First Trust Intermediate Duration Preferred & Income Fund
Form N-CSR
January 04, 2019
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number 811-22795

First Trust Intermediate Duration Preferred & Income Fund
(Exact name of registrant as specified in charter)

120 East Liberty Drive, Suite 400
Wheaton, IL 60187
(Address of principal executive offices) (Zip code)

W. Scott Jardine, Esq.
First Trust Portfolios L.P.
120 East Liberty Drive, Suite 400
Wheaton, IL 60187
(Name and address of agent for service)

registrant's telephone number, including area code:N30-765-8000

Date of fiscal year end: October 31

Date of reporting period: October 31, 2018

Form N-CSR is to be used by management investment companies to file reports with the Commission not later than 10 days after the transmission to stockholders of any report that is required to be transmitted to stockholders under Rule 30e-1 under the Investment Company Act of 1940 (17 CFR 270.30e-1). The Commission may use the information provided on Form N-CSR in its regulatory, disclosure review, inspection, and policymaking roles.

A registrant is required to disclose the information specified by Form N-CSR, and the Commission will make this information public. A registrant is not required to respond to the collection of information contained in Form N-CSR unless the Form displays a currently valid Office of Management and Budget ("OMB") control number. Please direct comments concerning the accuracy of the information collection burden estimate and any suggestions for reducing the burden to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549. The OMB has reviewed this collection of information under the clearance requirements of 44 U.S.C. § 3507.

Item 1. Reports to Stockholders.

The Report to Shareholders is attached herewith.

First Trust
Intermediate Duration Preferred & Income Fund (FPF)
Annual Report
For the Year Ended
October 31, 2018

Table of Contents
First Trust Intermediate Duration Preferred & Income Fund (FPF)
Annual Report
October 31, 2018

Caution Regarding Forward-Looking Statements

This report contains certain forward-looking statements within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. Forward-looking statements include statements regarding the goals, beliefs, plans or current expectations of First Trust Advisors L.P. (“First Trust” or the “Advisor”) and/or Stonebridge Advisors LLC (“Stonebridge” or the “Sub-Advisor”) and their respective representatives, taking into account the information currently available to them. Forward-looking statements include all statements that do not relate solely to current or historical fact. For example, forward-looking statements include the use of words such as “anticipate,” “estimate,” “intend,” “expect,” “believe,” “plan,” “may,” “should,” “would” or other words that convey uncertainty of future e outcomes.

Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause the actual results, performance or achievements of First Trust Intermediate Duration Preferred & Income Fund (the “Fund”) to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. When evaluating the information included in this report, you are cautioned not to place undue reliance on these forward-looking statements, which reflect the judgment of the Advisor and/or Sub-Advisor and their respective representatives only as of the date hereof. We undertake no obligation to publicly revise or update these forward-looking statements to reflect events and circumstances that arise after the date hereof.

Performance and Risk Disclosure

There is no assurance that the Fund will achieve its investment objectives. The Fund is subject to market risk, which is the possibility that the market values of securities owned by the Fund will decline and that the value of the Fund shares may therefore be less than what you paid for them. Accordingly, you can lose money by investing in the Fund. See "Risk Considerations" in the Additional Information section of this report for a discussion of certain other risks of investing in the Fund.

Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit www.ftportfolios.com or speak with your financial advisor. Investment returns, net asset value and common share price will fluctuate and Fund shares, when sold, may be worth more or less than their original cost.

The Advisor may also periodically provide additional information on Fund performance on the Fund's web page at www.ftportfolios.com.

How to Read This Report

This report contains information that may help you evaluate your investment in the Fund. It includes details about the Fund and presents data and analysis that provide insight into the Fund's performance and investment approach.

By reading the portfolio commentary by the portfolio management team of the Fund, you may obtain an understanding of how the market environment affected the Fund's performance. The statistical information that follows may help you understand the Fund's performance compared to that of relevant market benchmarks.

It is important to keep in mind that the opinions expressed by personnel of First Trust and Stonebridge are just that: informed opinions. They should not be considered to be promises or advice. The opinions, like the statistics, cover the period through the date on the cover of this report. The material risks of investing in the Fund are spelled out in the prospectus, the statement of additional information, this report and other Fund regulatory filings.

Table of Contents

Shareholder Letter

First Trust Intermediate Duration Preferred & Income Fund (FPF)

Annual Letter from the Chairman and CEO

October 31, 2018

Dear Shareholders,

First Trust is pleased to provide you with the annual report for the First Trust Intermediate Duration Preferred & Income Fund (the “Fund”), which contains detailed information about the Fund for the twelve months ended October 31, 2018, including a market overview and a performance analysis. We encourage you to read this report carefully and discuss it with your financial advisor.

As I mentioned in my April 2018 letter, 2017 was a very strong year for U.S. and global markets. Investors were rewarded with rising markets and very little volatility. As 2018 began, investors were hoping for another strong year in the markets. For the entire first quarter, however, increased market volatility was the norm for U.S. and global markets. The markets continued their volatility throughout the second quarter. During April and May, the Dow Jones Industrial Average (“DJIA”) closed out each month slightly down, but ended both June and July slightly up. August was a strong month for stocks, and the DJIA finished August just under its previous high in January of 2018. At the close of the third quarter in September, the markets had moved higher into positive territory. In fact, all three major U.S. indices (the Nasdaq Composite Index, the DJIA and the S& P 500® Index) hit record levels during the third quarter. In October, markets were again very volatile, surprising analysts and investors alike. Both global and U.S. markets fell on fears of slowing growth, trade wars and higher interest rates. The DJIA was down 5% for October and the MSCI EAFE Index, an index of stocks in 21 developed markets (excluding the U.S. and Canada), was down 9% for the same period.

Based on continued strong job growth and the economic outlook in the U.S., the Federal Reserve (the “Fed”) raised interest rates in March, June and September. At their September meeting, the Fed also indicated the possibility of one more rate hike in 2018 as well as three more rate hikes in 2019.

Trade tensions have had an impact on markets around the world and could continue to do so in the future. However, our economists believe that the long-term impact of U.S. tariffs will be to encourage countries to come back to the table and talk about more equal trade. Despite market volatility, we continue to believe that the combination of low interest rates, low inflation and strong corporate earnings still point to a positive economic environment and further growth, though we understand that past performance can never guarantee future performance.

We continue to believe that you should invest for the long term and be prepared for market movements, which can happen at any time. You can do this by keeping current on your portfolio and by speaking regularly with your investment professional. Markets go up and they also go down, but savvy investors are prepared for either through careful attention to investment goals.

Thank you for giving First Trust the opportunity to be a part of your financial plan. We value our relationship with you and will report on the Fund again in six months.

Sincerely,

James A. Bowen

Chairman of the Board of Trustees

Chief Executive Officer of First Trust Advisors L.P.

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
"AT A GLANCE"
As of October 31, 2018 (Unaudited)

Fund Statistics	
Symbol on New York Stock Exchange	FPF
Common Share Price	$20.47
Common Share Net Asset Value ("NAV")	$22.84
Premium (Discount) to NAV	(10.38)%
Net Assets Applicable to Common Shares	$1,387,960,520
Current Distribution per Common Share[(1)]	$0.1425
Current Annualized Distribution per Common Share	$1.7100
Current Distribution Rate on Common Share Price[(2)]	8.35%
Current Distribution Rate on NAV[(2)]	7.49%

Common Share Price & NAV (weekly closing price)

Performance			
		Average Annual Total Return	
	1 Year Ended 10/31/18	5 Years Ended 10/31/18	Inception (5/23/13) to 10/31/18
Fund Performance[(3)]			
NAV	-2.23%	8.30%	7.72%
Market Value	-10.78%	8.36%	4.68%
Index Performance			
ICE BofAML Fixed Rate Preferred Securities Index	-1.23%	6.41%	4.63%
ICE BofAML U.S. Capital Securities Index	-2.14%	4.45%	4.07%
Blended Index[(4)]	-1.67%	5.44%	4.37%

(1) Most recent distribution paid or declared through 10/31/2018. Subject to change in the future.

(2) Distribution rates are calculated by annualizing the most recent distribution paid or declared through the report date and then dividing by Common Share Price or NAV, as applicable, as of 10/31/2018. Subject to change in the future.

(3) Total return is based on the combination of reinvested dividend, capital gain, and return of capital distributions, if any, at prices obtained by the Dividend Reinvestment Plan and changes in NAV per share for NAV returns and changes in Common Share Price for market value returns. Total returns do not reflect sales load and are not annualized for periods of less than one year. Past performance is not indicative of future results.

(4) The Blended Index consists of the following: ICE BofAML Fixed Rate Preferred Securities Index (50%) and ICE BofAML U.S. Capital Securities Index (50%). The Blended Index was added to reflect the diverse allocation of institutional preferred and hybrid securities in the Fund's Portfolio. The indexes do not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Indexes are unmanaged and an investor cannot invest directly in an index.

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
“AT A GLANCE” (Continued)
As of October 31, 2018 (Unaudited)

Industry Classification	% of Total Investments
Banks	47.2%
Insurance	19.7
Food Products	5.4
Oil, Gas & Consumable Fuels	4.8
Electric Utilities	4.7
Capital Markets	4.1
Multi-Utilities	2.3
Diversified Telecommunication Services	2.0
Metals & Mining	1.3
Energy Equipment & Services	1.3
Independent Power and Renewable Electricity Producers	1.1
Mortgage Real Estate Investment Trusts	1.1
Transportation Infrastructure	1.0
Automobiles	1.0
Equity Real Estate Investment Trusts	1.0
Diversified Financial Services	0.9
Thrifts & Mortgage Finance	0.5
Wireless Telecommunication Services	0.3
Consumer Finance	0.3
Total	100.0%

Top Ten Holdings	% of Total Investments
Enel S.p.A.	2.3%
Catlin Insurance Co., Ltd.	2.0
Emera, Inc., Series 16-A	1.9
Barclays PLC	1.8
Land O’Lakes, Inc.	1.8
Farm Credit Bank of Texas, Series 1	1.8
Credit Agricole S.A.	1.8
Cooperatieve Rabobank UA	1.7
Royal Bank of Scotland Group PLC	1.7
BNP Paribas S.A.	1.6
Total	18.4%

Credit Quality(5)	% of Total Fixed-Income Investments
A-	3.8%
BBB+	11.3
BBB	17.2
BBB-	25.1
BB+	21.3
BB	11.8
BB-	2.0

B+	2.5
B	0.2
Not Rated	4.8
Total	100.0%

(5) The credit quality and ratings information presented above reflect the ratings assigned by one or more nationally recognized statistical rating organizations (NRSROs), including Standard & Poor's Ratings Group, a division of the McGraw Hill Companies, Inc., Moody's Investors Service, Inc., Fitch Ratings or a comparably rated NRSRO. For situations in which a security is rated by more than one NRSRO and the ratings are not equivalent, the highest rating is used. Sub-investment grade ratings are those rated BB+/Ba1 or lower. Investment grade ratings are those rated BBB-/Baa3 or higher. The credit ratings shown relate to the creditworthiness of the issuers of the underlying securities in the Fund, and not to the Fund or its shares. Credit ratings are subject to change.

