchanged with 19 members.

Accounting Treatment

The merger by absorption of Terra Networks with and into Telefónica will be accounted for as a transaction of entities under common control in the consolidated financial statements of Telefónica under both Spanish and U.S. GAAP except for the acquisition of the noncontrolling equity interests in Terra Networks, which will be accounted for under the pooling of interests method under Spanish GAAP and under the purchase method under U.S. GAAP (purchase of the noncontrolling equity interests).

Material Spanish and U.S. Federal Income Tax Consequences of the Merger

Holders of Terra Networks ordinary shares or ADSs (except those who reside in certain tax haven jurisdictions, as defined by Spanish tax regulations) generally will not recognize any gain or loss for Spanish tax purposes on the exchange of their Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs in the merger, except for any gain or loss recognized in connection with the receipt of cash in lieu of fractional ordinary shares. In addition, the companies will not recognize gain or loss as a result of the merger.

Based on certain factual representations made by Telefónica and assuming that (a) there will not be any changes in facts or in law between the date of this joint information statement/prospectus and the date on which the merger is completed and (b) the merger is completed in accordance with the current terms of the merger plan and any other related agreements, although there is no authority that directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and therefore it is not certain, for U.S. federal income tax purposes, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger should qualify as a reorganization under Section 368(a) of the U.S. Internal Revenue Code of 1986, as amended (the Code). However, even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992, if Terra Networks was a passive foreign investment company (PFIC) for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. Furthermore, the U.S. Internal Revenue Service (the IRS) or the courts may disagree with the conclusion that the merger should qualify as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be treated as a taxable exchange for U.S. federal income tax purposes. See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

Your tax consequences will depend upon your personal situation. You should consult your tax advisor for a full understanding of the tax consequences of the merger to you.

Conditions to the Completion of the Merger

The completion of the merger depends upon meeting a number of conditions, including the conditions described below. For a more detailed discussion of conditions to the merger, see Part Three The Merger Conditions to the Completion of the Merger :

- approval of the merger on the terms and conditions set forth in the merger plan by the shareholders of Telefónica and Terra Networks at their respective annual general shareholders meetings;
- approval by the shareholders of Telefónica of its merger balance sheets and approval by the shareholders of Terra Networks of its merger balance sheets at their respective annual general shareholders meetings;
- approval by the shareholders of Telefónica and Terra Networks of any other applicable resolutions related to the merger at their respective annual shareholders meetings;
- compliance with all corporate requirements under Spanish law, including registration of the merger deed with the Madrid Commercial Registry;

Telefónica s registration statement on Form F-4, which includes this joint information statement/prospectus, being effective and not subject to any stop order by the SEC; and

approval for the listing on the NYSE of the Telefónica ADSs to be issued in the merger.

We can give no assurance as to when or whether any of these approvals and consents will be obtained, the terms and conditions that may be imposed in connection with any such approvals and consents, or the consequences of failing to obtain and approvals and consents.

Table of Contents

Part One Summary

Opinions of Financial Advisors

In deciding to approve the merger plan, each Board of Directors considered the opinion of one or more financial advisors. The Board of Directors of Terra Networks received opinions from (i) Lehman Brothers Europe Limited, that based upon and subject to the matters stated therein, as of February 23, 2005, from a financial point of view, the exchange ratio to be offered in the proposed merger was fair to the shareholders of Terra Networks (other than Telefónica) and (ii) Citigroup Global Markets Limited, that, based upon and subject to the assumptions and qualifications set forth therein, as of February 23, 2005, the exchange ratio was fair, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates). In connection with rendering their opinions, each of Lehman Brothers Europe Limited and Citigroup Global Markets Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Networks shareholders prior to the merger. The Board of Directors of Telefónica received an opinion from Morgan Stanley & Co. Limited as to the fairness from a financial point of view to Telefónica of the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan as of February 23, 2005, based upon and subject to the matters stated in its opinion. These opinions are attached as Annex B-2, Annex B-3 and Annex B-1, respectively. We encourage you to read these opinions in their entirety.

Directors Reports on the Merger plan

In accordance with the Spanish Corporations Law, the Boards of Directors of each of Telefónica and Terra Networks have prepared Directors reports on the merger plan. These reports describe certain of the merger plan s legal and economic aspects, including the exchange ratio and the procedure for the valuation of the companies. See Part Three The Merger Report of the Board of Directors of Telefónica and Part Three The Merger Report of the Board of Directors of Terra Networks for a description of these reports. English-language translations of the Directors reports are attached as Annexes C-2 and C-3, respectively, to this joint information statement/prospectus.

Summary Selected Historical Financial Data

We are providing the following information to aid you in your analysis of the financial aspects of the merger. We derived this information from the audited financial statements of Telefónica and Terra Networks at and for the years ended December 31, 2000 through 2004. The information is only a summary and you should read it together with the annual reports and other information that we have filed with the SEC and incorporated by reference and information that we incorporate by reference in the future. See Part Eight Additional Information for Shareholders Where You Can Find More Information.

Table of Contents

Part One Summary

Summary Selected Historical Consolidated Financial Data of Telefónica

For important information concerning the preparation and presentation of the financial statements from which these data have been selected, see Part Eight Additional Information for Shareholders Presentation of Financial Information.

	At and for the year ended December 31,				
	2000	**2001**	**2002**	**2003**	**2004**
	(in millions of euro, except per ordinary share and per ADS data)				
INCOME STATEMENT DATA					
Amounts in accordance with Spanish GAAP:					
Revenues from operations	28,485.5	31,052.6	28,411.3	28,399.8	30,321.9
Other operating revenues[(1)]	266.7	254.7	297.6	288.9	381.7
Internal expenditures capitalized	899.1	730.4	496.7	530.3	474.3
Increase (decrease) in inventories (net)	112.3	(103.9)	(18.1)	(135.5)	32.9
Total Revenues	**29,763.6**	**31,933.8**	**29,187.5**	**29,083.5**	**31,210.8**
Goods purchased	(6,045.2)	(7,111.9)	(6,953.6)	(6,276.6)	(7,558.69)
External services and local taxes	(5,786.1)	(5,534.3)	(4,976.7)	(5,082.7)	(5,601.63)
Personnel expenses	(5,111.7)	(5,390.3)	(4,793.8)	(4,641.3)	(4,411.81)
Provision for depreciation and amortization	(6,960.8)	(7,374.0)	(6,692.4)	(6,274.2)	(5,980.15)
Trade provisions	(761.1)	(1,023.8)	(645.6)	(420.6)	(336.16)
Other operating expenses	(140.7)	(69.3)	(93.7)	(60.3)	(87.20)
Total operating costs before financial expenses and goodwill amortization	**(24,805.6)**	**(26,503.6)**	**(24,155.7)**	**(22,755.7)**	**(23,975.6)**
Operating profit	4,958.0	5,430.2	5,031.8	6,327.9	7,235.3
Amortization of goodwill and reversal of negative goodwill	(500.6)	(841.6)	(665.4)	(442.5)	(432.6)
Financial income (expense)	(1,611.8)	(1,608.4)	(1,589.3)	(1,555.9)	(1,240.21)
Exchange gains (losses), net	(248.5)	(782.7)	(632.3)	495.8	56.41
Income (losses) from associated companies	(161.4)	(376.5)	(527.9)	(212.6)	(56.11)
Profit from ordinary activities	**2,435.7**	**1,821.1**	**1,616.8**	**4,612.2**	**5,562.8**
Extraordinary revenues	4,302.3	1,167.1	474.6	1,167.2	409.0
Losses on fixed assets	(239.9)	(233.0)	(9,614.6)	(55.3)	(49.71)
Extraordinary expenses	(3,630.5)	(721.3)	(7,078.0)	(2,361.6)	(1,525.1)
Income (loss) before tax and minority interest	**2,867.6**	**2,033.9**	**(14,601.1)**	**3,362.5**	**4,397.0**
Corporate income tax	(242.2)	(198.1)	3,228.7	(913.4)	(1,138.7)
Minority interest	(120.6)	271.0	5,795.6	(245.5)	(381.0)
Net income (loss)	**2,504.8**	**2,106.8**	**(5,576.8)**	**2,203.6**	**2,877.3**
Net income (loss) per ordinary share[(2)]	0.59	0.43	(1.13)	0.45	0.60
Weighted average number of ordinary shares (thousands)	4,269,839	4,916,564	4,948,037	4,960,125	4,795,892
Net income (loss) per ADS[(2)(3)]	1.76	1.28	(3.38)	1.35	1.80
Weighted average number of ADSs (thousands)	1,423,280	1,638,855	1,649,346	1,653,375	1,598,631

Table of Contents

Part One Summary

	At and for the year ended December 31,				
	2000	2001	2002	2003	2004
	(in millions of euro, except per ordinary share and per ADS data)				
Amounts in accordance with U.S. GAAP:					
Total revenues	27,326.1	31,577.2	28,912.6	27,708.4	29,854.9
Income (loss) before tax	1,549.7	(6,713.6)	(8,593.5)	3,804.9	3,979.2
Corporate income tax	295	(477.8)	3,387.5	(1,114.6)	(1,401.2)
Net income	1,844.6	(7,191.3)	(5,206.1)	2,690.3	2,578.0
Net income per ordinary share(2)(5)	0.43	(1.46)	(1.05)	0.54	0.55
Net income per ADS(2)(3)(5)	1.30	(4.39)	(3.16)	1.63	1.64
BALANCE SHEET DATA					
Amounts in accordance with Spanish GAAP:					
Cash	765.6	621.9	543.9	336.4	855.0
Property plant and equipment	38,721.9	36,606.1	27,099.7	24,315.8	23,348.1
Total assets	92,377.3	86,422.6	68,041.3	62,075.2	63,466.3
Total long term debt	24,692.9	27,692.4	21,726.1	18,495.4	16,003.7
Total shareholders equity	25,930.5	25,861.6	16,996.0	16,756.6	16,225.1
Amounts in accordance with U.S. GAAP (4):					
Cash	678.7	619.6	517.5	336.4	827.5
Property, plant and equipment	38,277.9	35,563.2	25,282.7	27,718.4	21,823.2
Total assets	107,884.6	90,930.9	67,211.0	61,600.4	62,519.3
Total long term debt	20,618.5	27,771.2	21,778.0	18,310.0	14,881.9
Total shareholders equity	44,225.3	31,659.6	16,973.7	17,224.0	16,314.6
CASH FLOW DATA					
Amounts in accordance with Spanish GAAP:					
Net cash provided by operating activities	8,996.9	8,828.8	8,814.6	9,191.1	10,186.8
Net cash used in (provided by) investing activities	(17,719.5)	(9,895.4)	(5,780.2)	(5,171.7)	(8,978.7)
Net cash used in (received from) financing activities(6)	14,320.9	(1,321.1)	(2,101.1)	(4,178.9)	(1,961.2)
Amounts in accordance with U.S. GAAP:					
Net cash provided by operating activities	16,370.1	8,995.8	9,019.5	9,558.7	10,042.7
Net cash used in (provided by) investing activities	(25,572.6)	(9,528.5)	(5,585.4)	(5,462.8)	(8,543.1)
Net cash used in (received from) financing activities(6)	14,689.4	(1,347.0)	(2,082.0)	(4,220.0)	(2,264.6)

(1) Includes internal capitalized expenditures on fixed assets and increase in inventories (net).