Table of Contents

Portfolio Commentary

First Trust Intermediate Duration Preferred & Income Fund (FPF)

Annual Report

October 31, 2018 (Unaudited)

Advisor

First Trust Advisors L.P. ("First Trust" or the "Advisor") serves as the investment advisor to the First Trust Intermediate Duration Preferred & Income Fund (the "Fund"). First Trust is responsible for the ongoing monitoring of the Fund's investment portfolio, managing the Fund's business affairs and providing certain administrative services necessary for the management of the Fund.

Sub-Advisor

Stonebridge Advisors LLC ("Stonebridge" or the "Sub-Advisor") is the sub-advisor to the Fund and is a registered investment advisor based in Wilton, Connecticut. Stonebridge specializes in the management of preferred and hybrid securities.

Stonebridge Advisors LLC Portfolio Management Team

Scott T. Fleming – Chief Executive Officer and President

Robert Wolf – Chief Investment Officer, Senior Vice President and Senior Portfolio Manager

Commentary

Market Recap

The fiscal year ended October 31, 2018 was a volatile period for the preferred and hybrid securities market with all parts of the market experiencing negative performance. This was largely driven by rising interest rates as well as economic and political headlines across the globe. The Federal Reserve (the "Fed") guided short-term interest rates higher by 0.25% four times during the period as improving economic and employment data in the United States supported further rate hikes. Longer term interest rates also moved higher, but the curve flattened substantially as short-term rates increased at a faster pace. Credit spreads also managed to tighten within the preferred and hybrid securities market amid continued improvement in credit fundamentals, despite political uncertainty in Turkey, BREXIT negotiations, and trade tensions between China and the United States weighing on fixed income markets overall. These headlines pressured contingent capital securities ("CoCos") in particular, which are largely issued by European banks. As a result, CoCos, as measured by the ICE BofAML USD Investment Grade Contingent Capital Index ("COCU"), were the worst performing part of the preferred and hybrid market during the period, as COCU was down -2.52%. Finally, the retail $25 par market outperformed the institutional $1000 par market during the period, as limited new issuance and net negative supply supported that part of the market. For the fiscal year, the retail market fell 1.23% while the institutional market lost 2.14% according to The ICE BofAML Fixed Rate Preferred Securities Index ("P0P1") and the ICE BofAML U.S. Capital Securities Index ("C0CS"), respectively.

Performance Analysis

For the fiscal year ended October 31, 2018, the net asset value ("NAV") and market price total returns for the Fund were -2.23% and -10.78%, respectively. This compares to a total return of -1.67% for the Fund's benchmark, which is a 50/50 blend of P0P1 and C0CS. The Fund's underperformance was primarily due to leverage and an overweight to CoCos. However, the Fund was able to partially offset the underperformance through security selection within $25 par securities and non-CoCo institutional securities and an overweight to floating rate securities.

While the Fund's leverage weighed on performance in a negative market, CoCos issued by European banks, which are not held in the benchmark, were the primary reason for underperformance during the period. Political volatility in Italy, BREXIT negotiations, and tariffs from the United States all weighed on CoCos throughout the period, despite improvements in European bank capitalization. CoCos continue to offer some of the most attractive yields and structures in the preferred and hybrid securities market and the Fund's CoCo holdings are issued by well-capitalized multinational banks with stable credit fundamentals that we believe will outperform longer term.

Positive contributors to the Fund's performance relative to the benchmark included superior security selection within $25 par securities and non-CoCo institutional securities. The Fund's focus on variable rate securities with wide back-end reset spreads and shorter durations both contributed positively to relative performance.

The Fund also benefited from overweighting floating rate securities, which appreciated with rising short-term interest rates, spread tightening and a flattening yield curve. In the current rising interest rate environment, we believe it is

prudent to maintain a conservative stance in regard to interest rates relative to the benchmark and peers.
The Fund also employed a hedging strategy throughout the year in order to further manage its interest rate risk. This strategy consisted of an interest rate swap, which benefited from the rising rate environment. Going forward, we continue to believe it is prudent to

Table of Contents

Portfolio Commentary (Continued)
First Trust Intermediate Duration Preferred & Income Fund (FPF)
Annual Report
October 31, 2018 (Unaudited)

maintain a conservative interest rate stance relative to the benchmark, particularly if we are able to do so while the Fund continues to pay the highest distribution rate of peer closed-end funds.

Market and Fund Outlook

As we approach 2019, we believe the preferred and hybrid securities market will be positively supported by strong issuer credit fundamentals, attractive yields compared to other fixed income asset classes and a positive market technical from limited net new issue supply into 2019. Although headline risks of global trade wars and other geopolitical events will likely persist for the next 6 to 12 months, in our opinion, preferred and hybrid securities valuations already reflect these risks, in our opinion, and we believe credit fundamentals of issuers in this asset class are generally strong enough to withstand the possibility of slowing economic growth.

We continue to believe that U.S. interest rates should broadly continue to shift higher and the Treasury yield curve is likely to remain relatively flat into 2019. We believe short-term rates are likely to increase due to Fed normalization, while inflation pressures are likely to slowly push longer term rates higher overall. In the current environment, we believe the best total return and risk profile will likely be achieved by overweighting short to intermediate term securities. Additionally, absolute yields and yield spreads of preferreds and hybrids relative to U.S. Treasuries and other credit spread products remain at attractive levels and may continue to provide a cushion against rising interest rates, in our opinion.

The Fund will attempt to position the portfolio to protect against the largest risks in the market and continue to identify the best securities in all parts of the preferred and hybrid securities market to construct balanced portfolios that we believe will lead to long term outperformance.

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments
October 31, 2018

Shares	Description	Stated Rate	Stated Maturity	Value
	$25 PAR PREFERRED SECURITIES – 19.6%			
	Banks – 3.4%			
85,593	Banc of California, Inc., Series E	7.00%	(a)	$2,191,181
197,943	Bank of America Corp., Series HH (b)	5.88%	(a)	4,932,740
149,642	FNB Corp. (b) (c)	7.25%	(a)	4,097,198
864,211	GMAC Capital Trust I, Series 2, 3 Mo. LIBOR + 5.79% (b) (d)	8.10%	02/15/40	22,694,181
206,326	JPMorgan Chase & Co., Series DD	5.75%	(a)	5,133,391
166,268	Synovus Financial Corp., Series D (b) (c)	6.30%	(a)	4,248,147
44,878	Valley National Bancorp, Series A (c)	6.25%	(a)	1,145,735
98,964	Wintrust Financial Corp., Series D (b) (c)	6.50%	(a)	2,557,230
				46,999,803
	Capital Markets – 1.4%			
211,494	Apollo Global Management, LLC, Series B (b)	6.38%	(a)	5,221,787
145,201	Apollo Investment Corp. (b)	6.88%	07/15/43	3,651,805
3,067	Ares Management L.P., Series A	7.00%	(a)	79,712
388,704	Morgan Stanley, Series F (b) (c)	6.88%	(a)	10,421,154
				19,374,458
	Diversified Telecommunication Services – 1.3%			
302,222	Qwest Corp. (b)	6.88%	10/01/54	7,313,772
141,191	Qwest Corp. (b)	7.00%	02/01/56	3,525,539
128,413	Qwest Corp.	6.50%	09/01/56	2,832,791
200,000	Qwest Corp. (b)	6.75%	06/15/57	4,626,000
				18,298,102
	Electric Utilities – 0.3%			
73,257	PPL Capital Funding, Inc., Series B	5.90%	04/30/73	1,827,030

59,233	Southern (The) Co.	6.25%	10/15/75	1,515,772
				3,342,802
	Equity Real Estate Investment Trusts – 1.4%			
150,000	Colony Capital, Inc., Series E (b)	8.75%	(a)	3,873,000
193,100	Farmland Partners, Inc., Series B, steps up 10/01/24 to 10.00% (b) (e)	6.00%	(a)	4,228,890
91,002	Global Net Lease, Inc., Series A	7.25%	(a)	2,265,040
114,430	Urstadt Biddle Properties, Inc., Series H	6.25%	(a)	2,649,054
250,000	VEREIT, Inc., Series F (b)	6.70%	(a)	6,220,000
				19,235,984
	Food Products – 2.5%			
824,835	CHS, Inc., Series 2 (b) (c)	7.10%	(a)	21,231,253
546,059	CHS, Inc., Series 3 (b) (c)	6.75%	(a)	13,760,687
				34,991,940
	Insurance – 3.8%			
54,323	Allstate Corp., Series E	6.63%	(a)	1,376,545
193,648	AmTrust Financial Services, Inc. (b)	7.25%	06/15/55	4,473,269
210,480	AmTrust Financial Services, Inc. (b)	7.50%	09/15/55	5,001,005
100,000	AmTrust Financial Services, Inc., Series F	6.95%	(a)	1,600,000
59,196	Aspen Insurance Holdings Ltd.	5.63%	(a)	1,352,037
379,385	Delphi Financial Group, Inc., 3 Mo. LIBOR + 3.19% (b) (d)	5.50%	05/15/37	8,631,009
428,412	Enstar Group Ltd., Series D (b) (c)	7.00%	(a)	11,005,904
158,193	Global Indemnity Ltd. (b)	7.75%	08/15/45	3,957,989
190,380	Global Indemnity Ltd. (b)	7.88%	04/15/47	4,812,806
19,685	National General Holdings Corp.	7.63%	09/15/55	491,338
133,133	National General Holdings Corp., Series C (b)	7.50%	(a)	3,187,204
107,835	PartnerRe Ltd., Series G (b)	6.50%	(a)	2,774,594

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Shares	Description	Stated Rate	Stated Maturity	Value
	$25 PAR PREFERRED SECURITIES (Continued)			
	Insurance (Continued)			
225,000	Phoenix Cos., Inc.	7.45%	01/15/32	$3,853,125
				52,516,825
	Mortgage Real Estate Investment Trusts – 1.6%			
346,092	Annaly Capital Management, Inc., Series F (b) (c)	6.95%	(a)	8,697,292
121,000	Invesco Mortgage Capital, Inc., Series B (b) (c)	7.75%	(a)	3,115,750
207,000	Two Harbors Investment Corp., Series B (b) (c)	7.63%	(a)	5,108,760
220,000	Two Harbors Investment Corp., Series C (b) (c)	7.25%	(a)	5,337,200
				22,259,002
	Multi-Utilities – 2.4%			
221,976	Algonquin Power & Utilities Corp. (c)	6.88%	10/17/78	5,663,163
133,279	CMS Energy Corp.	5.88%	10/15/78	3,345,303
732,571	Integrys Holding, Inc. (b) (c)	6.00%	08/01/73	18,559,686
350,000	Just Energy Group, Inc., Series A (b) (c)	8.50%	(a)	6,268,500
				33,836,652
	Oil, Gas & Consumable Fuels – 0.3%			
148,780	Enbridge, Inc., Series B (c)	6.38%	04/15/78	3,671,890
24,279	Energy Transfer Operating L.P., Series D (c)	7.63%	(a)	608,189
				4,280,079
	Thrifts & Mortgage Finance – 0.7%			
379,159	New York Community Bancorp, Inc., Series A (b) (c)	6.38%	(a)	9,615,472
	Wireless Telecommunication Services – 0.5%			
262,545	United States Cellular Corp. (b)	7.25%	12/01/64	6,634,512
	Total $25 Par Preferred Securities			271,385,631
	(Cost $275,892,843)			
	$100 PAR PREFERRED SECURITIES – 3.7%			
	Banks – 3.7%			
80,000	Agribank FCB (c) (f)	6.88%	(a)	8,580,000

179,000	CoBank ACB, Series F (b) (c) (f)	6.25%	(a)	18,526,500
82,220	CoBank ACB, Series G (b) (f)	6.13%	(a)	8,250,777
54,250	CoBank ACB, Series H (b) (c) (f)	6.20%	(a)	5,663,700
100,000	Farm Credit Bank of Texas (b) (c) (g)	6.75%	(a)	10,650,000
	Total $100 Par Preferred Securities			51,670,977
	(Cost $50,687,346)			
$1,000 PAR PREFERRED SECURITIES – 7.4%				
	Banks – 3.9%			
3,557	CoBank ACB, 3 Mo. LIBOR + 1.18% (d) (g)	3.59%	(a)	2,329,835
30,859	Farm Credit Bank of Texas, Series 1 (b) (f)	10.00%	(a)	35,333,555
15,364	Sovereign Real Estate Investment Trust (g)	12.00%	(a)	17,169,270
				54,832,660
	Diversified Financial Services – 0.9%			
12,000	Compeer Financial ACA (b) (c) (g)	6.75%	(a)	12,840,000
	Insurance – 2.0%			
27,596	XLIT Ltd., Series D, 3 Mo. LIBOR + 3.12% (d)	5.56%	(a)	27,733,980

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Shares	Description	Stated Rate	Stated Maturity	Value
$1,000 PAR PREFERRED SECURITIES (Continued)				
	Oil, Gas & Consumable Fuels – 0.6%			
8,500	Kinder Morgan GP, Inc., 3 Mo. LIBOR + 3.90% (d) (g)	6.22%	08/18/57	$7,794,249
	Total $1,000 Par Preferred Securities			103,200,889
	(Cost $104,731,795)			
$1,000,000 PAR PREFERRED SECURITIES – 1.0%				
	Banks – 1.0%			
12	FT Real Estate Securities Co., Inc. (g) (h) (i)	9.50%	(a)	14,552,328
	(Cost $15,990,000)			

Par Amount	Description	Stated Rate	Stated Maturity	Value
CAPITAL PREFERRED SECURITIES – 110.0%				
	Automobiles – 1.4%			
$4,700,000	General Motors Financial Co., Inc., Series A (c)	5.75%	(a)	4,244,006
16,400,000	General Motors Financial Co., Inc., Series B (b) (c)	6.50%	(a)	15,457,000
				19,701,006
	Banks – 55.2%			
16,000,000	Australia & New Zealand Banking Group Ltd. (b) (c) (j) (k)	6.75%	(a)	16,460,000
6,800,000	Banco Bilbao Vizcaya Argentaria S.A. (c) (k)	6.13%	(a)	5,873,500
8,000,000	Banco Mercantil del Norte S.A. (c) (j) (k)	7.63%	(a)	7,860,080
12,200,000	Banco Santander S.A. (b) (c) (k)	6.38%	(a)	12,061,079
18,000,000	Bank of America Corp., Series DD (b) (c)	6.30%	(a)	19,012,500
5,000,000	Bank of America Corp., Series X (c)	6.25%	(a)	5,156,250
23,867,000	Bank of America Corp., Series Z (b) (c)	6.50%	(a)	25,339,594
40,000	Barclays Bank PLC (j)	10.18%	06/12/21	45,472
5,200,000	Barclays PLC (c) (k)	7.75%	(a)	5,201,040
35,136,000	Barclays PLC (b) (c) (k)	7.88%	(a)	36,277,920

2,000,000	BNP Paribas S.A. (c) (j) (k)	7.38%	(a)	2,057,500
29,774,000	BNP Paribas S.A. (b) (c) (j) (k)	7.63%	(a)	31,002,178
9,500,000	BPCE S.A. (b) (c) (j)	12.50%	(a)	10,213,260
5,000,000	Citigroup, Inc., Series O (b) (c)	5.88%	(a)	5,075,000
25,000,000	Citigroup, Inc., Series R (b) (c)	6.13%	(a)	25,593,750
5,250,000	Citizens Financial Group, Inc., Series C (c)	6.38%	(a)	5,262,521
25,000,000	CoBank ACB, Series I (b) (c) (f)	6.25%	(a)	26,250,000
32,104,000	Cooperatieve Rabobank UA (b) (c) (j)	11.00%	(a)	33,701,174
24,100,000	Credit Agricole S.A. (b) (c) (j) (k)	7.88%	(a)	24,976,131
32,500,000	Credit Agricole S.A. (b) (c) (j) (k)	8.13%	(a)	34,940,490
10,000,000	Credit Agricole S.A. (b) (c) (j)	8.38%	(a)	10,400,000
14,180,000	Danske Bank A.S. (b) (c) (k)	6.13%	(a)	12,712,966
3,450,000	Farm Credit Bank of Texas, Series 3 (b) (c) (j)	6.20%	(a)	3,458,625
16,500,000	HSBC Holdings PLC (b) (c) (k)	6.38%	(a)	16,066,875
3,000,000	HSBC Holdings PLC (c) (k)	6.38%	(a)	2,914,500
9,400,000	HSBC Holdings PLC (b) (c) (k)	6.88%	(a)	9,764,250
13,920,000	ING Groep N.V. (b) (c) (k)	6.50%	(a)	13,230,960
10,000,000	ING Groep N.V. (b) (c) (k)	6.88%	(a)	10,118,750
27,300,000	Intesa Sanpaolo S.p.A. (b) (c) (j) (k)	7.70%	(a)	24,808,875
7,884,000	JPMorgan Chase & Co., Series I, 3 Mo. LIBOR + 3.47% (b) (d)	5.99%	(a)	7,936,113
20,000,000	JPMorgan Chase & Co., Series S (b) (c)	6.75%	(a)	21,355,000
5,580,000	JPMorgan Chase & Co., Series V (b) (c)	5.00%	(a)	5,586,975
18,000,000	Lloyds Bank PLC (b) (c) (j)	12.00%	(a)	21,678,498
14,150,000	Lloyds Bank PLC (b) (c)	12.00%	(a)	17,041,708

27,313,000	Lloyds Banking Group PLC (b) (c) (k)	7.50%	(a)	27,620,271
12,000,000	Lloyds Banking Group PLC (c) (k)	7.50%	(a)	12,090,000
5,363,000	Nordea Bank Abp (c) (k)	6.13%	(a)	5,168,591

See Notes to Financial Statements

Table of Contents
First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Par Amount	Description	Stated Rate	Stated Maturity	Value
CAPITAL PREFERRED SECURITIES (Continued)				
	Banks (Continued)			
$1,600,000	Nordea Bank Abp (c) (j) (k)	6.13%	(a)	$1,542,000
23,400,000	Royal Bank of Scotland Group PLC (b) (c) (k)	8.00%	(a)	24,204,375
31,050,000	Royal Bank of Scotland Group PLC (b) (c) (k)	8.63%	(a)	32,718,937
10,200,000	Societe Generale S.A. (b) (c) (j) (k)	6.00%	(a)	10,059,852
24,600,000	Societe Generale S.A. (b) (c) (j) (k)	7.38%	(a)	24,999,750
15,250,000	Societe Generale S.A. (b) (c) (j) (k)	7.88%	(a)	15,383,438
2,000,000	Societe Generale S.A. (c) (k)	7.38%	03/13/67	2,032,500
65,000	Standard Chartered PLC (c)	7.01%	(a)	67,540
12,400,000	Standard Chartered PLC (b) (c) (j) (k)	7.50%	(a)	12,570,500
7,500,000	Standard Chartered PLC (c) (j) (k)	7.75%	(a)	7,593,750
825,000	Standard Chartered PLC (c) (k)	7.75%	(a)	835,313
3,400,000	Swedbank AB (c) (k)	6.00%	(a)	3,336,250
29,746,000	UniCredit S.p.A. (b) (c) (k)	8.00%	(a)	26,813,342
16,000,000	UniCredit S.p.A. (b) (c) (j)	5.86%	06/19/32	13,735,392
21,500,000	Wells Fargo & Co., Series K, 3 Mo. LIBOR + 3.77% (b) (d)	6.10%	(a)	21,688,125
12,670,000	Zions Bancorporation, Series J (b) (c)	7.20%	(a)	13,588,575
				765,482,035
	Capital Markets – 4.5%			
5,100,000	Credit Suisse Group AG (c) (j) (k)	7.25%	(a)	5,055,375
17,079,000	Credit Suisse Group AG (b) (c) (j) (k)	7.50%	(a)	17,829,161
7,875,000	Credit Suisse Group AG (c) (k)	7.50%	(a)	8,220,894

12,000,000	Credit Suisse Group AG (c) (j) (k)	7.50%	(a)	12,240,000
3,350,000	UBS Group Funding Switzerland AG (c) (k)	7.00%	(a)	3,496,562
15,000,000	UBS Group Funding Switzerland AG (b) (c) (k)	7.13%	(a)	15,289,305
				62,131,297
	Consumer Finance – 0.4%			
6,200,000	American Express Co., Series C (b) (c)	4.90%	(a)	6,184,500
	Diversified Financial Services – 0.3%			
3,904,000	Voya Financial, Inc. (b) (c)	5.65%	05/15/53	3,855,200
	Diversified Telecommunication Services – 1.6%			
20,000,000	Koninklijke KPN N.V. (b) (c) (j)	7.00%	03/28/73	20,830,000
1,000,000	Koninklijke KPN N.V. (b) (c)	7.00%	03/28/73	1,041,500
				21,871,500
	Electric Utilities – 6.5%			
36,500,000	Emera, Inc., Series 16-A (b) (c)	6.75%	06/15/76	38,142,500
42,128,000	Enel S.p.A. (b) (c) (j)	8.75%	09/24/73	45,603,560
6,500,000	Southern (The) Co., Series B (b) (c)	5.50%	03/15/57	6,499,814
				90,245,874
	Energy Equipment & Services – 1.8%			
24,800,000	Transcanada Trust, Series 16-A (b) (c)	5.88%	08/15/76	24,475,120
	Food Products – 5.1%			
9,000,000	Dairy Farmers of America, Inc. (b) (g)	7.13%	(a)	9,427,500
14,488,000	Land O’Lakes Capital Trust I (b) (g)	7.45%	03/15/28	15,701,370
10,000,000	Land O’Lakes, Inc. (b) (j)	7.25%	(a)	10,400,000
33,000,000	Land O’Lakes, Inc. (b) (j)	8.00%	(a)	35,970,000
				71,498,870
	Independent Power and Renewable Electricity Producers – 1.6%			
9,850,000	AES Gener S.A. (c) (j)	8.38%	12/18/73	10,006,123