(2) The per ordinary share and per ADS computations for all periods presented have been adjusted to reflect the stock split and stock dividends which occurred during the periods presented.

(3) Each ADS represents the right to receive three Telefónica ordinary shares. Figures do not include any charges of the depositary.

(4) U.S. GAAP data for the years ended December 31, 2000, 2001, 2002, and 2003 have been restated retroactively to record our investment in Portugal Telecom, SGPS under the equity method. See Note 25.7 to our Consolidated Financial Statements incorporated by reference herein. The effect of the change on net income in 2003, 2002, 2001 and 2000 was an increase or (decrease) of 4.2 million, 8.4 million, (9.0) million and (11.4) million, respectively. The effect of the change on Shareholders equity in 2003, 2002, 2001 and 2000 was a decrease of 67.3 million, 15.6 million, 110.2 million and 132.5 million, respectively.

(5) U.S. GAAP earnings per ordinary share and per ADS have been computed using the weighted average number of ordinary shares outstanding for each period.

(6) Includes net cash outflow for capital expenditures and for investments in affiliates.

Table of Contents

Summary Selected Historical Consolidated Financial Data of Terra Networks

For important information concerning the preparation and presentation of the financial statements from which these data have been selected, see Part Eight Additional Information for Shareholders Presentation of Information.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands of euro, except per ordinary share data)				
Consolidated Statement of Operations Data:					
Amounts in accordance with Spanish GAAP:					
Revenues:					
Access	117,666	200,451	220,416	216,492	236,501
Advertising and E-commerce	145,328	389,142	281,362	143,021	119,661
Communication and Portal Services	2,017	33,936	66,638	119,023	122,304
Corporate Services	29,306	46,130	43,657	58,581	59,633
Other	13,212	23,853	9,718	9,510	2,379
Total revenues	307,529	693,512	621,791	546,627	540,478
Operating expenses					
Goods purchased	(193,626)	(352,039)	(293,619)	(265,836)	(256,307)
Personnel expenses	(116,868)	(204,969)	(165,433)	(119,653)	(95,785)
Depreciation and amortization	(83,513)	(157,426)	(142,718)	(78,742)	(79,513)
Other	(356,281)	(396,522)	(304,433)	(200,622)	(167,520)
Total operating expenses before financial expenses	(750,288)	(1,110,956)	(906,203)	(664,853)	(599,125)
Operating loss	(442,759)	(417,444)	(284,412)	(118,226)	(58,627)
Financial income (expense), net	35,487	126,262	63,544	57,743	18,277
Amortization of goodwill[(1)]	(253,484)	(386,332)	(254,157)	(83,269)	(65,577)
Reversal of negative goodwill in Consolidation		2,825	1,602	972	729
Equity share of affiliate losses, net	(54,721)	(181,732)	(148,902)	(34,734)	(14,559)
Loss from ordinary activities	(715,477)	(856,421)	(622,325)	(177,514)	(119,777)
Extraordinary income (expense)[(2)]	(89,710)	(74,847)	(1,046,332)	4,534	(25,773)
Corporate income tax	248,142	363,350	(342,625)	(266)	306,456
Minority interest	691	1,620	2,412	536	3,066
Net income (loss)	(556,354)	(566,298)	(2,008,870)	(172,710)	163,972
Basic and diluted net income (loss) per ordinary share	(1.61)	(1.02)	(3.59)	(0.31)	0.292
Weighted average ordinary shares outstanding	344,819,216	557,603,245	559,298,611	560,532,170	562,157,469
Dividends per ordinary share					2.00
Amounts in accordance with U.S. GAAP					
Net income (loss)	(1,236,441)	(11,411,749)	(1,597,689)	(219,033)	(977,799)
Basic and diluted net income (loss) per ordinary share	(3.59)	(20.47)	(2.86)	(0.39)	(1.74)

(1) Under U.S. GAAP, goodwill amortization is included in operating expenses. Under U.S. GAAP, goodwill is not amortized after 2001.

(2) Extraordinary income (expense) items under Spanish GAAP would not qualify as extraordinary items under U.S. GAAP.

Table of Contents

Part One Summary

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(in thousands of euro, except ordinary share data)				
Selected Consolidated Balance Sheet Data:					
Amounts in accordance with Spanish GAAP:					
Cash and cash equivalents	2,673,384	2,190,124	1,761,088	1,599,521	854,182
Working capital[(1)]	2,467,155	1,980,947	1,675,746	1,563,973	837,784
Total assets	6,738,237	6,107,331	3,497,508	2,987,218	1,852,210
Total long-term obligations	159,888	97,877	36,235	52,802	67,817
Shareholders equity	6,126,833	5,556,792	3,190,887	2,720,541	1,634,736
Capital stock (excluding long-term debt and redeemable preferred stock)	1,242,532	1,242,532	1,216,321	1,202,936	1,149,883
Amounts in accordance with U.S. GAAP					
Total assets	16,958,819	4,743,246	2,691,526	2,518,171	1,507,867
Shareholders equity	16,409,923	4,220,453	2,346,243	2,207,834	1,249,295

(1) Working capital is defined as total current assets minus total current liabilities.

Summary Comparative Per Ordinary Share Data

Set forth below are net income, cash dividends and book value per ordinary share data for Telefónica and Terra Networks on a historic basis and on a per Terra Networks equivalent ordinary share basis. The exchange ratio for the merger is 2 ordinary shares of Telefónica for every 9 ordinary shares of Terra Networks. The Terra Networks per Telefónica equivalent ordinary share data shows the effect of the merger from the perspective of an owner of Terra Networks ordinary shares and was calculated by multiplying Telefónica s net income, cash dividends and book value by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares.

You should read the information below together with our historical financial statements and related notes contained in the annual reports and other information that we have filed with the SEC and incorporated by reference. See Part Eight Additional Information for Shareholders Where You Can Find More Information .

	Year ended December 31, 2004
	(in euro)
Spanish GAAP	
Telefónica Historic per Ordinary Share Data:	
Net income	0.60
Cash dividends	0.40
Book value	3.38
U.S. GAAP	
Telefónica Historic per Ordinary Share Data:	
Net income	0.54
Cash dividends	0.40

Book value	3.40
Spanish GAAP	
Terra Networks Historic per Ordinary Share Data:	
Net income	0.29
Cash dividends	2.00
Book value	2.91
U.S. GAAP	
Terra Networks Historic per Ordinary Share Data:	
Net income (loss)	(1.74)

I-10

Table of Contents

	Year ended December 31, 2004 (in euro)
Cash dividends	2.00
Book value	2.22
Spanish GAAP	
Terra Networks per Telefónica Equivalent Ordinary Share Data:	
Net income	0.13
Cash dividends	0.09
Book value	0.75
U.S. GAAP	
Terra Networks per Telefónica Equivalent Ordinary Share Data:	
Net income	0.12
Cash dividends	0.09
Book value	0.76

Comparative Market Price Data

The following table presents the per ordinary share closing prices for Telefónica ordinary shares and Terra Networks ordinary shares as quoted on the Automated Quotation System of the Spanish stock exchanges. These prices are presented on the following dates:

February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger; and April 21, 2005, the latest practicable date before the date of this joint information statement/prospectus.

The table also presents implied equivalent per ordinary share values for Terra Networks ordinary shares by multiplying the price per Telefónica ordinary share, converted into U.S. dollars, on each of the two dates by the merger exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares.

	Telefónica ordinary share price (in)	Telefónica ordinary share price (in U.S. dollars)	Terra Networks ordinary share price (in)	Terra Networks ordinary share price (in U.S. dollars)	Implied value per Terra Networks ordinary share (in U.S. dollars)
February 11, 2005	14.46	18.60	3.19	4.10	4.13
April 21, 2005	13.12	17.18	3.32	4.35	3.82

You are urged to obtain current market quotations for Telefónica ordinary shares and Terra Networks ordinary shares before making a decision with respect to the merger.

Table of Contents

Part Two Risk Factors Relating Specifically to the Merger

Telefónica s 2003 Form 20-F and current reports on Form 6-K that are incorporated by reference into this joint information statement/prospectus describe a variety of risks relevant to Telefónica s business and financial condition, which you are urged to read. The following discussion concerns risk factors relating specifically to the merger.

The merger agreement was negotiated between Telefónica and its subsidiary, which may result in actual or perceived conflicts of interest relating to the merger.

The merger agreement was negotiated between Telefónica and its 75.87% -owned subsidiary, Terra Networks, which may result in actual or perceived conflicts of interest relating to the merger. To address conflicts of interest relating to the merger, Terra Networks Board of Directors created a Merger Committee comprised solely of independent Directors with no relationship with Telefónica to analyze and negotiate the merger. In addition, Terra Networks Board of Directors received opinions from two investment banks regarding the fairness of the consideration to be received by Terra Networks shareholders in the merger. In connection with the merger, the Boards of Directors of each of Telefónica and Terra Networks have issued Directors reports on the merger plan describing certain of the merger plan s legal and economic aspects, including the exchange ratio and the procedure used for the valuation of the companies, and an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the exchange ratio is justified.

Telefónica has the power to establish a quorum at the annual general shareholders meeting and approve the merger at such duly constituted meeting.

Approval of the merger balance sheets and the merger on the terms and conditions set forth in the merger plan requires the affirmative vote of a majority of the ordinary shares present or represented by proxy at the first or second call of Terra Networks annual general shareholders meeting if a quorum of at least 50% of the issued share capital of Terra Networks entitled to vote is present or 2/3 of the votes present or represented by proxy at the second call of the annual general shareholders meeting if the quorum is less than 50% but at least 25%. As of February 23, 2005, we owned 75.87% of the outstanding ordinary shares of Terra Networks and, as a result, have the power to establish a quorum at the annual general shareholders meeting and approve the merger at such duly constituted meeting. We intend to vote in favor of the merger.

We may fail to realize the anticipated benefits of the merger.

The success of the merger will depend, in part, on our ability to realize the anticipated growth opportunities and synergies from fully integrating the businesses of Telefónica with the businesses of Terra Networks. To realize the anticipated benefits of this combination, members of the management team of Telefónica must develop strategies and implement a business plan that will:

- effectively and efficiently integrate the policies, procedures and operations of Telefónica and Terra Networks;

successfully retain and attract key employees of the combined company, including operating management and key technical personnel, during a period of transition and in light of the competitive employment market;

and achieve the benefits described in Part Three The Merger Telefónica and Terra Networks Reasons for the Merger .