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Par Amount	Description	Stated Rate	Stated Maturity	Value
CAPITAL PREFERRED SECURITIES (Continued)				
	Independent Power and Renewable Electricity Producers (Continued)			
$12,150,000	AES Gener S.A. (c)	8.38%	12/18/73	$12,342,577
				22,348,700
	Insurance – 21.6%			
9,600,000	AG Insurance S.A. (b) (c)	6.75%	(a)	9,708,883
5,350,000	American International Group, Inc., Series A-9 (b) (c)	5.75%	04/01/48	5,065,808
3,839,000	Asahi Mutual Life Insurance Co. (b) (c)	7.25%	(a)	3,932,672
16,975,000	Assurant, Inc. (b) (c)	7.00%	03/27/48	17,059,875
39,700,000	Catlin Insurance Co., Ltd., 3 Mo. LIBOR + 2.98% (b) (d) (j)	5.42%	(a)	39,104,500
10,600,000	CNP Assurances (b) (c)	6.88%	(a)	10,832,288
12,500,000	Dai-Ichi Life Insurance (The) Co., Ltd. (b) (c) (j)	7.25%	(a)	13,518,750
8,134,000	Everest Reinsurance Holdings, Inc., 3 Mo. LIBOR + 2.39% (b) (d)	4.70%	05/15/37	7,930,650
15,300,000	Fortegra Financial Corp. (b) (c) (g)	8.50%	10/15/57	15,567,750
14,876,000	Friends Life Holdings PLC (c)	7.88%	(a)	14,897,273
1,000,000	Fukoku Mutual Life Insurance Co. (c)	6.50%	(a)	1,068,125
9,200,000	Hartford Financial Services Group (The), Inc., 3 Mo. LIBOR + 2.13% (b) (d) (j)	4.44%	02/12/47	8,487,000
25,616,000	La Mondiale SAM (b) (c)	7.63%	(a)	26,108,980
14,115,000	Liberty Mutual Group, Inc. (b) (j)	7.80%	03/15/37	16,196,963
2,000,000	Liberty Mutual Group, Inc. (b) (c)	10.75%	06/15/58	2,945,000
5,000,000	Liberty Mutual Group, Inc., 3 Mo. LIBOR + 2.91% (b) (d) (j)	5.24%	03/15/37	4,837,500
320,000	Meiji Yasuda Life Insurance, Co. (c) (j)	5.10%	04/26/48	317,600

25,000,000	Mitsui Sumitomo Insurance Co., Ltd. (b) (c) (j)	7.00%	03/15/72	27,000,000
3,000,000	Nationwide Financial Services Capital Trust (b) (f)	7.90%	03/01/37	3,305,098
11,300,000	Nationwide Financial Services, Inc. (b)	6.75%	05/15/37	12,147,500
24,300,000	QBE Insurance Group, Ltd. (b) (c) (j)	7.50%	11/24/43	26,395,875
20,250,000	QBE Insurance Group, Ltd. (b) (c)	6.75%	12/02/44	20,806,875
8,130,000	Sumitomo Life Insurance Co. (b) (c) (j)	6.50%	09/20/73	8,720,238
3,800,000	VIVAT N.V. (c)	6.25%	(a)	3,795,972
				299,751,175
	Metals & Mining – 1.8%			
23,500,000	BHP Billiton Finance USA Ltd. (b) (c) (j)	6.75%	10/19/75	25,497,500
	Multi-Utilities – 0.8%			
5,150,000	CenterPoint Energy, Inc., Series A (b) (c)	6.13%	(a)	5,207,937
5,500,000	NiSource, Inc. (b) (c) (j)	5.65%	(a)	5,397,975
				10,605,912
	Oil, Gas & Consumable Fuels – 5.9%			
8,000,000	DCP Midstream L.P., Series A (b) (c)	7.38%	(a)	7,680,000
28,243,000	Enbridge Energy Partners L.P., 3 Mo. LIBOR + 3.80% (b) (d)	6.19%	10/01/37	28,104,751
5,400,000	Enbridge, Inc. (b) (c)	5.50%	07/15/77	4,815,165
14,700,000	Enbridge, Inc. (b) (c)	6.25%	03/01/78	13,799,446
5,000,000	Enbridge, Inc., Series 16-A (b) (c)	6.00%	01/15/77	4,699,780
20,700,000	Energy Transfer Operating L.P., 3 Mo. LIBOR + 3.02% (b) (d)	5.36%	11/01/66	17,595,000
4,200,000	Energy Transfer Operating L.P., Series B (b) (c)	6.63%	(a)	3,871,875
2,000,000	Enterprise Products Operating LLC, 3 Mo. LIBOR + 2.78% (d)	5.10%	06/01/67	1,985,254
				82,551,271
	Transportation Infrastructure – 1.5%			
19,817,000	AerCap Global Aviation Trust (b) (c) (j)	6.50%	06/15/45	20,411,510
	Total Capital Preferred Securities			1,526,611,470
	(Cost $1,572,301,751)			

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Principal Value	Description	Stated Coupon	Stated Maturity	Value
CORPORATE BONDS AND NOTES – 0.7%				
	Insurance – 0.7%			
$10,000,000	AmTrust Financial Services, Inc. (b)	6.13%	08/15/23	$9,394,702
	(Cost $9,965,963)			

Total Investments – 142.4% (Cost $2,029,569,698) (l)	1,976,815,997
Outstanding Loan – (44.7)%	(620,000,000)
Net Other Assets and Liabilities – 2.3%	31,144,523
Net Assets – 100.0%	$1,387,960,520

Interest Rate Swap Agreements:

Counterparty	Floating Rate [1]	Expiration Date	Notional Amount	Fixed Rate [1]	Unrealized Appreciation (Depreciation)/ Value
Bank of Nova Scotia	1 month LIBOR	01/23/25	$165,000,000	1.786%	$11,516,276

(1) The Fund pays the fixed rate and receives the floating rate. The floating rate on October 31, 2018 was 2.282%.

(a) Perpetual maturity.
(b) All or a portion of this security serves as collateral on the outstanding loan.
(c) Fixed-to-floating or fixed-to-variable rate security. The interest rate shown reflects the fixed rate in effect at October 31, 2018. At a predetermined date, the fixed rate will change to a floating rate or a variable rate.
(d) Floating rate security.
(e) Step-up security. A security where the coupon increases or steps up at a predetermined date.
(f) Pursuant to procedures adopted by the Fund's Board of Trustees, this security has been determined to be illiquid by Stonebridge Advisors LLC (the "Sub-Advisor").
(g) This security, sold within the terms of a private placement memorandum, is exempt from registration upon resale under Rule 144A under the Securities Act of 1933, as amended (the "1933 Act"), and may be resold in transactions exempt from registration, normally to qualified institutional buyers (see Note 2D - Restricted Securities in the Notes to Financial Statements).
(h) This security is fair valued by the Advisor's Pricing Committee in accordance with procedures adopted by the Fund's Board of Trustees, and in accordance with the provisions of the Investment Company Act of 1940, as amended. At October 31, 2018, securities noted as such are valued at $14,552,328 or 1.0% of net assets.
(i) This security's value was determined using significant unobservable inputs (see Note 2A-Portfolio Valuation in the Notes to Financial Statements).
(j)

This security, sold within the terms of a private placement memorandum, is exempt from registration upon resale under Rule 144A under the 1933 Act, and may be resold in transactions exempt from registration, normally to qualified institutional buyers. Pursuant to procedures adopted by the Fund's Board of Trustees, this security has been determined to be liquid by the Sub-Advisor. Although market instability can result in periods of increased overall market illiquidity, liquidity for each security is determined based on security specific factors and assumptions, which require subjective judgment. At October 31, 2018, securities noted as such amounted to $661,306,595 or 47.6% of net assets.

(k) This security is a contingent convertible capital security which may be subject to conversion into common stock of the issuer under certain circumstances. At October 31, 2018, securities noted as such amounted to $535,427,260 or 26.7% of managed assets. Of these securities, 1.5% originated in emerging markets, and 98.5% originated in foreign markets.

(l) Aggregate cost for federal income tax purposes was $2,027,465,476. As of October 31, 2018, the aggregate gross unrealized appreciation for all investments in which there was an excess of value over tax cost was $40,523,403 and the aggregate gross unrealized depreciation for all investments in which there was an excess of tax cost over value was $79,656,606. The net unrealized depreciation was $39,133,203. The amounts presented are inclusive of derivative contracts.

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Portfolio of Investments (Continued)
October 31, 2018

Valuation Inputs

A summary of the inputs used to value the Fund's investments as of October 31, 2018 is as follows (see Note 2A - Portfolio Valuation in the Notes to Financial Statements):

	Total Value at 10/31/2018	Level 1 Quoted Prices	Level 2 Significant Observable Inputs	Level 3 Significant Unobservable Inputs
$25 Par Preferred Securities:				
Insurance	$ 52,516,825	$ 40,032,691	$ 12,484,134	$ —
Multi-Utilities	33,836,652	15,276,966	18,559,686	—
Other industry categories*	185,032,154	185,032,154	—	—
$100 Par Preferred Securities*	51,670,977	—	51,670,977	—
$1,000 Par Preferred Securities*	103,200,889	—	103,200,889	—
$1,000,000 Par Preferred Securities*	14,552,328	—	—	14,552,328
Capital Preferred Securities*	1,526,611,470	—	1,526,611,470	—
Corporate Bonds and Notes*	9,394,702	—	9,394,702	—
Total Investments	1,976,815,997	240,341,811	1,721,921,858	14,552,328
Interest Rate Swap Agreement	11,516,276	—	11,516,276	—
Total	$ 1,988,332,273	$ 240,341,811	$ 1,733,438,134	$ 14,552,328

*See Portfolio of Investments for industry breakout.

Level 3 Par Preferred Securities are fair valued using broker quotes and are footnoted in the Portfolio of Investments. These values are based on unobservable and non-quantitative inputs.

The following table presents the activity of the Fund's investments measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the period presented.

Beginning Balance at October 31, 2017	
$1,000,000 Par Preferred Securities	$15,126,120
Net Realized Gain (Loss)	—
Net Change in Unrealized Appreciation/Depreciation	(573,792)
Purchases	—
Sales	—
Transfers In	—
Transfers Out	—

Ending Balance at October 31, 2018	
$1,000,000 Par Preferred Securities	14,552,328
Total Level 3 holdings	$14,552,328

There was a net change of $(573,792) in unrealized appreciation (depreciation) from Level 3 investments held as of October 31, 2018.

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Statement of Assets and Liabilities
October 31, 2018

ASSETS:	
Investments, at value	
(Cost $2,029,569,698)	$ 1,976,815,997
Cash	6,322,039
Swap contracts, at value	11,516,276
Receivables:	
Interest	21,532,287
Investment securities sold	1,268,963
Dividends	587,904
Interest reclaims	506,785
Dividend reclaims	85,323
Total Assets	2,018,635,574
LIABILITIES:	
Outstanding loan	620,000,000
Payables:	
Due to broker	7,169,022
Interest and fees on loan	1,674,333
Investment advisory fees	1,455,477
Administrative fees	190,883
Custodian fees	76,024
Shareholder reporting fees	57,473
Audit and tax fees	33,928
Legal fees	8,310
Financial reporting fees	2,313

Transfer agent fees	1,558
Trustees' fees and expenses	1,317
Other liabilities	4,416
Total Liabilities	630,675,054
NET ASSETS	$1,387,960,520
NET ASSETS consist of: Paid-in capital	$ 1,443,781,239
Par value	607,660
Accumulated distributable earnings (loss)	(56,428,379)
NET ASSETS	$1,387,960,520
NET ASSET VALUE, per Common Share (par value $0.01 per Common Share)	$22.84
Number of Common Shares outstanding (unlimited number of Common Shares has been authorized)	60,765,997

See Notes to Financial Statements
Page 13

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Statement of Operations
For the Year Ended October 31, 2018

INVESTMENT INCOME:	
Interest (net of foreign withholding tax of $839)	$ 110,934,848
Dividends (net of foreign withholding tax of $69,575)	30,653,753
Total investment income	141,588,601
EXPENSES:	
Investment advisory fees	17,975,804
Interest and fees on loan	16,904,106
Administrative fees	686,480
Custodian fees	334,040
Shareholder reporting fees	209,164
Legal fees	73,483
Listing expense	53,542
Audit and tax fees	34,181
Transfer agent fees	20,505
Trustees' fees and expenses	17,660
	9,250

Financial reporting fees	
Other	33,848
Total expenses	36,352,063
NET INVESTMENT INCOME (LOSS)	105,236,538
NET REALIZED AND UNREALIZED GAIN (LOSS): Net realized gain (loss) on: Investments	(5,971,170)
Swap contracts	(159,110)
Net realized gain (loss)	(6,130,280)
Net change in unrealized appreciation (depreciation) on: Investments	(146,879,192)
Swap contracts	8,055,425
Net change in unrealized appreciation (depreciation)	(138,823,767)
NET REALIZED AND UNREALIZED GAIN (LOSS)	(144,954,047)
NET INCREASE (DECREASE)	$(39,717,509)

IN NET
ASSETS
RESULTING
FROM
OPERATIONS

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Statements of Changes in Net Assets

	Year Ended 10/31/2018	Year Ended 10/31/2017
OPERATIONS:		
Net investment income (loss)	$ 105,236,538	$ 113,143,853
Net realized gain (loss)	(6,130,280)	2,811,134
Net change in unrealized appreciation (depreciation)	(138,823,767)	74,197,864
Net increase (decrease) in net assets resulting from operations	(39,717,509)	190,152,851
DISTRIBUTIONS TO SHAREHOLDERS FROM:		
Investment operations	(103,284,084)	
Net investment income		(114,847,734)
Return of capital	(4,271,731)	—
Total distributions to shareholders	(107,555,815)	(114,847,734)
Total increase (decrease) in net assets	(147,273,324)	75,305,117
NET ASSETS:		
Beginning of period	1,535,233,844	1,459,928,727
End of period	$ 1,387,960,520	$ 1,535,233,844
Accumulated net investment income (loss) at end of period		$5,555,240
COMMON SHARES:		
Common Shares at end of period	60,765,997	60,765,997

See Notes to Financial Statements
Page 15

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Statement of Cash Flows
For the Year Ended October 31, 2018

Cash flows from operating activities:	
Net increase (decrease) in net assets resulting from operations	$(39,717,509)
Adjustments to reconcile net increase (decrease) in net assets resulting from operations to net cash provided by operating activities:	
Purchases of investments	(597,187,123)
Sales, maturities and paydown of investments	644,995,397
Net amortization/accretion of premiums/discounts on investments	357,674
Net realized gain/loss on investments	5,971,170
Net change in unrealized appreciation/depreciation on investments	146,879,192
Net change in unrealized appreciation/depreciation on swap contracts	(8,055,425)
Decrease in cash segregated as collateral for open swap contracts	3,927,669
Changes in assets and liabilities:	
Decrease in interest receivable	1,530,335
Increase in interest reclaims receivable	(244,941)
Increase in dividend reclaims receivable	(55,781)
Decrease in dividends receivable	290,598
Increase in interest and fees payable on loan	472,722
Increase in due to broker	7,169,022
Decrease in investment advisory fees payable	(135,001)
Increase in audit and tax fees payable	431
Decrease in legal fees payable	(784)
Increase in shareholder reporting fees payable	3,618
Decrease in administrative fees payable	(62,619)
Increase in custodian fees payable	69,791

Increase in transfer agent fees payable	8	
Decrease in Trustees' fees and expenses payable	(206)	
Increase in financial reporting fees payable	1,542	
Increase in other liabilities payable	2,784	
Cash provided by operating activities		$166,212,564
Cash flows from financing activities: Distributions to Common Shareholders from investment operations	(103,284,084)	
Distributions to Common Shareholders from return of capital	(4,271,731)	
Repayment of borrowing	(60,000,000)	
Cash used in financing activities		(167,555,815)
Decrease in cash		(1,343,251)
Cash at beginning of period		7,665,290
Cash at end of period		$6,322,039
Supplemental disclosure of cash flow information: Cash paid during the period for interest and fees		$16,431,384

See Notes to Financial Statements

Table of Contents

First Trust Intermediate Duration Preferred & Income Fund (FPF)
Financial Highlights
For a Common Share outstanding throughout each period

	Year Ended October 31, 2018	2017	2016	2015	2014
Net asset value, beginning of period	$ 25.26	$ 24.03	$ 23.69	$ 24.42	$ 23.51
Income from investment operations:					
Net investment income (loss)	1.73	1.86	1.94	1.96	1.85
Net realized and unrealized gain (loss)	(2.38)	1.26	0.35	(0.58)	0.97
Total from investment operations	(0.65)	3.12	2.29	1.38	2.82
Distributions paid to shareholders from:					
Net investment income	(1.70)	(1.89)	(1.95)	(2.11)	(1.91)
Return of capital	(0.07)	—	—	—	—
Total distributions paid to Common Shareholders	(1.77)	—	—	—	—
Common Shares offering costs charged to paid-in capital	—	—	—	0.00 (a)	—
Net asset value, end of period	$22.84	$25.26	$24.03	$23.69	$24.42
Market value, end of period	$20.47	$24.80	$22.66	$21.95	$21.94
Total return based on net asset value (b)	(2.23)%	13.85%	10.68%	6.68%	13.37%
Total return based on market value (b)	(10.78)%	18.53%	12.65%	10.02%	13.98%
Ratios to average net assets/supplemental data:					
Net assets, end of period (in 000's)	$ 1,387,961	$ 1,535,234	$ 1,459,929	$ 1,438,361	$ 1,482,490
Ratio of total expenses to average net assets	2.49%	2.09%	1.88%	1.76%	1.69%
Ratio of total expenses to average net assets excluding interest expense	1.33%	1.31%	1.34%	1.34%	1.33%
Ratio of net investment income (loss) to average net assets	7.21%	7.67%	8.34%	8.15%	7.66%
Portfolio turnover rate	29%	31%	50%	48%	62%
Indebtedness:					
Total loan outstanding (in 000's)	$ 620,000	$ 680,000	$ 645,000	$ 645,000	$ 665,000

Asset coverage per $1,000 of indebtedness (c)	$ 3,239	$ 3,258	$ 3,263	$ 3,230	$ 3,229

(a) Amount is less than $0.01.

(b) Total return is based on the combination of reinvested dividend, capital gain and return of capital distributions, if any, at prices obtained by the Dividend Reinvestment Plan, and changes in net asset value per share for net asset value returns and changes in Common Share Price for market value returns. Total returns do not reflect sales load and are not annualized for periods of less than one year. Past performance is not indicative of future results.

(c) Calculated by subtracting the Fund's total liabilities (not including the loan outstanding) from the Fund's total assets, and dividing by the outstanding loan balance in 000's.

See Notes to Financial Statements

Table of Contents

Notes to Financial Statements
First Trust Intermediate Duration Preferred & Income Fund (FPF)
October 31, 2018

1. Organization

First Trust Intermediate Duration Preferred & Income Fund (the "Fund") is a non-diversified, closed-end management investment company organized as a Massachusetts business trust on February 4, 2013, and is registered with the Securities and Exchange Commission ("SEC") under the Investment Company Act of 1940, as amended (the "1940 Act"). The Fund trades under the ticker symbol FPF on the New York Stock Exchange ("NYSE").

The primary investment objective is to seek a high level of current income. The Fund has a secondary objective of capital appreciation. The Fund seeks to achieve its objectives by investing, under normal market conditions, at least 80% of its managed assets in preferred securities and other income producing securities issued by U.S. and non-U.S. companies, including traditional preferred securities, hybrid preferred securities that have investment and economic characteristics of both preferred securities and debt securities, floating rate and fixed-to-floating rate preferred securities, debt securities, convertible securities and contingent convertible securities. There can be no assurance that the Fund will achieve its investment objectives. The Fund seeks to maintain, under normal market conditions, a duration of between three and eight years. The Fund may not be appropriate for all investors.

2. Significant Accounting Policies

The Fund is considered an investment company and follows accounting and reporting guidance under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 946, "Financial Services-Investment Companies." The following is a summary of significant accounting policies consistently followed by the Fund in the preparation of the financial statements. The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") requires management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates.

A. Portfolio Valuation

The net asset value ("NAV") of the Common Shares of the Fund is determined daily as of the close of regular trading on the NYSE, normally 4:00 p.m. Eastern time, on each day the NYSE is open for trading. If the NYSE closes early on a valuation day, the NAV is determined as of that time. Domestic debt securities and foreign securities are priced using data reflecting the earlier closing of the principal markets for those securities. The Fund's NAV per Common Share is calculated by dividing the value of all assets of the Fund (including accrued interest and dividends), less all liabilities (including accrued expenses, dividends declared but unpaid and any borrowings of the Fund), by the total number of Common Shares outstanding.