If members of the management team of Telefónica are not able to develop strategies and implement a business plan that achieves these objectives, among others, the anticipated benefits of the combination may not

Table of Contents

Part Two Risk Factors

be realized. In particular, anticipated growth in operating profit before depreciation and amortization and cash flow may not be realized, which would have an adverse impact on Telefónica and the market price of ordinary shares and ADSs of Telefónica.

The market price of Telefónica ordinary shares and ADSs may decrease significantly between the time you vote on the merger plan and the time the merger is completed. As a result, at the time you vote on the merger plan you will not know the market value you will receive for your Terra Networks ordinary shares and ADSs.

The merger exchange ratio is fixed, and the merger plan does not contain a mechanism to adjust the merger exchange ratio in the event that the market price of the Telefónica ordinary shares or ADSs declines. As a result, if the market price of Telefónica ordinary shares or ADSs at the completion of the merger is lower than their market prices on the date of the Terra Networks annual general shareholders meeting, the market value of the Telefónica ordinary shares or ADSs that you receive in the merger will be less than the market value on the date of the Terra Networks annual general shareholders meeting and may be less than you paid for your Terra Networks ordinary shares or ADSs. We expect that the closing of the merger will occur in July, 2005, but it may occur at some other time.

The trading market for Terra Networks ordinary shares or ADSs after the merger plan has been approved by the requisite shareholders meetings may be severely impaired or disrupted. As a result, until the merger closes and you receive Telefónica ordinary shares or ADSs, the liquidity of the Terra Networks ordinary shares or ADSs may decline and their volatility may increase.

Following approval of the merger plan by the requisite shareholders meetings and prior to registration of the merger deed in the Madrid Commercial Registry, the trading volume of Terra Networks ordinary shares or ADSs and the liquidity of the ordinary shares or ADSs could decrease. This could result in substantial fluctuations in the trading price for Terra Networks ordinary shares or ADSs.

Following the registration of the merger deed in the Madrid Commercial Registry, Terra Networks will cease to exist and we intend to solicit the delisting of the Terra Networks ADSs from the Nasdaq National Market and terminate Terra Networks reporting obligations in the United States.

Investors who wished to own Terra Networks ordinary shares or ADSs but who do not wish to hold Telefónica ordinary shares or ADSs may sell the Telefónica ordinary shares or ADSs they receive or expect to receive in the merger. This may put downward pressure on the market price of the Telefónica ordinary shares or ADSs that you will receive in the merger. Arbitrageurs may also adversely influence the price of the ordinary shares or ADSs.

For a number of reasons, some shareholders of Terra Networks may wish to sell their Terra Networks ordinary shares or ADSs prior to completion of the merger, or the Telefónica ordinary shares or ADSs that they will receive in the merger. In addition, the market price of the Telefónica ordinary shares or ADSs may be adversely affected by arbitrage activities prior to the completion of the merger. These sales or the prospect of future sales, as well as arbitrage activity, could adversely affect the market price for Terra Networks ordinary shares or ADSs and Telefónica ordinary shares or ADSs.

The merger may be taxable for U.S. federal income tax purposes

While the merger should qualify as a tax free reorganization under Section 368(a) of the Code, such treatment is not certain because there is no authority which directly addressees a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization. Even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992, if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. Furthermore, the IRS or the courts could disagree with the conclusion that the merger should qualify as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be a taxable exchange for U.S. federal income tax purposes and a U.S. Holder would recognize gain or loss for U.S. federal income tax purposes equal to the difference between the fair market value of the Telefónica ordinary shares or ADSs received, plus the amount of any cash received in lieu of a fractional Telefónica ordinary share or ADS, and such U.S. Holders tax basis in the Terra Networks ordinary shares or ADSs exchanged therefor.

See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

Possible adverse tax consequences if Terra Networks is or was a PFIC

Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in one or more prior years. If Terra Networks was a PFIC for any taxable year during which a U.S. Holder held ordinary shares or ADSs, (i) under proposed Treasury regulations which are not yet in effect but which are proposed to be effective from April 11, 1992, gain realized on the U.S. Holder s exchange of such Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be taxable under the PFIC rules and (ii) the proposed 0.60 per Terra Networks ordinary share distribution would, unless the U.S. Holder acquired its Terra Networks ordinary shares or ADSs in the current taxable year, be treated as an Excess Distribution under the PFIC rules to the extent it exceeds 125 percent of the average of the annual distributions on the Terra Networks ordinary shares received by the U.S. Holder during the preceding three years or, if shorter, the U.S. Holder s holding period. Under the PFIC rules, any such gain or Excess Distribution would be allocated ratably over the U.S. Holder s holding period for the ordinary shares or ADSs. The amount allocated to the current taxable year and any year before Terra Networks became a PFIC would be taxed as ordinary income. Amounts allocated to each other taxable year would be subject to tax at the highest rate of tax in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the amount allocated to each such taxable year.

See Part Three The Merger Material Spanish and U.S. Federal Income Tax Consequences.

The merger exchange ratio that was agreed in the merger plan by the Boards of Directors of Telefónica and Terra Networks was based on a valuation methodology routinely used in mergers in the telecommunications sector. You should not assume that the methodology employed produces values that everyone would agree are intrinsically correct or representative of fair value. You should also not assume that they are indicative of future market prices or valuations.

The merger exchange ratio that was agreed in the merger plan by the Boards of Directors of Telefónica and Terra Networks was based on a valuation methodology routinely used in mergers in the telecommunications sector. An independent expert appointed by the Madrid Commercial Registry has prepared a report on the merger plan and on the net worth contributed by Terra Networks to Telefónica. Such report address, among other matters, whether (i) the exchange ratio is justified, (ii) what methods were used to establish the exchange ratio, (iii) whether such methods were adequate and (iv) the valuations that are produced by such methodologies, including whether any issues relating to the valuation arose. Notwithstanding the methodologies discussed in the independent expert s report, you should be aware that other valuation methodologies may have produced

different results, particularly if the assumptions underlying the valuation methodologies are modified. You should make your own assessment concerning the Telefónica ordinary shares and the merger exchange ratio, calling on your advisors as you deem appropriate. You should not assume that everyone would agree that relative valuations applied are intrinsically correct or representative of fair value. You should also not assume that they are indicative of future market prices or valuations. See Part Three The Merger Report of the Spanish Independent Expert for a description of the Spanish Independent Expert s report. An English-language translation of the report is attached as Annex C-1 to this joint information statement/prospectus.

Table of Contents

Part Three The Merger

General

The Board of Directors of each of Telefónica and Terra Networks is using this joint information statement/prospectus to solicit proxies from the holders of Telefónica and Terra Networks ordinary shares and Telefónica and Terra Networks ADSs for use at their respective annual general shareholders meetings.

Telefónica Proposals

At the Telefónica annual general shareholders meeting, holders of Telefónica ordinary shares and Telefónica ADSs will be asked to vote upon:

I. Examination and approval, if applicable, of the Annual Accounts and Management Report of Telefónica, S.A. and its consolidated group of companies, as well as the proposal for the application of the results of Telefónica, S.A., and that of the management of the company s Board of Directors, all for the 2004 financial year.

II. Shareholder remuneration: A) distribution of dividends with a charge to the additional paid-in capital reserve and B) extraordinary non-cash distribution of additional paid-in capital.

III. Examination and approval, as the case may be, of the merger plan between Telefónica, S.A. and Terra Networks, S.A. and approval, as the Merger Balance Sheet, of Telefónica, S.A. s Balance Sheet closed as of December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by absorption (*absorción*) of Terra Networks, S.A. by Telefónica, S.A. with the dissolution without liquidation of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares as a result of the merger. Delegation of powers.

IV. Appointment of Directors.

V. Designation of the Accounts Auditor for Telefónica, S.A. and its consolidated group of companies, under the provisions of article 42 of the Spanish Commerce Code (Código de Comercio) and article 204 of the Spanish Corporations Act (Ley de Sociedades Anónimas).

VI. Authorization for the acquisition of treasury stock, directly or through group companies.

VII.

Reduction of share capital through the amortization of treasury stock, with the exclusion of the right to opposition by creditors, through the redrafting of the article in the bylaws that refers to the share capital.

VIII. Delegation of powers to formalize, construe, correct and execute the resolutions adopted by the annual general shareholders meeting.

The merger will not be completed unless proposal III is approved by Telefónica s shareholders at the annual general shareholders meeting.

Table of Contents

Part Three The Merger

Terra Networks Proposals

At the Terra Networks annual general shareholders meeting, holders of Terra Networks ordinary shares and Terra Networks ADSs will be asked to vote upon:

I. Examination and, if appropriate, approval of the financial statements and management report, both of Terra Networks, S.A. (parent company) and of its consolidated group, as well as the proposed distribution of income and the conduct of business by its Board of Directors, all in relation to 2004.

II. Reappointment, ratification and, if appropriate, appointment of Directors.

III. Shareholders remuneration: distribution of dividends with a charge to the additional paid-in capital reserve.

IV. Designation of auditor for Terra Networks, S.A. and its consolidated group of companies.

V. Examination and approval, if applicable, of the merger plan of Telefónica, S.A. and Terra Networks, S.A. and approval, as the merger balance sheet, of Terra Networks, S.A. s balance sheet closed on December 31, 2004. Approval of the merger between Telefónica, S.A. and Terra Networks, S.A. by means of the absorption (*absorción*) of the latter by the former with the extinction of Terra Networks, S.A. and the en bloc transfer, by universal succession, of all of its assets and liabilities to Telefónica, S.A., stating that the exchange of shares will be fully satisfied by means of the delivery of Telefónica, S.A. s treasury shares, all in accordance with the merger plan. Application of the special tax regime set forth in Chapter VIII of Title VII of the Restated Text of the Companies Income Tax Law in connection with the merger. Establishment of procedures to facilitate the exchange of shares. Delegation of powers.

VI. To consent to and approve, as far as necessary, the resolutions to be adopted by the annual shareholders meeting of Telefónica, S.A. s under items IV and VII of the Agenda for the Meeting relating to: (i) appointment of Directors and (ii) capital reduction by means of the retirement of treasury stock, with the exclusion of the right of creditors to object, rewording the Article in the corporate bylaws relating to capital stock.

VII. Delegation of powers to formalize, interpret, rectify and implement the resolutions adopted by the shareholders meeting.

The merger will not be completed unless proposal V is approved by Terra Networks shareholders at the annual general shareholders meeting.

Background of the Merger

General Background

Terra Networks was created as a subsidiary of Telefónica in December 1998 to operate the Spanish residential and small office/home office Internet access business carried out by the Telefónica Group since 1995. In November 1999, Terra Networks issued approximately 66 million Terra Networks ordinary shares, or approximately 24% of Terra Networks capital stock, in an initial public offering. Following the initial public offering, Terra Networks ordinary shares have traded on the Spanish stock exchanges and been quoted on the Nasdaq National Market. In May 2000, Terra Networks entered into a strategic alliance agreement with Bertelsmann, one of the largest media companies in the world, as well as Telefónica and Lycos, Inc., then one of the leading Internet multi-brand networks, pursuant to which Bertelsmann agreed to purchase content and services from Terra Networks beginning in November 2000 and Telefónica agreed to subscribe to a rights offering by Terra Networks. In September 2000, pursuant to such agreement, Terra Networks completed a 2.2 billion rights offering, substantially all of which was subscribed by Telefónica. In October 2000, Terra Networks acquired 100% of the outstanding shares of Lycos, Inc. in a stock-for-stock exchange. On February 12, 2003 Telefónica and Terra Networks entered into a strategic alliance framework agreement to replace the Bertelsmann strategic alliance agreement.

On May 28, 2003, Telefónica launched a tender offer for 100% of the outstanding ordinary shares of Terra Networks that it did not own and on June 19, 2003, the CNMV approved the prospectus for the tender offer. The offer price was 5.25 per ordinary share, payable in cash. The offer was subject to Telefónica owning at least 75% of the total share capital of Terra Networks on the closing date of the offer. Terra Networks shareholders owning 33.6% of the outstanding ordinary shares of Terra Networks accepted the offer, which, following Telefónica s waiver of the 75% minimum ownership condition, resulted in Telefónica holding 71.97% of Terra Networks capital stock. During 2004, Terra Networks distributed a 2.00 per ordinary share cash dividend and Telefónica purchased in the open market an additional 3,753,140 ordinary shares of Terra Networks and sold in the open market 432,092 ordinary shares. As of February 23, 2005, Telefónica held 75.87% of Terra Networks share capital.

Background of the Merger

The management of each of Telefónica and Terra Networks continually review their companies respective positions in light of the changing competitive environment of the telecommunications and Internet industries in Spain, Europe and Latin America, with the objective of determining what alternatives are available to further enhance shareholder value. Terra Networks began operations with a business model based on the separation of traditional telecommunications and Internet service providers. However, in the past several years a new business model has emerged based on combining traditional telecommunications, internet and broadband services. The emergence of this new model has significantly changed the competitive environment for Internet service providers. In this context, both Telefónica and Terra Networks have considered a range of options to improve their competitive positions, including acquisitions or dispositions of assets, possible partnerships, alliances or other significant transactions.

On February 9, 2005, the Executive Committee of Telefónica met and, following an analysis of the opportunity to merge Telefónica and Terra Networks, resolved to initiate all necessary actions to execute the transaction. As the first step, on that date, Mr. César Alierta, Executive Chairman of Telefónica, sent a letter to Mr. Kim Faura, Executive Chairman of Terra Networks, inviting the latter to jointly explore the possibility of merging both companies in order to successfully face the challenges of technological changes, evolving clients needs and the telecommunication industry s evolution. The letter enclosed a form of the merger plan with proposed terms and conditions, which included an exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares. The Telefónica Executive Committee decision took into account, among other matters, the advice of Morgan Stanley & Co. Limited, as financial advisor, and, regarding matters of Spanish telecommunications and antitrust law, the advice of Uría & Menéndez, as external Spanish legal counsel, to Telefónica.

On February 10, 2005, at a special meeting of the Terra Networks Board of Directors, it was agreed that the three Directors appointed by Telefónica and one independent Director were subject to a conflict of interest and, accordingly, would abstain from participating in any meetings or discussions regarding, and from voting on, the merger plan. It was further agreed that the remaining five members of the Terra Networks Board of Directors not subject to a conflict of interest would create a Merger Committee comprised solely of independent Directors, with no relationship with Telefónica, namely, Mr. Moreno de Alborán y de Vierna and Mr. Badía Almirall, charged with the responsibility of negotiating the merger and determining the full Board of Directors position regarding the merger. The remaining three Directors, Mr. Faura, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez agreed unconditionally to vote on all matters relating to the merger plan according to the Merger Committee s recommendation. The Board of Directors of Terra Networks agreed that the Merger Committee should initiate a phase of analysis and negotiation of the transaction.

On February 10 and February 16, 2005, the Terra Networks Merger Committee of the Board of Directors resolved and ratified the appointment of Lehman Brothers Europe Limited and Citigroup Global Markets Limited as financial advisors to the Board of Directors. Mr. Faura Battle, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez voted unanimously in accordance with the recommendation of the Merger Committee.

On February 11, 2005, Mr. Faura addressed a letter to Mr. Alierta acknowledging the receipt of Mr. Alierta s letter, and informing Mr. Alierta of the willingness of the Board of Directors of Terra Networks to study and evaluate the proposed transaction.

On February 14, 2005, Telefónica issued a press release stating that its Executive Committee, in its meeting held February 9, 2005, agreed to propose to Terra Networks the initiation of negotiations leading to a potential merger of the two companies. On the same date, Terra Networks issued a press release stating that it had received Telefónica s proposal, and that its Board of Directors was studying the proposed transaction.

On February 23, 2005, the two companies agreed that prior to the merger Terra Networks would issue to holders of Terra Networks ordinary shares and ADSs a dividend of 0.60 per Terra Networks ordinary share.

On February 23, 2005, the Board of Directors of Terra Networks met to consider the proposed transaction. At this meeting (i) Lehman Brothers Europe Limited rendered its oral opinion, subsequently confirmed in writing, that based upon and subject to the matters set forth therein, as of February 23, 2005, from a financial point of view, the exchange ratio to be offered in the proposed merger was fair to the shareholders of Terra Networks (other than Telefónica) and (ii) Citigroup Global Markets Limited delivered its oral opinion, subsequently confirmed in writing, to the effect that, based upon and subject to the qualifications and assumptions set forth therein, as of February 23, 2005, the exchange ratio was fair, from a financial point of view, to the holders of Terra Networks ordinary shares (other than Telefónica and its affiliates). In connection with rendering their opinions, each of Lehman Brothers Europe Limited and Citigroup Global Markets Limited assumed, among other things, payment of the proposed dividend of 0.60 per Terra Networks ordinary share to be paid to all Terra Networks shareholders prior to the merger. The Merger Committee of the Terra Networks Board of Directors approved the merger plan, subject to shareholder approval at the annual general shareholders meeting, and the three Terra Networks Directors not subject to a conflict of interest, Mr. Faura, Mr. Merry del Val Gracie and Mr. Fernández-Prida Méndez-Núñez, voted in accordance with the Merger Committee s recommendation.

On February 23, 2005, the Board of Directors of Telefónica met to consider the proposed transaction. At this meeting, the Board of Directors was presented with the written fairness opinion rendered by Morgan Stanley & Co. Limited to the effect that, as of February 23, 2005 and based upon and subject to the matters stated in its opinion, the merger exchange ratio to be paid by Telefónica and the extraordinary dividend to be distributed by Terra Networks to its shareholders, including Telefónica, pursuant to the merger plan was fair, from a financial point of view, to Telefónica. After considering the opinion of Morgan Stanley & Co. Limited, among other matters, the Telefónica Board of Directors approved the merger plan, subject to shareholder approval at the annual general shareholders meeting.

After finalizing the merger plan on February 23, 2005, representatives of Telefónica and Terra Networks executed the merger plan and each company issued a press release announcing the proposed merger of Telefónica and Terra Networks.

Table of Contents

Part Three The Merger

Telefónica and Terra Networks Reasons for the Merger

Telefónica and Terra Networks believe that by combining Terra Networks Internet access and portal services with Telefónica s fixed-line telephony network and broadband services, the two companies can create more shareholder value than could be achieved by the companies on their own. This is the fundamental reason for the merger.

Telefónica and Terra Networks believe that the strategy of independently developing telecommunications and Internet businesses is no longer attractive, particularly in light of the recent growth in penetration of broadband technology in many of the markets in which the two companies operate. As a result of the success of broadband technology, a new market dynamic has developed in which Internet access and connection and telephony services offered in one integrated package is the business model that best serves customers increasing desire to obtain these services from one telecommunications provider.

For Telefónica and Terra Networks, the integration of Telefónica s telecommunications business, and in particular its fixed-line telephony network infrastructure, with the requisite technical and human capital to operate such network, and broadband capability, with Terra Networks Internet access and portal services, provides greater growth opportunities for the companies as an integrated unit than as independent operators. As an integrated telephony and Internet services provider, Telefónica will be able to provide a complete package of services in order to compete successfully with other integrated operators, such as cable companies.

In addition, after the merger, Telefónica and Terra Networks believe that:

- The two companies competitive position will be stronger as a result of an increased capability to compete with the integrated telephony, internet service and content packages offered by competitors;
- The two companies will be better positioned to develop new services that optimize the use of Terra Networks network or that require significant resources;
- The two companies will improve their ability to leverage each company s client relationships by creating global strategies based on client segment, rather than product line, reducing customer churn through the sale of packaged services and increasing cross-selling; and
- The two companies costs and expenses will decrease as a result of, among other measures, integrating their networks and platforms, eliminating duplicative marketing and advertising and reducing corporate overhead.

Telefónica and Terra Networks believe the combined company can be run more efficiently and can compete more effectively and use its capital more profitably than either company on its own. Of course, these benefits and the other benefits described above depend on our ability to obtain the necessary approvals for the merger, to integrate the businesses of Telefónica and Terra Networks successfully after the merger and on other uncertainties.

For additional information regarding the reasons the Boards of Directors of Telefónica and Terra Networks approved the merger plan, see section 1.1 of the English-language translation of the merger plan attached hereto as Annex A-1.

Accounting Treatment

The merger by absorption of Terra Networks with and into Telefónica will be accounted for as a transaction of entities under common control in the consolidated financial statements of Telefónica under both Spanish and U.S. GAAP except for the acquisition of the noncontrolling equity interests in Terra, which will be accounted for under the pooling of interests method under Spanish GAAP and under the purchase method under U.S. GAAP (purchase of the noncontrolling equity interests).

III-5

Material Spanish and U.S. Federal Income Tax Consequences

In the opinion of Uría & Menendez, Spanish counsel to Telefónica, with respect to taxes imposed by the Kingdom of Spain, and Davis Polk & Wardwell, U.S. counsel to Telefónica (U.S. counsel), with respect to U.S. federal income taxes, the following are the material Spanish tax consequences and the material U.S. federal income tax consequences of the merger and of the ownership and disposition of the Telefónica ordinary shares or ADSs to U.S. Holders (as defined below). However, the following is not a complete discussion of all potential tax consequences that might be relevant to the merger or the ownership of Telefónica ordinary shares or ADSs and it does not address all of the tax consequences that may be relevant to investors subject to special rules, including U.S. expatriates, insurance companies, tax-exempt organizations, certain financial institutions, partnerships, persons subject to the alternative minimum tax, dealers or traders in securities or currencies, persons who acquired their ordinary shares or ADSs pursuant to the exercise of employee stock options or otherwise as compensation, persons whose functional currency is not the U.S. dollar, persons who own Telefónica or Terra Networks ordinary shares or ADSs as part of an integrated investment (including a straddle) comprised of such ordinary shares or ADSs and one or more other positions for tax purposes, or persons who will own 5 percent or more of the stock of Telefónica immediately following the merger. Such holders may be subject to U.S. federal income tax consequences different from those set forth below. This tax section also does not address the Spanish tax consequences applicable to look-through (*entidades en régimen de atribución de rentas*) entities that may be subject to the tax regime applicable to such entities under the Spanish Non-Resident Income Tax Law.