The Fund's investments are valued daily at market value or, in the absence of market value with respect to any portfolio securities, at fair value. Market value prices represent last sale or official closing prices from a national or foreign exchange (i.e., a regulated market) and are primarily obtained from third-party pricing services. Fair value prices represent any prices not considered market value prices and are either obtained from a third-party pricing service or are determined by the Pricing Committee of the Fund's investment advisor, First Trust Advisors L.P. ("First Trust" or the "Advisor"), in accordance with valuation procedures adopted by the Fund's Board of Trustees, and in accordance with provisions of the 1940 Act. Investments valued by the Advisor's Pricing Committee, if any, are footnoted as such in the footnotes to the Portfolio of Investments. The Fund's investments are valued as follows:

Preferred stocks and other equity securities listed on any national or foreign exchange (excluding The Nasdaq Stock Market LLC ("Nasdaq") and the London Stock Exchange Alternative Investment Market ("AIM")) are valued at the last sale price on the exchange on which they are principally traded or, for Nasdaq and AIM securities, the official closing price. Securities traded on more than one securities exchange are valued at the last sale price or official closing price, as applicable, at the close of the securities exchange representing the principal market for such securities.

Corporate bonds, notes and other debt securities are fair valued on the basis of valuations provided by dealers who make markets in such securities or by a third-party pricing service approved by the Fund's Board of Trustees, which may use the following valuation inputs when available:

1) benchmark yields;
2) reported trades;

3) broker/dealer quotes;
4) issuer spreads;
5) benchmark securities;
6) bids and offers; and
7) reference data including market research publications.

Table of Contents

Notes to Financial Statements (Continued)
First Trust Intermediate Duration Preferred & Income Fund (FPF)
October 31, 2018

Securities traded in an over-the-counter market are fair valued at the mean of their most recent bid and asked price, if available, and otherwise at their closing bid price.

Swaps are fair valued utilizing quotations provided by a third-party pricing service or, if the third-party pricing service does not provide a value, by quotes provided by the selling dealer or financial institution.

Certain securities may not be able to be priced by pre-established pricing methods. Such securities may be valued by the Fund's Board of Trustees or its delegate, the Advisor's Pricing Committee, at fair value. These securities generally include, but are not limited to, restricted securities (securities which may not be publicly sold without registration under the Securities Act of 1933, as amended (the "1933 Act")) for which a third-party pricing service is unable to provide a market price; securities whose trading has been formally suspended; a security whose market or fair value price is not available from a pre-established pricing source; a security with respect to which an event has occurred that is likely to materially affect the value of the security after the market has closed but before the calculation of the Fund's NAV or make it difficult or impossible to obtain a reliable market quotation; and a security whose price, as provided by the third-party pricing service, does not reflect the security's fair value. As a general principle, the current fair value of a security would appear to be the amount which the owner might reasonably expect to receive for the security upon its current sale. When fair value prices are used, generally they will differ from market quotations or official closing prices on the applicable exchanges. A variety of factors may be considered in determining the fair value of such securities, including, but not limited to, the following:

1) the type of security;
2) the size of the holding;
3) the initial cost of the security;
4) transactions in comparable securities;
5) price quotes from dealers and/or third-party pricing services;
6) relationships among various securities;
7) information obtained by contacting the issuer, analysts, or the appropriate stock exchange;
8) an analysis of the issuer's financial statements; and
9) the existence of merger proposals or tender offers that might affect the value of the security.

If the securities in question are foreign securities, the following additional information may be considered:

1) the value of similar foreign securities traded on other foreign markets;
2) ADR trading of similar securities;
3) closed-end fund trading of similar securities;
4) foreign currency exchange activity;
5) the trading prices of financial products that are tied to baskets of foreign securities;
6) factors relating to the event that precipitated the pricing problem;
7) whether the event is likely to recur; and
8) whether the effects of the event are isolated or whether they affect entire markets, countries or regions.

The Fund is subject to fair value accounting standards that define fair value, establish the framework for measuring fair value and provide a three-level hierarchy for fair valuation based upon the inputs to the valuation as of the measurement date. The three levels of the fair value hierarchy are as follows:

- Level 1 – Level 1 inputs are quoted prices in active markets for identical investments. An active market is a market in which transactions for the investment occur with sufficient frequency and volume to provide pricing information on an ongoing basis.

- Level 2 – Level 2 inputs are observable inputs, either directly or indirectly, and include the following:

o Quoted prices for similar investments in active markets.
o Quoted prices for identical or similar investments in markets that are non-active. A non-active market is a market where there are few transactions for the investment, the prices are not current, or price quotations vary substantially

either over time or among market makers, or in which little information is released publicly.

- o Inputs other than quoted prices that are observable for the investment (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates).
- o Inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Page 19

- Level 3 – Level 3 inputs are unobservable inputs. Unobservable inputs may reflect the reporting entity's own assumptions about the assumptions that market participants would use in pricing the investment.

The inputs or methodologies used for valuing investments are not necessarily an indication of the risk associated with investing in those investments. A summary of the inputs used to value the Fund's investments as of October 31, 2018, is included with the Fund's Portfolio of Investments.

B. Swap Agreements

The Fund may enter into interest rate swap agreements. A swap is a financial instrument that typically involves the exchange of cash flows between two parties ("Counterparties") on specified dates (settlement dates) where the cash flows are based on agreed upon prices, rates, etc. Payment received or made by the Fund for interest rate swaps are recorded on the Statement of Operations as "Net realized gain (loss) on swap contracts." When an interest rate swap is terminated, the Fund will record a realized gain or loss equal to the difference between the proceeds from (or cost of) the closing transaction and the Fund's basis in the contract, if any. Generally, the basis of the contracts, if any, is the premium received or paid. Swap agreements are individually negotiated and involve the risk of the potential inability of the Counterparties to meet the terms of the agreement. In connection with these agreements, cash and securities may be identified as collateral in accordance with the terms of the respective swap agreements to provide assets of value and recourse in the event of default under the swap agreement or bankruptcy/insolvency of a party to the swap agreement. In the event of a default by a Counterparty, the Fund will seek withdrawal of the collateral and may incur certain costs exercising its rights with respect to the collateral. If a Counterparty becomes bankrupt or otherwise fails to perform its obligations due to financial difficulties, the Fund may experience significant delays in obtaining any recovery in a bankruptcy or other reorganization proceeding. The Fund may obtain only limited recovery or may obtain no recovery in such circumstances.

Swap agreements may increase or decrease the overall volatility of the investments of the Fund. The performance of swap agreements may be affected by changes in the specific interest rate, security, currency, or other factors that determine the amounts of payments due to and from the Fund. The Fund's maximum interest rate risk to meet its future payments under swap agreements outstanding at October 31, 2018, is equal to the total notional amount as shown on the Portfolio of Investments. The notional amount represents the U.S. dollar value of the contract as of the day of the opening transaction or contract reset. When the Fund enters into a swap agreement, any premium paid is included in "Swap contracts, at value" on the Statement of Assets and Liabilities.

The Fund held interest rate swap agreements at October 31, 2018. An interest rate swap agreement involves the Fund's agreement to exchange a stream of interest payments for another party's stream of cash flows. Interest rate swaps do not involve the delivery of securities or other underlying assets or principal. Accordingly, the risk of loss with respect to interest rate swaps is limited to the net amount of interest payments that the Fund is contractually obligated to make.

C. Securities Transactions and Investment Income

Securities transactions are recorded as of the trade date. Realized gains and losses from securities transactions are recorded on the identified cost basis. Dividend income is recorded on the ex-dividend date. Interest income is recorded on the accrual basis. Amortization of premiums and the accretion of discounts are recorded using the effective interest method.

The Fund may hold the securities of real estate investments trusts ("REITs"). Distributions from such investments may include income, capital gains and return of capital. The actual character of amounts received during the year is not known until after the REITs' fiscal year end. The Fund records the character of distributions received from the REITs during the year based on estimates available. The characterization of distributions received by the Fund may be subsequently revised based on information received from the REITs after their tax reporting periods conclude.

D. Restricted Securities

The Fund invests in restricted securities, which are securities that may not be offered for public sale without first being registered under the 1933 Act. Prior to registration, restricted securities may only be resold in transactions exempt from registration under Rule 144A under the 1933 Act, normally to qualified institutional buyers. As of

October 31, 2018, the Fund held restricted securities as shown in the following table that Stonebridge Advisors LLC (the "Sub-Advisor") has deemed illiquid pursuant to procedures adopted by the Fund's Board of Trustees. Although market instability can result in periods of increased overall market illiquidity, liquidity for each security is determined based on security-specific factors and assumptions, which require subjective judgment. The Fund does not have the right to demand that such securities be registered. These securities are valued according to the valuation procedures as stated in the Portfolio Valuation note (Note 2A) and are not expressed as a discount to the carrying value of a comparable unrestricted security. There are no unrestricted securities with the same maturity dates and yields for these issuers.

Table of Contents

Notes to Financial Statements (Continued)

First Trust Intermediate Duration Preferred & Income Fund (FPF)

October 31, 2018

Security	Acquisition Date	Par Amount/Shares	Current Price	Carrying Cost	Value	% of Net Assets
CoBank ACB, 3.59%	3/29/18	3,557	$655.00	$2,409,867	$2,329,835	0.17%
Compeer Financial ACA, 6.75%	5/29/13 - 7/31/15	12,000	1,070.00	12,105,000	12,840,000	0.93
Dairy Farmers of America, Inc., 7.13%	9/15/16	$9,000,000	104.75	9,000,000	9,427,500	0.68
Farm Credit Bank of Texas, 6.75%	7/16/13 - 7/17/13	100,000	106.50	10,020,000	10,650,000	0.77
Fortegra Financial Corp., 8.50%, 10/15/57	10/12/17 - 3/12/18	$15,300,000	101.75	15,344,525	15,567,750	1.12
FT Real Estate Securities Co., Inc., 9.50%	6/15/16	12	1,212,694.00	15,990,000	14,552,328	1.05
Kinder Morgan GP, Inc., 6.22%,08/18/57	3/21/17 - 6/20/17	8,500	916.97	7,765,000	7,794,249	0.56
Land O'Lakes Capital Trust I, 7.45%, 03/15/28	6/6/14 - 7/7/17	$14,488,000	108.38	15,093,310	15,701,370	1.13
Sovereign Real Estate Investment Trust, 12.00%	6/11/13 - 3/22/16	15,364	1,117.50	20,231,885	17,169,270	1.24
				$107,959,587	$106,032,302	7.65%

E. Dividends and Distributions to Shareholders

Dividends from net investment income, if any, are declared and paid monthly by the Fund, or as the Board of Trustees may determine from time to time. Distributions of net realized capital gains earned by the Fund, if any, are distributed at least annually.

Distributions from income and realized capital gains are determined in accordance with federal income tax regulations, which may differ from U.S. GAAP. Certain capital accounts in the financial statements are periodically adjusted for permanent differences in order to reflect their tax character. These permanent differences are primarily due to the varying treatment of income and gain/loss on portfolio securities held by the Fund and have no impact on net assets or NAV per share. Temporary differences, which arise from recognizing certain items of income, expense and gain/loss in different periods for financial statement and tax purposes, will reverse at some point in the future. Permanent differences incurred during the fiscal year ended October 31, 2018, resulting in book and tax accounting differences, have been reclassified at year end to reflect a decrease in accumulated net investment income (loss) of $4,942,252 and an increase in accumulated net realized gain (loss) of $4,942,252. Accumulated distributable earnings (loss) consists of accumulated net investment income (loss), accumulated net realized gain (loss) on investments, and unrealized appreciation (depreciation) on investments. Net assets were not affected by this reclassification.