As used herein, the term U.S. Holder means a beneficial owner of one or more Telefónica or Terra Networks ordinary shares or ADSs:

(a) who is, for U.S. federal income tax purposes, one of the following:

  i. a citizen or resident of the United States,

  ii. a corporation (or other entity taxable as a corporation) created or organized in or under the laws of the United States or any political subdivision thereof, or

  iii. an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source;

(b) who is entitled to the benefits of the Treaty (defined below) under the Limitation on Benefits provisions contained in the Treaty;

(c) who holds the ordinary shares or ADSs as capital assets for U.S. federal income tax purposes;

(d) who owns, directly, indirectly or by attribution, less than 5 percent of the share capital or voting stock of Telefónica or Terra Networks; and

(e) whose holding is not effectively connected with a permanent establishment in Spain.

If a partnership holds ordinary shares or ADSs, the tax treatment of a partner generally will depend upon the status of the partner and the activities of the partnership. A partner in a partnership that holds ordinary shares or ADSs is urged to consult its own tax advisor regarding the specific tax consequences of the merger and of acquiring, owning and disposing of Telefónica ordinary shares or ADSs.

This summary is based upon Spanish tax laws, U.S. tax laws, including the U.S. Internal Revenue Code of 1986, as amended (the Code), final, temporary and proposed Treasury regulations, rulings, judicial decisions, administrative pronouncements, and the Convention Between the United States of America and the Kingdom of Spain for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income, signed February 22, 1990, together with related protocol (the Treaty), all as currently in effect and all of which are subject to change or changes in interpretation, possibly with retroactive effect. In addition, the summary is based in part on representations of the depositary and assumes that each obligation provided for in, or otherwise contemplated by, the deposit agreement or any other related document will be performed in accordance with its terms.

The U.S. Treasury has expressed concerns that parties to whom ADSs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. Holders of ADSs. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate U.S. Holders. Accordingly, the availability of foreign tax credits to U.S. Holders of ADSs and the reduced tax rate for dividends received by certain non-corporate U.S. Holders, both as described below, could be affected by future actions that may be taken by parties to whom ADSs are pre-released.

For purposes of the Treaty and for U.S. federal income tax purposes, U.S. Holders of American Depositary Receipts will generally be treated as owners of the ADSs evidenced thereby and the ordinary shares represented by such ADSs.

This discussion assumes that Telefónica is not, and will not become, a passive foreign investment company (PFIC), as discussed below under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks -U.S. Federal Income Tax Considerations- Telefónica-Passive Foreign Investment Company Considerations.

U.S. Holders of ordinary shares or ADSs should consult their own tax advisors concerning the specific Spanish and U.S. federal, state and local tax consequences of the merger and of the ownership and disposition of Telefónica ordinary shares or ADSs in light of their particular situations, as well as any consequences arising under the laws of any other taxing jurisdiction. In particular, U.S. Holders are urged to consult their own tax advisors concerning whether they are eligible for benefits under the Treaty.

Income Tax Consequences of the Merger

Spanish Taxation

Under Spanish general merger regulations, shareholders of Terra Networks would be taxed on the capital gain realized upon the exchange of their ordinary shares, which is equal to the difference between the fair market value of the ordinary shares of Telefónica received in exchange for the ordinary shares of Terra Networks and the shareholder s basis in such Terra Networks ordinary shares as determined under Spanish tax law.

However, the merger plan provides that Telefónica and Terra Networks will opt for the special tax regime applicable to mergers provided in Chapter VIII, Title VII of Spanish Corporate Income Tax Law (approved by Royal Decree Legislative 4/2004 of March 5, 2004).

According to this law, income derived from the receipt of ordinary shares of Telefónica in exchange for ordinary shares of Terra Networks will not be taxable in Spain for shareholders since the ordinary shares received pertain to a participation in the capital of an entity resident in Spain for tax purposes.

However, this special tax regime will not apply to Terra Networks investors who reside in tax haven territories (the United States is not a tax haven territory for this purpose), as defined by Spanish Royal Decree 1080/1991. Such residents will be taxed in Spain at a rate of 35 percent on any capital gain realized from the merger. The special tax regime described above shall apply at the option of Telefónica and Terra Networks and must be communicated to the Ministry of Finance within the three-month period following the registration of the merger in the Madrid Commercial Registry. The special tax regime will not apply if the merger is not effected for valid economic reasons. Telefónica and Terra Networks have described the economic reasons for the merger above under Telefónica and Terra Networks Reasons For the Merger.

Based on the above, to the extent Telefónica duly communicates its election to consider the merger as falling under the special tax regime:

The holders of Terra Networks ordinary shares or Terra Networks ADSs not residing in a tax-haven jurisdiction, as defined under Spanish tax law, will not incur any tax obligation in Spain upon the

III-7

exchange of their Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs. For Spanish tax purposes, these shareholders tax basis and the acquisition date of the Telefónica ordinary shares or ADSs received will be the same as those of the Terra Networks ordinary shares or ADSs exchanged.

The holders of Terra Networks ordinary shares or ADSs residing in a tax haven jurisdiction will be taxed at a rate of 35 percent in Spain on the capital gain realized upon the exchange of their ordinary shares or ADSs.

The special tax regime does not apply to the sale of fractional ordinary shares or ADSs. Consequently, capital gains realized upon the sale of ordinary shares or ADSs of Terra Networks that do not entitle the holder to one ordinary share or ADS of Telefónica will be taxed as explained below under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-Spanish Tax Considerations-Taxation of Capital Gains.

United States Taxation

U.S. counsel is unable to opine that U.S. Holders will not be subject to U.S. federal income tax on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger because (a) there is no authority which directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and, therefore, while the merger should qualify as a reorganization under Section 368(a) of the Code, due to the lack of authority qualification is not certain, and (b) even if the merger qualifies as a reorganization under Section 368(a) of the Code, gains realized by U.S. Holders on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger may be subject to tax under proposed Treasury regulations, which are not yet effective but which are proposed to be effective from April 11, 1992 (the Proposed Regulations), if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs. Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years. See Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-U.S. Federal Income Tax Considerations-Terra Networks-Passive Foreign Investment Company Considerations below.

Under the Proposed Regulations, if Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs, any gain realized by a U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be taxable under the PFIC rules unless Telefónica were a PFIC for the 2005 taxable year, which is not expected to be the case. If the exchange of shares were to be taxable under this PFIC rule, any gain realized by a U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger (generally, the excess, if any, of the value of Telefónica ordinary shares or ADSs and cash in lieu of fractional ordinary shares or ADSs received over the U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs surrendered) would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year. In addition, the U.S. Holder s holding period for its Telefónica ordinary shares or ADSs received in the exchange would begin the day after they were received, and such Telefónica ordinary shares or ADSs would have a tax basis equal to their fair

Table of Contents

market value on the date the exchange of shares occurred. U.S. Holders are urged to consult their own tax advisors regarding any PFIC considerations with respect to the exchange of Terra Networks ordinary shares or ADSs pursuant to the merger that may be relevant to their particular circumstances.

If the exchange of ordinary shares or ADSs qualifies as a reorganization under Section 368(a) of the Code and Terra Networks was not a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs, for U.S. federal income tax purposes:

A U.S. Holder of Terra Networks ordinary shares or ADSs would not recognize any gain or loss upon its exchange pursuant to the merger of such ordinary shares or ADSs for Telefónica ordinary shares or ADSs.

If a U.S. Holder of Terra Networks ordinary shares or ADSs receives cash in respect of a fractional ordinary share or ADS, the U.S. Holder would recognize gain or loss, measured by the difference between the amount of cash received in respect of that fractional ordinary share or ADS and the portion of the U.S. Holder s tax basis allocable to that fractional ordinary share or ADS. This gain or loss would be capital gain or loss, and would be long-term capital gain or loss if the U.S. Holder had held the Terra Networks ordinary shares or ADSs exchanged for more than one year at the time the share exchange occurs.

A U.S. Holder of Terra Networks ordinary shares or ADSs would have a tax basis in the Telefónica ordinary shares or ADSs received in the exchange of Terra Networks ordinary shares or ADSs pursuant to the merger equal to (1) the U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs exchanged by that U.S. Holder pursuant to the merger, reduced by (2) the tax basis that is allocable to any fractional ordinary share or ADS for which cash is received.

The holding period for the Telefónica ordinary shares or ADSs received in exchange for Terra Networks ordinary shares or ADSs would include the holding period for such Terra Networks ordinary shares or ADSs so exchanged.

In general, any cash received by a U.S. Holder in respect of a fractional ordinary share or ADS may be subject to backup withholding under circumstances comparable to those described under Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks-U.S. Federal Income Tax Considerations-Telefónica-Information Reporting and Backup Withholding below. Furthermore, if a U.S. Holder realizes gain or loss on a sale or other disposition of euro it receives with respect to a fractional ordinary share or ADS, it will be U.S. source ordinary income or loss.

The foregoing discussion is based on U.S. counsel s opinion that, although there is no authority that directly addresses a reorganization that has facts similar to that of the merger where an acquired company in which the acquiror has a significant pre-existing ownership interest pays an extraordinary dividend prior to the reorganization and therefore the conclusion is not certain, the exchange of Terra Networks ordinary shares and ADSs for Telefónica ordinary shares and ADSs pursuant to the merger should qualify as a reorganization under Section 368(a) of the Code. This opinion is based on certain factual representations made by Telefónica and assumes that (a) there will not be any changes in facts or in law between the date of this joint information statement/prospectus and the date on which the merger is completed and (b) the merger will be completed in accordance with the current terms of the merger plan and any other related agreements. If any of the representations or assumptions described above are inaccurate, the U.S. federal income tax consequences may differ from those described herein.

An opinion of counsel is not binding upon the IRS or the courts, either or both of which could reach a contrary conclusion with respect to the qualification of the merger as a reorganization under Section 368(a) of the Code. If that were the case, the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary

III-9

shares or ADSs pursuant to the merger would be treated as taxable for U.S. federal income tax purposes and a U.S. Holder would recognize gain or loss equal to the difference between the fair market value of the Telefónica ordinary shares or ADSs received, plus the amount of any cash received in lieu of a fractional ordinary share or ADS, and such U.S. Holder s tax basis in the Terra Networks ordinary shares or ADSs exchanged therefor. Such gain or loss would be capital gain or loss and would be long-term if the U.S. Holder has held such Terra Networks ordinary shares or ADSs for more than one year at the time the share exchange occurs, unless Terra Networks was treated as a PFIC for any taxable year during which the U.S. Holder held such Terra Networks ordinary shares or ADS. If Terra Networks was treated as a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADS, gain recognized by such U.S. Holder on the exchange of Terra Networks ordinary shares or ADSs for Telefónica ordinary shares or ADSs pursuant to the merger would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year. In addition, the U.S. Holder s holding period for its Telefónica ordinary shares or ADSs received in the exchange would begin the day after they were received, and such Telefónica ordinary shares or ADSs would have a tax basis equal to their fair market value on the date the exchange of shares occurred.

Income Tax Considerations of Ownership of Ordinary Shares and ADSs of Telefónica and Terra Networks

Spanish Tax Considerations

Taxation of Dividends

Under Spanish law, dividends paid by a Spanish resident company to a U.S. Holder of ordinary shares or ADSs are subject to Spanish Non-Resident Income Tax, approved by Royal Decree Legislative 5/2004 of March 5, 2004 (NRIT), withheld at source on the gross amount of dividends, currently at a tax rate of 15 percent.

Taxation of Extraordinary Distributions

The merger plan describes that the holders of ordinary shares and ADSs of Telefónica and Terra Networks will receive separate dividends as follows: (1) prior to the merger holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share in connection with the fiscal year ended December 31, 2004; (2) prior to the merger holders of Terra Networks ordinary shares and ADSs will receive (subject to the approval of the shareholders at the annual general shareholders meeting of Terra Networks) 0.60 per Terra Networks ordinary share, which will be treated as a distribution of paid-in surplus (*reserva de prima de emisión*); and (3) prior to the merger holders of Telefónica ordinary shares or ADSs will receive (subject to the approval of the shareholders at the annual general shareholders meeting of Telefónica) a dividend of one Telefónica ordinary share for every 25 Telefónica ordinary shares already held, which will be treated as a distribution of paid-in surplus (*reserva de prima de emisión*). This share dividend will not be paid in respect of Telefónica ordinary shares to be received in connection with the merger.

In addition, subject to the approval of the shareholders at the annual general shareholders meeting of Telefónica, holders of Telefónica ordinary shares and ADSs received in connection with the merger will be entitled to receive (along with all other shareholders of Telefónica) a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share consisting of a distribution of paid-in surplus (*reserva de prima de emisión*) and payable on November 11, 2005.

Under Spanish law, these distributions of paid-in surplus (*reserva de prima de emisión*) are subject to special tax treatment. In general, the amount of these distributions received in cash or in shares is not taxable

Table of Contents

under Spanish income tax law but instead reduces the tax acquisition cost of the ordinary shares or ADSs on which it was distributed for Spanish tax purposes (i.e., in the event of a subsequent sale or disposition of such ordinary shares or ADSs, the amount of gain realized will be greater). In the case of the distribution of Telefónica ordinary shares, the amount by which a U.S. Holder must reduce the tax acquisition cost of its Telefónica ordinary shares or ADSs will be the market value of the ordinary shares or ADSs received. However, if the amount of the distributions received in cash or in shares is greater than the U.S. Holder s adjusted tax acquisition cost for the Telefónica shares or ADSs, then the amount by which the distributions exceed the U.S. Holder s adjusted tax acquisition cost generally will be subject to tax in Spain at a 15 percent tax rate and such U.S. Holder will be required to file a Spanish Form 210 within one month of the distribution. No amount will be withheld by Telefónica in respect of Spanish taxes on those distributions of paid-in surplus.

Taxation of Capital Gains

Under Spanish law, any capital gains derived from securities issued by persons residing in Spain for Spanish tax purposes are considered to be Spanish source income and, therefore, are taxable in Spain. Spanish income tax is generally levied at a 35 percent tax rate on capital gains of non-residents of Spain who are not entitled to the benefit of any applicable treaty for the avoidance of double taxation and who do not operate through a fixed base or a permanent establishment in Spain.

Under the Treaty, capital gains realized by U.S. Holders arising from the disposition of Telefónica ordinary shares or ADSs will not be taxed in Spain provided that the seller has not maintained a direct or indirect holding of 25 percent of the company s capital during the twelve months preceding the disposition of the stock. U.S. Holders will be required to establish that they are entitled to the exemption from tax under the Treaty by providing to the relevant Spanish tax authorities Spanish Form 210 and a certificate of residence on IRS Form 6166 from the IRS stating that to the best knowledge of the IRS such U.S. Holder is a U.S. resident within the meaning of the Treaty. Spanish law requires that both of these forms be filed within one month from the date on which the capital gain is realized. U.S. Holders must request the IRS Form 6166 certificate of residence by filing IRS Form 8802 with the IRS. The U.S. Holder must attach to IRS Form 8802 a statement declaring that it was or will be a resident of the United States for the period for which the Treaty benefit is claimed.

Spanish Wealth Tax

Individual U.S. Holders who hold ordinary shares or ADSs located in Spain or rights attached to such ordinary shares or ADSs exercisable in Spain are subject to the Spanish Wealth Tax (*Impuesto sobre el Patrimonio*) (Spanish Law 19/1991), which imposes tax on property and rights located in Spain, or that can be exercised within the Spanish territory, on the last day of any year. Therefore, U.S. Holders who held Telefónica ordinary shares or ADSs on the last day of any year are subject to the Spanish Wealth Tax for such year at marginal rates varying between 0.2 percent and 2.5 percent of the average market value of such ordinary shares or ADSs during the last quarter of such year, as published by the Spanish Ministry of Economic Affairs. U.S. Holders should consult their tax advisors with respect to the Spanish Wealth Tax.

Spanish Inheritance and Gift Taxes

Transfers of ordinary shares or ADSs upon death and by gift to individuals not resident in Spain for tax purposes are subject to Spanish inheritance and gift taxes (*Impuesto sobre Sucesiones y Donaciones*) (Spanish Law 29/1987), respectively, if the ordinary shares or ADSs are located in Spain or the rights attached to such ordinary shares or ADSs are exercisable in Spain at the time of death or gift, regardless of the residence of the heir or the beneficiary. The applicable tax rate, after applying all relevant factors, ranges from between 7.65 percent and 81.6 percent for individuals. Gifts of ordinary shares granted to U.S. Holders that are not individuals

Table of Contents

will be subject to the NRIT at a 35 percent tax rate on the fair market value of the ordinary shares as a capital gain. However, if the donee is a U.S. Holder entitled to the benefits of the Treaty, the exclusions available under the Treaty described under -Taxation of Capital Gains above will be applicable.

Expenses of Transfer

Transfers of ordinary shares or ADSs will be exempt from Transfer Tax (*Impuesto sobre Transmisiones Patrimoniales*) and Value Added Tax. Additionally, no Stamp Duty will be levied on such transfers.

U.S. Federal Income Tax Considerations

Terra Networks

Passive Foreign Investment Company Considerations

A foreign company is considered a PFIC for any taxable year if either: (i) 75 percent or more of its gross income consists of passive income (such as dividends, interest, rents and royalties) or (ii) 50 percent or more of the average quarterly value of its assets consists of assets that produce, or are held for the production of, passive income. For these purposes, the foreign company is treated as owning its proportionate share of the assets and receiving its proportionate share of the income of each company in which it owns directly or indirectly at least 25 percent by value of the stock (25 percent owned companies).

Accordingly, Terra Networks PFIC status is dependent upon the composition of its and its 25 percent owned companies income and assets and the value of its and its 25 percent owned companies assets from time to time. Because there are uncertainties in the application of the PFIC rules to companies such as Terra Networks and its 25 percent owned companies and the law regarding the classification of certain assets as active or passive is unclear, and the value of assets is uncertain, Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in prior taxable years.

Taxation of Extraordinary Distributions

Terra Networks cannot provide any assurance that it will not be a PFIC for the current taxable year or that it has not been a PFIC in one or more prior years. If Terra Networks was a PFIC for any taxable year during which a U.S. Holder held Terra Networks ordinary shares or ADSs then, unless the U.S. Holder acquired its Terra Networks ordinary shares or ADSs in the current taxable year, the proposed 0.60 per Terra Networks ordinary share distribution will be treated as an Excess Distribution to the extent it exceeds 125 percent of the average of the annual distributions on the Terra Networks ordinary shares or ADSs received by the U.S. Holder during the preceding three years or, if shorter, the U.S. Holder s holding period. The Excess Distribution would be allocated ratably over the U.S. Holder s holding period for the Terra Networks ordinary shares or ADSs. The amount allocated to the current taxable year and to any year before Terra Networks became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest change would be imposed on the amount allocated to each such taxable year.

Subject to the PFIC discussion above, distributions, including the proposed 0.60 per Terra Networks ordinary share distribution, received by a U.S. Holder on Terra Networks ordinary shares or ADSs, including the amount of any Spanish taxes withheld, will constitute foreign source dividend income to the extent paid out of Terra Networks current or accumulated earnings and profits (as determined for U.S. federal income tax purposes). Distributions in excess of current or accumulated earnings and profits will be treated first as a tax-free return of capital to the extent of the U.S. Holder s basis in the Terra Networks ordinary shares or ADSs and then as capital gain. Terra Networks has not calculated, and does not intend to calculate, its earnings and profits for U.S. federal income tax purposes.

The amount of a dividend a U.S. Holder is required to include in income will equal the U.S. dollar value of the euro, calculated by reference to the exchange rate in effect on the date the payment is received by the depositary (in the case of ADSs) or by the U.S. Holder (in the case of ordinary shares) regardless of whether the payment is converted into U.S. dollars on the date of receipt. If a U.S. Holder realizes gain or loss on a sale or other disposition of euro, it will be U.S. source ordinary income or loss. Corporate U.S. Holders will not be entitled to claim the dividends-received deduction with respect to dividends paid by Terra Networks. Subject to applicable limitations, dividends received by certain non-corporate U.S. Holders in taxable years beginning before January 1, 2009 will be taxable at a maximum rate of 15 percent, provided Terra Networks is not a PFIC for the taxable year in which the dividend is paid or the prior taxable year. Non-corporate U.S. Holders should consult their own tax advisors to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Spanish taxes withheld from the proposed 0.60 per Terra Networks ordinary share distribution will be creditable against a U.S. Holder s U.S. federal income tax liability, subject to applicable restrictions and limitations that may vary depending upon the U.S. Holder s circumstances. Instead of claiming a credit, a U.S. Holder may elect to deduct such Spanish taxes in computing its taxable income, subject to generally applicable limitations. The limitation of foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex. Therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

Telefónica

Taxation of Dividends

Distributions received by a U.S. Holder on Telefónica ordinary shares or ADSs, including the amount of any Spanish taxes withheld, other than certain pro rata distributions of Telefónica ordinary shares to all shareholders (including ADS holders), will constitute foreign source dividend income to the extent paid out of Telefónica s current or accumulated earnings and profits (as determined for U.S. federal income tax purposes). The amount of the dividend a U.S. Holder will be required to include in income will equal the U.S. dollar value of the euro, calculated by reference to the exchange rate in effect on the date the payment is received by the depositary (in the case of ADSs) or by the U.S. Holder (in the case of ordinary shares) regardless of whether the payment is converted into U.S. dollars on the date of receipt. If a U.S. Holder realizes gain or loss on a sale or other disposition of euro, it will be U.S. source ordinary income or loss. Corporate U.S. Holders will not be entitled to claim the dividends-received deduction with respect to dividends paid by Telefónica. Subject to applicable limitations, dividends received by certain non-corporate U.S. Holders in taxable years beginning before January 1, 2009 will be taxable at a maximum rate of 15 percent. Non-corporate U.S. Holders should consult their own tax advisors to determine whether they are subject to any special rules that limit their ability to be taxed at this favorable rate.