The tax character of distributions paid by the Fund during the fiscal years ended October 31, 2018 and 2017, was as follows:

Distributions paid from:	2018	2017
Ordinary income	$103,284,084	$114,847,734
Capital gains	—	—
Return of capital	4,271,731	—

Table of Contents

Notes to Financial Statements (Continued)
First Trust Intermediate Duration Preferred & Income Fund (FPF)
October 31, 2018

As of October 31, 2018, the components of distributable earnings and net assets on a tax basis were as follows:

Undistributed ordinary income	$—
Undistributed capital gains	—
Total undistributed earnings	—
Accumulated capital and other losses	(17,295,176)
Net unrealized appreciation (depreciation)	(39,133,203)
Total accumulated earnings (losses)	(56,428,379)
Other	—
Paid-in capital	1,444,388,899
Total net assets	$1,387,960,520

F. Income Taxes

The Fund intends to continue to qualify as a regulated investment company by complying with the requirements under Subchapter M of the Internal Revenue Code of 1986, as amended, which includes distributing substantially all of its net investment income and net realized gains to shareholders. Accordingly, no provision has been made for federal and state income taxes. However, due to the timing and amount of distributions, the Fund may be subject to an excise tax of 4% of the amount by which approximately 98% of the Fund's taxable income exceeds the distributions from such taxable income for the calendar year.

The Fund intends to utilize provisions of the federal income tax laws, which allow it to carry a realized capital loss forward indefinitely following the year of the loss and offset such loss against any future realized capital gains. The Fund is subject to certain limitations under U.S. tax rules on the use of capital loss carryforwards and net unrealized built-in losses. These limitations apply when there has been a 50% change in ownership. At October 31, 2018, the Fund had $17,295,176 of capital loss carryforwards for federal income tax purposes.

The Fund is subject to accounting standards that establish a minimum threshold for recognizing, and a system for measuring, the benefits of a tax position taken or expected to be taken in a tax return. Taxable years ended 2015, 2016, 2017, and 2018 remain open to federal and state audit. As of October 31, 2018, management has evaluated the application of these standards to the Fund and has determined that no provision for income tax is required in the Fund's financial statements for uncertain tax positions.

G. Expenses

The Fund will pay all expenses directly related to its operations.

H. New Accounting Pronouncements

On March 30, 2017, the FASB issued Accounting Standards Update ("ASU") 2017-08 "Premium Amortization on Purchased Callable Debt Securities," which amends the amortization period for certain purchased callable debt securities held at a premium by shortening such period to the earliest call date. The new guidance requires an entity to amortize the premium on a callable debt security within its scope to the earliest call date, unless the guidance for considering estimated prepayments is applied. If the call option is not exercised at the earliest call date, the yield is reset to the effective yield using the payment terms of the security. If the security has more than one call date and the premium was amortized to a call price greater than the next call price, any excess of the amortized cost basis over the amount repayable at the next call date will be amortized to that date. If there are no other call dates, any excess of the amortized cost basis over the par amount will be amortized to maturity. Discounts on purchased callable debt securities will continue to be amortized to the security's maturity date. ASU 2017-08 is effective for public business entities for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Earlier adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the ASU in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. Management is still assessing the impact of the adoption of ASU 2017-08 on the financial statements but does not expect it to have a material impact.

On August 28, 2018, the FASB issued ASU 2018-13, "Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement," which amends the fair value measurement disclosure requirements of ASC 820. The amendments of ASU 2018-13 include new, eliminated, and modified disclosure requirements of ASC 820. In addition, the amendments clarify that materiality is an appropriate consideration of entities when evaluating disclosure requirements. The ASU is effective for fiscal years beginning after December 15, 2019, including interim periods therein. Early adoption is permitted for any eliminated or modified disclosures upon issuance of this ASU. The Fund has early adopted ASU 2018-13 for these financial statements, which did not result in a material impact.

Table of Contents

Notes to Financial Statements (Continued)

First Trust Intermediate Duration Preferred & Income Fund (FPF)

October 31, 2018

3. Investment Advisory Fee, Affiliated Transactions and Other Fee Arrangements

First Trust, the investment advisor to the Fund, is a limited partnership with one limited partner, Grace Partners of DuPage L.P., and one general partner, The Charger Corporation. The Charger Corporation is an Illinois corporation controlled by James A. Bowen, Chief Executive Officer of First Trust. First Trust is responsible for the ongoing monitoring of the Fund's investment portfolio, managing the Fund's business affairs and providing certain administrative services necessary for the management of the Fund. For these investment management services, First Trust is entitled to a monthly fee calculated at an annual rate of 0.85% of the Fund's average daily net assets . First Trust also provides fund reporting services to the Fund for a flat annual fee in the amount of $9,250.

Stonebridge, a majority-owned affiliate of First Trust, serves as the Fund's sub-advisor and manages the Fund's portfolio subject to First Trust's supervision. The Sub-Advisor receives a monthly portfolio management fee calculated at an annual rate of 0.425% of average daily net assets that is paid by First Trust out of its investment advisory fee. First Trust Capital Partners, LLC, an affiliate of First Trust, owns a 51% ownership interest in Stonebridge.

Brown Brothers Harriman & Co. ("BBH") serves as the Fund's administrator, fund accountant and custodian in accordance with certain fee arrangements. As administrator and fund accountant, BBH is responsible for providing certain administrative and accounting services to the Fund, including maintaining the Fund's books of account, records of the Fund's securities transactions, and certain other books and records. As custodian, BBH is responsible for custody of the Fund's assets.

Computershare, Inc. ("Computershare") serves as the Fund's transfer agent in accordance with certain fee arrangements. As transfer agent, Computershare is responsible for maintaining shareholder records for the Fund.

Each Trustee who is not an officer or employee of First Trust, any sub-advisor or any of their affiliates ("Independent Trustees") is paid a fixed annual retainer that is allocated equally among each fund in the First Trust Fund Complex. Each Independent Trustee is also paid an annual per fund fee that varies based on whether the fund is a closed-end or other actively managed fund, or is an index fund.

Additionally, the Lead Independent Trustee and the Chairmen of the Audit Committee, Nominating and Governance Committee and Valuation Committee are paid annual fees to serve in such capacities, with such compensation allocated pro rata among each fund in the First Trust Fund Complex based on net assets. Independent Trustees are reimbursed for travel and out-of-pocket expenses in connection with all meetings. The Lead Independent Trustee and Committee Chairmen rotate every three years. The officers and "Interested" Trustee receive no compensation from the Fund for acting in such capacities.

4. Purchases and Sales of Securities

For the fiscal year ended October 31, 2018, the cost of purchases and proceeds from sales of investments, excluding short term investments and in-kind transactions, were $595,096,695 and $638,050,717, respectively.

5. Derivative Transactions

The following table presents the type of derivatives held by the Fund at October 31, 2018, the primary underlying risk exposure and the location of these instruments as presented on the Statement of Assets and Liabilities.

		Asset Derivatives		Liability Derivatives	
Derivative Instrument	Risk Exposure	Statement of Assets and Liabilities Location	Value	Statement of Assets and Liabilities Location	Value
Interest Rate Swap Agreements	Interest Rate Risk	Swap contracts, at value	$11,516,276	Swap contracts, at value	$ -

The following table presents the amount of net realized gain (loss) and change in net unrealized appreciation (depreciation) recognized for the fiscal year ended October 31, 2018, on derivative instruments, as well as the primary underlying risk exposure associated with each instrument.

Statement of Operations Location	
Interest Rate Risk Exposure	
Net realized gain (loss) on swap contracts	$(159,110)

Net change in unrealized appreciation (depreciation) on swap contracts 8,055,425
The average notional value of interest rate swaps was $165,000,000 for the fiscal year ended October 31, 2018.

Subtotal
82,576

Table of Contents

(Millions of euros)		Notional	
Notional amounts of structured products with options	**Value in euros**	**value**	**Currency**
Interest rate options Caps & Floors	**11,004**		
External counterparties			
USD	655	911	USD
EUR	8,774	8,774	EUR
GBP	1,575	1,500	GBP
Currency options	**2,311**		
External counterparties			
USD/EUR	2,295	3,194	USD
ARS/USD	16	23	USD
Subtotal	**13,315**		
TOTAL	**95,891**		

The breakdown by average maturity is as follows:

(Millions of euros)		**Up to**	**From 1 to**	**From 3 to**	**Over**
Hedged underlying item	**Notional**	**1 year**	**3 years**	**5 years**	**5 years**
With underlying instrument					
Promissory notes	**500**		**500**		
Loans	**26,092**	**11,386**	**5,333**	**5,575**	**3,798**
In national currency	21,034	9,522	3,991	4,977	2,544
In foreign currencies	5,058	1,864	1,342	598	1,254
Debentures and bonds	**47,942**	**10,884**	**17,179**	**5,140**	**14,739**
In national currency	18,791	7,326	7,232	3,242	991
In foreign currencies	29,151	3,558	9,947	1,898	13,748
Without underlying (*)	**21,357**	**9,796**	**5,899**	**1,968**	**3,694**
Swaps	11,735	2,266	5,706	1,788	1,975
Spots	11	11			
Currency options	2,311	271	183	138	1,719
Forwards	7,300	7,248	10	42	
Total	**95,891**	**32,066**	**28,911**	**12,683**	**22,231**

* Most of these transactions are related to economic hedges of investments, assets and liabilities of subsidiaries, and

provisions for
restructuring
plans.

The debentures and bonds hedged relate to both those issued by Telefónica, S.A. and intragroup loans on the same terms as the issues of Telefónica Europe, B.V. and Telefónica Emisiones, S.A.U.

The fair value of Telefónica, S.A. derivatives portfolio at December 31, 2009 was equivalent to a net asset of 78 million euros (net asset of 1,469 million euros in 2008).

b) Risk management policy

Telefónica, S.A. is exposed to various financial market risks as a result of (i) its ordinary business activity, (ii) debt taken on to finance its business, (iii) investments in companies, and (iv) other financial instruments related to the above commitments.

The main market risks affecting the Group are as follows:

1. Foreign currency risk

Exchange rate risk arises primarily from (i) Telefónica s international presence, through its investments and businesses in countries that use currencies other than the euro (primarily in Latin America, but also in the United Kingdom and the Czech Republic), and (ii) debt denominated in currencies other than that of the country where the business is conducted or the home country of the company incurring such debt.

Table of Contents

2. Interest rate risk

Interest rate risk arises primarily in connection with changes in interest rates affecting (i) financial expenses on floating rate debt (or short-term debt likely to be renewed), due to changes in interest rates and (ii) the value of long-term liabilities at fixed interest rates.