Spanish taxes withheld from dividends on Telefónica ordinary shares or ADSs at a rate not exceeding the rate provided in the Treaty will be creditable against a U.S. Holder s U.S. federal income tax liability, subject to applicable restrictions and limitations that may vary depending upon the U.S. Holder s circumstances. Instead of claiming a credit, a U.S. Holder may elect to deduct such Spanish taxes in computing its taxable income, subject to generally applicable limitations. The limitation of foreign taxes eligible for credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex. Therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

Pro rata distributions of ordinary shares to all shareholders (including ADS holders) are not generally subject to U.S. federal income tax provided that no shareholder may elect to receive cash or other property in lieu of receiving ordinary shares.

Table of Contents

Taxation Upon Sale or Other Disposition of Telefónica Ordinary Shares or ADSs

A U.S. Holder will generally recognize capital gain or loss on the sale or other disposition of Telefónica ordinary shares or ADSs, which will be long-term capital gain or loss if the U.S. Holder has held such ordinary shares or ADSs for more than one year. The amount of the U.S. Holder s gain or loss will be equal to the difference between such U.S. Holder s tax basis in the ordinary shares or ADSs sold or otherwise disposed of and the amount realized on the sale or other disposition. Any gain or loss will generally be U.S. source gain or loss for foreign tax credit purposes.

As discussed under Spanish Tax Considerations-Taxation of Capital Gains above, gain realized by a U.S. Holder on the sale or other disposition of Telefónica ordinary shares or ADSs may be subject to Spanish tax unless the U.S. Holder provides the relevant Spanish tax authorities with both a certificate of U.S. tax residence on IRS Form 6166 and Spanish Form 210. Spanish law requires that both of these forms be filed within one month from the date on which the capital gain is realized. Applicants are advised to submit IRS Form 8802 and the accompanying declaration to the IRS well in advance of the date on which the IRS Form 6166 that will be issued by the IRS may be required by the Spanish tax authorities, as there may be delays in obtaining the necessary forms. U.S. Holders should consult their own tax advisors regarding the potential Spanish tax consequences of a sale or other disposition of Telefónica ordinary shares or ADSs and the procedures available for an exemption from such tax.

Passive Foreign Investment Company Considerations

Telefónica believes that it was not a PFIC for its most recent taxable year and does not expect to become a PFIC in the foreseeable future. However, since PFIC status depends upon the composition of a company s income and assets and the market value of its assets from time to time, there can be no assurance that it will not be considered a PFIC for any taxable year. If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADSs, certain adverse tax consequences could apply to the U.S. Holder.

If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADSs, gains recognized by such U.S. Holder on a sale or other disposition of Telefónica ordinary shares or ADSs would be allocated ratably over the U.S. Holder s holding period for such ordinary shares or ADSs. The amount allocated to the taxable year of the sale or other disposition and to any year before Telefónica became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, and an interest charge would be imposed on the amount allocated to each such taxable year. Further, any distribution in respect of Telefónica ordinary shares or ADSs in excess of 125 percent of the average of the annual distributions on such ordinary shares or ADSs received by a U.S. Holder during the preceding three years or the U.S. Holder s holding period, whichever is shorter (an Excess Distribution), would be subject to taxation as described above.

If Telefónica were treated as a PFIC for any taxable year during which a U.S. Holder held Telefónica ordinary shares or ADS and the ordinary shares or ADSs are regularly traded on a qualified exchange, such U.S. Holder may make a mark-to-market election, which may mitigate some of the adverse tax consequences resulting from Telefónica s PFIC status. The ordinary shares and ADSs will be treated as regularly traded in any calendar year in which more than a de minimis quantity of ordinary shares or ADSs are traded on a qualified exchange on at least 15 days during each calendar quarter of such calendar year. A qualified exchange includes certain exchanges in the United States, including the New York Stock Exchange where Telefónica ADSs are traded, and foreign exchanges that are regulated by a governmental authority in which the exchange is located and with respect to which certain other requirements are met. The IRS has not yet identified specific foreign exchanges that are qualified for this purpose.

If a U.S. Holder makes the mark-to-market election, for each year in which Telefónica is a PFIC, the U.S. Holder generally will include as ordinary income the excess, if any, of the fair market value of the Telefónica ordinary shares or ADSs at the end of the taxable year over their adjusted basis, and will be permitted an ordinary loss in respect of the excess, if any, of the adjusted basis of the Telefónica ordinary shares or ADSs over their fair market value at the end of the taxable year (but only to the extent of the net amount of previously included income as a result of the mark-to-market election). If a U.S. Holder makes the election, such U.S. Holder s basis in the Telefónica ordinary shares or ADSs will be adjusted to reflect any such income or loss amounts. Any gain recognized on the sale or other disposition of Telefónica ordinary shares or ADSs will be treated as ordinary income.

Regardless of whether a mark-to-market election is made, dividends paid by a PFIC will not be eligible for the preferential rates applicable to dividends received by certain non-corporate U.S. Holders, as discussed above.

U.S. Holders should consult their own tax advisors regarding the potential application of the PFIC rules to their ownership of Telefónica ordinary shares or ADSs.

Information Reporting and Backup Withholding

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and to backup withholding unless the U.S. Holder is a corporation or other exempt recipient or, in the case of backup withholding, the U.S. Holder provides a correct taxpayer identification number and certifies that no loss of exemption from backup withholding has occurred. The amount of any backup withholding from a payment to a U.S. Holder will be allowed as a credit against the U.S. Holder s U.S. federal income tax liability and may entitle such U.S. Holder to a refund, provided that the required information is furnished to the IRS.

Appraisal Rights

The holders of Telefónica and Terra Networks ordinary shares and ADSs do not have any right to an appraisal of the value of their ordinary shares in connection with the merger. However, an independent expert appointed by the Madrid Commercial Registry (*Registro Mercantil*) has prepared a report concerning the merger and whether the share exchange ratio is justified. See Report of the Spanish Independent Expert and Annex C-1 for an English-language translation of the report.

U.S. Federal Securities Laws Consequences

This joint information statement/prospectus does not cover any resales of the ordinary shares of Telefónica or Telefónica ADSs to be received by the shareholders of Terra Networks upon completion of the merger, and no person is authorized to make any use of this joint information statement/prospectus in connection with any such resale.

Relationship between Telefónica and Terra Networks

Telefónica Board of Directors Representation

As of February 23, 2005, Telefónica beneficially owned 436,205,419 Terra Networks ordinary shares, which represented 75.87% of the voting power of Terra Networks voting securities. As a result of our ownership of 75.87% of Terra Networks ordinary shares, we have the power to appoint at least 7 out of 9 members of Terra Networks Board of Directors. In addition, Mr. Isidro Fainé Casas, a member of Telefónica s Board of Directors, beneficially owned 3,546 ordinary shares of Terra Networks as of April 22, 2005.

Terra Networks is part of Telefónica s consolidated group for accounting purposes and, since 2004, has been included in Telefónica s consolidated tax group.

Table of Contents

Part Three The Merger

Strategic Alliance with Terra Networks

On February 12, 2003 Telefónica and Terra Networks entered into a Strategic Alliance Framework Agreement to replace a strategic alliance agreement dated May 16, 2000 to which Bertelsmann AG was also a party.

The Strategic Alliance Framework Agreement s term is for a period of six years ending on December 31, 2008 and will be renewed automatically on an annual basis thereafter, unless expressly terminated by the parties.

The following are the main characteristics of the Strategic Alliance Framework Agreement:

Terra Networks is to be the:

- Exclusive provider of essential portal elements within the Telefónica Group: the use of the brand, the aggregator of broad and narrowband Internet content and services aimed at household, SoHo and, when agreed, SME market segments in connection with Internet access and connectivity services offered by Telefónica Group companies.

- Preferred supplier of audit, consultancy, management and maintenance services for the Telefónica Group s country portals.

- Exclusive provider of online training services for the Telefónica Group s employees.

- Preferred supplier of comprehensive online marketing services for the companies of the Telefónica Group.

- Telefónica Group s exclusive provider of advanced network services and platforms necessary for developing services offered to household, SoHo and, when agreed, SME clients in both broad and narrowband, under most favored customer treatment, as allowed by regulations.

Pursuant to the Strategic Alliance Framework Agreement, Telefónica Group companies are required to acquire a minimum amount of online advertising space from Terra Networks Group companies and Terra Networks Group companies are required to purchase wholesale Internet access and connectivity services exclusively from Telefónica Group companies, provided, however, that such purchases are undertaken under the most favored customer treatment allowed by regulations. In addition, pursuant to the Strategic Alliance Framework Agreement, Terra Networks Group companies are to provide to Telefónica Group companies management of all or part of the service and/or operation of the network access elements for providing Internet access to the Telefónica Group companies household, SoHo and, when agreed, SME clients, under most favored customer treatment, as allowed by regulations.

Throughout its term, the Strategic Alliance Framework Agreement guarantees the Terra Networks Group at least 78.5 million per year in value, which represents the difference between the revenues arising from the services provided under the Strategic Alliance Framework Agreement and the costs and capital expenditures directly associated with those revenues. In compliance with the terms of the Strategic Alliance Framework Agreement, the annual minimum value was generated for the Terra Networks Group in 2003 and 2004.

Comparative per Ordinary Share and per ADS Market Price Information

The ordinary shares of Telefónica are listed on the Spanish stock exchanges in Madrid, Bilbao, Barcelona and Valencia and are traded on the Automated Quotation System of the Spanish stock exchanges. The ordinary shares of Terra Networks are listed on the Spanish stock exchanges in Madrid, Bilbao, Barcelona and Valencia and are traded on the Automated Quotation System of the Spanish stock exchanges.

ADSs representing ordinary shares of Telefónica are listed on the New York Stock Exchange. Each Telefónica ADS represents 3 ordinary shares of Telefónica. ADSs representing ordinary shares of Terra

Table of Contents

Networks are traded on Nasdaq National Market. Each Terra Networks ADS represents 1 ordinary share of Terra Networks. Citibank, N.A. is Telefónica s depositary issuing ADRs evidencing the Telefónica ADSs. Citibank, N.A. is Terra Networks depositary issuing ADRs evidencing the Terra Networks ADSs. Telefónica s ticker symbol on the NYSE is TEF and Terra Networks ticker symbol on the Nasdaq National Market is TRRA .

The following table shows, for the periods indicated, the high and low of the last reported closing prices per Telefónica and Terra Networks ordinary share and ADS, as reported on the Automated Quotation System, the NYSE and the Nasdaq National Market (as reported on the consolidated tape), respectively. All ordinary share and ADS prices are adjusted to reflect stock splits.

	Telefónica Ordinary Shares		**Telefónica ADSs**		**Terra Networks Ordinary shares**		**Terra Networks ADSs**	
	High	**Low**	**High**	**Low**	**High**	**Low**	**High**	**Low**
	(euro)		**(U.S. dollars)**		**(euro)**		**(U.S. dollars)**	
2002								
First Quarter	15.75	12.35	39.43	30.83	10.07	7.95	9.0	6.85
Second Quarter	13.20	8.15	33.63	23.10	8.85	4.17	7.85	4.07
Third Quarter	10.04	7.54	28.75	21.47	7.22	3.95	7.24	3.76
Fourth Quarter	10.31	7.45	29.52	21.97	5.50	3.71	5.32	3.60
2003								
First Quarter	10.18	7.82	31.39	26.08	5.03	3.96	5.66	4.3
Second Quarter	10.40	8.70	36.61	28.54	5.50	4.38	6.95	4.67
Third Quarter	11.11	9.83	37.26	33.32	5.31	4.60	6.20	5.22
Fourth Quarter	11.78	10.23	44.38	35.84	5.09	4.60	6.0	5.35
2004								
First Quarter	13.44	11.98	51.67	43.70	5.34	4.80	6.63	5.85
Second Quarter	13.06	11.33	46.95	40.59	5.21	4.82	6.25	5.70
Third Quarter	12.37	11.11	45.50	40.75	4.96	2.75	6.06	3.25
Fourth Quarter	14.08	12.11	56.94	46.12	3.05	2.77	3.98	3.34
2005								
First Quarter	14.61	13.32	56.89	51.86	3.67	2.85	4.75	3.71
Second Quarter (through April 21)	13.49	13.04	52.32	50.61	3.43	3.32	4.49	4.24

On February 11, 2005, the last full trading day prior to the public announcement of negotiations relating to the proposed merger, the last reported closing price, as reported on the Automated Quotation System was 14.46 for Telefónica ordinary shares and 3.19 for Terra Networks ordinary shares (or 3.21 per Telefónica-equivalent ordinary share, calculated by multiplying the Telefónica ordinary share price by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares). The last reported closing price on such day on the NYSE (as reported on the consolidated tape) was U.S.$55.91 for Telefónica ADSs and on the Nasdaq National Market was U.S.$4.07 for Terra Networks ADSs (or U.S.$4.14 per Telefónica-equivalent ADS, calculated by multiplying the Telefónica ADS price by the exchange ratio of 2 Telefónica ADSs for every 27 Terra Networks ADSs).

On April 21, 2005, the most recent practicable date prior to the date of this joint information statement/prospectus, the last reported closing price, as reported on the Automated Quotation System was 13.12 for Telefónica ordinary shares and 3.32 for Terra Networks ordinary shares (or 2.92 per Telefónica-equivalent ordinary share, calculated by multiplying the Telefónica ordinary share price by the exchange ratio of 2 Telefónica ordinary shares for every 9 Terra Networks ordinary shares). The last closing price on such day on the

III-17

NYSE (as reported on the consolidated tape) was U.S.$51.98 for Telefónica ADSs and on the Nasdaq National Market was U.S.$4.29 for Terra Networks ADSs (or U.S.$3.85 per Telefónica-equivalent ADS, calculated by multiplying the Telefónica ADS price by the exchange ratio of 2 Telefónica ADSs for every 27 Terra Networks ADSs). **We urge you to obtain current market quotations prior to making any decision with respect to the merger.**

The Telefónica ADSs to be issued in the merger, like the currently issued Telefónica ADSs, will be listed on the NYSE, subject to approval by the NYSE of Telefónica s application to list such ADSs.

The merger plan describes that the holders of ordinary shares of Telefónica and Terra Networks will receive separate dividends prior to the merger as follows: (1) holders of Telefónica ordinary shares and ADSs will receive 0.23 per Telefónica ordinary share as interim dividends with respect to the fiscal year ended December 31, 2004; (2) holders of Terra Networks ordinary shares and ADSs will receive 0.60 per Terra Networks ordinary share; and (3) holders of Telefónica ordinary shares and ADSs will receive a dividend of 1 Telefónica ordinary share for every 25 Telefónica ordinary shares already held. The determination of the exchange ratio took into consideration the dividends that both companies are expected to distribute. The dividends described under (2) and (3) above are subject to the final approval of the annual general shareholders meetings of each company.

Telefónica expects to continue to pay dividends on the ordinary shares of Telefónica and the Telefónica ADSs after completion of the merger. The payment of dividends by Telefónica in the future, however, will depend on business conditions, Telefónica s financial condition and earnings and other factors. Other than the dividends described in (1), (2) and (3) above, which will be paid prior to the merger, the holders of Telefónica ordinary shares and ADSs delivered in connection with the merger will be entitled to receive dividends on an equal basis with current holders of Telefónica ordinary shares and ADSs with respect to the year beginning January 1, 2005, including a dividend declared by the Board of Directors of Telefónica on November 24, 2004 in the amount of 0.27 per Telefónica ordinary share payable on November 11, 2005, subject to final approval by the annual general shareholders meeting of Telefónica.

Report of the Spanish Independent Expert Appointed Pursuant to Spanish Law

On March 3, 2005, pursuant to Section 236 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), an independent expert was appointed by the Madrid Commercial Registry to prepare a report (the Spanish Independent Expert s Report) on the merger plan and on the net worth contributed by Terra Networks.

A free English-language translation of the full text of the Spanish Independent Expert s Report to the Boards of Directors of Telefónica and Terra Networks, which sets forth the procedures followed, assumptions made, matters considered and limitations on the review undertaken, is attached to this joint information statement/prospectus as Annex C-1. We encourage you to read this report carefully in its entirety. The Spanish Independent Expert s Report was provided to the Boards of Directors of Telefónica and Terra Networks in connection with its evaluation of the exchange ratio and relates only to the adequacy of the valuation methodologies used to determine the exchange ratio of the ordinary shares and the assessment of the net equity transferred by the company being dissolved. The Spanish Independent Expert s Report does not address any other aspect of the transaction, does not express an opinion regarding the fairness of the transaction or the value of the securities and does not constitute a recommendation to any holder of Telefónica s or Terra Networks ordinary shares as to how such shareholder should vote at its annual general shareholders meeting. The summary of the independent expert s report in this document is qualified in its entirety by reference to the full text of the report. The independent expert has consented to the inclusion of its report in this joint information statement/prospectus. By giving such consent, the independent expert has not admitted it is an expert with respect to any part of this joint information statement/prospectus within the meaning of the term expert as used in, or that the independent

III-18

expert comes within the category of persons whose consent is required under, the Securities Act or the rules and regulations of the Securities and Exchange Commission promulgated thereunder. The independent expert has assumed responsibility for its work as an independent expert and prepared its report in accordance with the applicable provisions of Spanish law.

Subject to the assumptions made and limitations on the review undertaken in the Spanish Independent Expert s Report, and taking into account the matters described in section 4 of the report, the Spanish Independent Expert s Report considered that:

- the valuation methodologies used by the Board of Directors to determine the actual value of Telefónica and Terra Networks are appropriate in the context and the circumstances of the proposed transaction, and justify the share exchange ratio proposed in the merger plan and

- the net equity transferred by Terra Networks is at least equal to the maximum increase in capital of Telefónica as foreseen in the merger plan.

Report of the Board of Directors of Telefónica

Pursuant to Section 237 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), the Board of Directors of Telefónica has prepared and approved a report regarding the merger plan (the Telefónica Report) which, in accordance with the provisions of Section 237, provides a detailed explanation of the legal and financial aspects of the merger.

An English-language translation of the Telefónica Report is attached to this joint information statement/prospectus as Annex C-2. We encourage you to read this report carefully in its entirety. The Telefónica Report is divided into three parts. The first part contains the strategic rationale for the merger, which includes a discussion of recent changes in the telephony and Internet businesses and the Telefónica Board of Directors reasons for, and objectives of, the merger. The second part of the Telefónica Report contains a review of the legal aspects of the merger, including the legal structure of the merger, an analysis of legal aspects of the merger plan, the procedure for the exchange of shares, implementation of the legal process of a merger by absorption and a description of the information that will be made available to Telefónica shareholders prior to the annual general shareholders meeting. The third part of the Telefónica Report contains a discussion of the financial aspects of the merger, including the determination of the exchange ratio and the actual values of Telefónica and Terra Networks and valuation methodologies and procedures (which includes a discussion of the procedures employed by Morgan Stanley & Co. Limited in rendering its fairness opinion to the Board of Directors of Telefónica).

For the reasons stated therein, the Telefónica Report states that the Directors of Telefónica conclude that:

- the merger plan which is the subject of this Report is highly appropriate for both entities and the shareholders thereof, given that the merger will allow for the integration of the telephony and Internet businesses and thereby ensure success in facing the challenges raised by the development of the industry, technological change and new customer needs and the exchange ratio proposed in the merger plan is justified, and is fair for the shareholders of both entities, as confirmed by the reports of the financial advisors and the independent expert appointed by the Commercial Registry.

Report of the Board of Directors of Terra Networks

Also pursuant to Section 237 of the Spanish Corporations Law (*Ley de Sociedades Anonimas*), the Board of Directors of Terra Networks has prepared and approved a report regarding the merger plan (the Terra Networks Report) which, in accordance with the provisions of Section 237, provides a detailed explanation of the legal and financial aspects of the merger.

Table of Contents

Part Three The Merger

An English-language translation of the Terra Networks Report is attached to this joint information statement/prospectus as Annex C-3. We encourage you to read this report carefully in its entirety. The Terra Networks Report is divided into two parts. The first part discusses the legal aspects of the merger, including the legal procedures for effecting the merger, the information that will be made available to Terra Networks shareholders prior to the annual general shareholders meeting, the procedure for the exchange of shares, treatment of the Terra Networks stock option plans and the tax treatment applicable to the merger. The second part of the Terra Networks Report contains a discussion of the financial aspects of the merger, including the strategic rationale for the merger and the Terra Networks Board of Director s reasons for, and objectives of, the merger, the determination of the exchange ratio and the actual values of Telefónica and Terra Networks and valuation methodologies and procedures (which includes a discussion of the procedures employed by Lehman Brothers Europe Limited and Citigroup Global Markets Limited in rendering the