3. Share price risk

Share price risk arises primarily from changes in the value of our equity investments (that may be bought, sold or otherwise involved in transactions), from changes in the value of derivatives associated with such investments, from changes in the value of our treasury shares and from equity derivatives.

Telefónica, S.A. is also exposed to liquidity risk if a mismatch arises between its financing needs (operating and financial expense, investment, debt redemptions and dividend commitments) and its sources of finance (revenues, divestments, credit lines from financial institutions and capital market operations). The cost of finance could also be affected by movements in the credit spreads (over benchmark rates) demanded by lenders.

Finally, Telefónica is exposed to country risk (which overlaps with market and liquidity risks). This refers to the possible decline in the value of assets, cash flows generated or cash flows returned to the parent company as a result of political, economic or social instability in the countries where Telefónica, S.A. operates, especially in Latin America.

Telefónica, S.A. actively manages these risks through the use of derivatives (primarily on exchange rates, interest rates and share prices) and by incurring debt in local currencies, where appropriate, with a view to stabilizing cash flows, the income statement and investments. In this way, it is attempted to protect Telefónica s solvency, and facilitate financial planning and take advantage of investment opportunities.

Telefónica manages its exchange rate risk and interest rate risk in terms of net debt and net financial debt as calculated by them. Telefónica believes that these parameters are more appropriate to understand its debt position. Net debt and net financial debt take into account the impact of our cash balance and cash equivalents including derivatives positions with a positive value linked to liabilities. Neither net debt nor net financial debt as calculated by Telefónica should be considered an alternative to gross financial debt (the sum of current and non-current interest-bearing debt) as a measure of our liquidity.

Foreign currency risk

The fundamental objective of our exchange rate risk management policy is that, in event of depreciation in foreign currencies relative to the euro, any potential losses in the value of the cash flows generated by our businesses in such currencies, caused by depreciation in exchange rates of a foreign currency relative to the euro, are offset (to some extent) by savings from the reduction in the euro value of our debt denominated in such currencies. The degree of exchange rate hedging we employ varies depending on the type of investment.

Telefónica aims to protect itself against declines in Latin American currencies relative to the euro affecting our asset values through, among other measures, the use of dollar-denominated debt, incurred either in Spain (where such debt is associated with an investment as long as it is considered to be an effective hedge) or in the country itself, where the market for local currency financing or hedges may be inadequate or non-existent.

At December 31, 2009, pound sterling-denominated net debt was approximately 2.3 times the value of our 2009 operating income before depreciation and amortization (OIBDA) from the Telefónica Europe business unit in the United Kingdom. Telefónica s aim is to maintain the same proportion of pound sterling-denominated net debt to OIBDA as the Telefónica net debt to OIBDA ratio, on a consolidated basis, in order to help them to reduce its sensitivity to changes in the pound sterling to euro exchange rate.

To protect its investment in the Czech Republic, the Company has net positions denominated in Czech crowns, which at December 31, 2009 amounted to nearly 59% of the original cost of the investment (compared to 75% of the original cost of the investment in 2008).

We also manage exchange rate risk by seeking to minimize the negative impact of any remaining exchange rate exposure on the income statement, regardless of whether we have open positions. Such open position exposure can arise for any of three reasons: (i) a thin market for local derivatives or difficulty in sourcing local currency finance which makes it impossible to arrange a low-cost hedge (as in Argentina and Venezuela), (ii) financing through intra-group loans, where the accounting treatment of exchange rate risk is different from that for financing through capital contributions, and (iii) as the result of a deliberate policy decision, to avoid the high cost of hedges that are not warranted by expectations or high risk of depreciation.

As Telefónica s direct exposure is counterbalanced by the positions held in subsidiaries, the Company analyses its foreign currency risk exposure at the Group level. To illustrate the sensitivity of exchange gains or losses to variability in exchange rates, assuming the exchange rate position affecting the income statement at the end of 2009 were constant during 2010 and Latin American currencies depreciated against the dollar and the rest of the currencies against the euro by 10%, Telefónica estimates that exchange gains or losses recorded for 2010 would be 46 million euros. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to an increase in finance costs of 41 million euros. Nonetheless, Telefónica manages its exposure on a dynamic basis to mitigate their impact.

Interest rate risk

Telefónica financial expenses are exposed to changes in interest rates. In 2009, the rates applied to the largest amount of our short-term debt were mainly based on the Euribor, the Czech crown Pribor, the Brazilian SELIC, the dollar Libor and the Colombian UVR. Telefónica manages its interest rate risk by entering into derivative financial instruments, primarily swaps and interest-rate options.

Table of Contents

Telefónica analyzes its exposure to changes in interest rates at the Telefónica Group level. To illustrate the sensitivity of net financial expense to variability in short-term interest rates at Group level, assuming a 100 basis point increase in interest rates in all currencies in which there are financial positions and no change in the currency make-up and balance of the position at year end, we estimate that net financial expense at December 31, 2010 would have been 124 million euros higher. For Telefónica, S.A., assuming only financing arranged with external counterparties, the same change would lead to an increase in finance costs of 16 million euros.

Share price risk

The Telefónica Group is exposed to changes in the value of equity investments that may be bought, sold or otherwise involved in transactions, from changes in the value of derivatives associated with such investments, from treasury shares and from equity derivatives.

As part of the shareholder remuneration policy, in 2008, Telefónica announced plans to buy back up to 150 million of our shares. The share buyback program was completed on March 31, 2009. Telefónica manages the share price risk of its share buyback programs by setting the timetable for execution in accordance with the pace of cash flow generation, the share price and other market conditions.

According to the PSP, the shares delivered under such plan may be either the Telefónica, S.A. treasury shares, acquired by them or any of its Group companies; or newly-issued shares. The possibility of delivering shares to employees in the future, in accordance with relative total shareholders return, implies a risk since there could be an obligation to hand over a maximum number of shares at the end of each cycle, whose acquisition (in the event of acquisition in the market) in the future could imply a higher cash outflow than required on the start date of each cycle if the share price is above the corresponding price on the phase start date. In the event that new shares are issued for delivery to the beneficiaries of the plan, there would be a dilutive effect for our ordinary shareholder as a result of the higher number of shares delivered under such plan outstanding.

To reduce the risk to us associated with variations in share price under this plan, Telefónica has acquired financial instruments that replicate the risk profile of some of the shares derivable under the plan as explained in Note 18. Telefónica will assess if at the moment of implementation it will have to take any action in order to reduce any risk implied in this plan.

Additionally, at the Ordinary General Shareholders Meeting of 2009, an incentive plan for all Telefónica Group employees to purchase Telefónica, S.A. shares was approved. The cost allocated to this Plan will be determined by the Board of Directors, but it will not exceed 60 million euros. It is expected that the Plan will be implemented during the first half of 2010. Telefónica will assess if at the moment of implementation, once the Plan is completely defined, it will have to take any action in order to reduce any risk related to the future delivery of shares.

In addition, part of the treasury shares of the parent company held at December 31, 2009 may be used to cover shares deliverable under the Plan. At December 31, 2009, we held 6,329,530 treasury shares (see Note 11). The net asset value of the treasury shares could increase or decrease depending on variations in Telefónica, S.A. s share price.

Table of Contents

Liquidity risk

Telefónica seeks to match the schedule for its debt maturity payments to its capacity to generate cash flows to meet these maturities, while allowing for some flexibility. In practice, this has been translated into two key principles:

1. The average maturity of our net financial debt is intended to stay above 6 years, or be restored above that threshold in a reasonable period of time if it eventually falls below it. This principle should be considered as a guideline when managing debt and access to credit markets, but not a rigid goal *per se*. When calculating the average maturity for the net financial debt, cash and part of the undrawn credit lines can be considered as offsetting the shorter debt maturities, and extension options on some financing facilities may be considered as exercised, for calculation purposes.
2. Telefónica must be able to pay all commitments over the next 12 months without accessing new borrowing or accessing the capital markets (although including firm credit lines arranged with banks), assuming budget projections are met.

Country risk

Telefónica managed or mitigated country risk by pursuing two lines of action (in addition to its normal business practices):

1. Partly matching assets to liabilities (those not guaranteed by the parent company) in its Latin American companies such that any potential asset impairment would be accompanied by a reduction in liabilities; and,
2. Repatriating funds generated in Latin America that are not required for the pursuit of new, profitable business development opportunities in the region.

Credit risk

Telefónica is exposed to credit risk. Telefónica, S.A. trades in derivatives with creditworthy counterparties. Therefore, the parent company trades with credit entities with senior debt ratings of at least A. In Spain, where it holds most of Telefónica s derivatives portfolio, it has netting agreements with financial institutions, with debtor or creditor positions offset in case of bankruptcy, limiting the risk to the net position. For other subsidiaries, particularly those in Latin America, given the stable sovereign rating provides a ceiling and is below A, trades are with local financial entities whose rating by local standards is considered to be of high creditworthiness.

Meanwhile, with credit risk arising from cash and cash equivalents, Telefónica places its cash surpluses in high quality and highly liquid money-market assets. These placements are regulated by a general framework, revised annually based on the conditions of the market and countries where Telefónica operates. The general framework sets: (i) the maximum amounts to be invested by counterparty based on its rating (long-term debt rating); (ii) the maximum tenor of the investment; and (iii) the instruments in which the surpluses may be invested. For the parent company which places the bulk of Telefónica surpluses, the maximum placement in 2009 was 180 days and the creditworthiness of the counterparties used, measured by their debt ratings, remained above A- and/or A3 by Standard & Poors and Moody s, respectively.

These placements are regulated by a general framework, authorization procedures and homogeneous management practices within Telefónica, based on particular conditions and best international practices observed in the telecom sector, and incorporating this commercial credit risk management approach to Telefónica s decision policy both from a strategic and operating (in the ordinary course of business) perspective.

Telefónica also considers managing commercial credit risk as crucial to meeting its business and customer base growth targets in a manner that is consistent with Telefónica s risk-management policy.

Therefore, Telefónica s commercial credit risk-management approach is based on continuous monitoring of the risk assumed and the resources necessary to manage its various units, in order to optimize the risk-reward relationship in its operations and the assessment, primarily, those clients that could cause a material impact on Telefónica s financial condition.

Telefónica s maximum exposure to credit risk is initially represented by the carrying amounts of the assets (see Notes 8 and 9) and the guarantees given by Telefónica (see Note 19).

Capital management

Telefónica s corporate finance department, which is in charge of Telefónica s capital management, takes into consideration several factors when determining Telefónica s capital structure, with the aim of ensuring sustainability of the business and maximizing the value to shareholders.

Telefónica monitors its cost of capital with a goal of optimizing its capital structure. In order to do this, Telefónica monitors the financial markets and updates to standard industry approaches for calculating weighted average cost of capital, or WACC. The second, a gearing ratio that enables the Company to obtain and maintain the desired credit rating over the medium term, and with which Telefónica can use to match its potential cash flow generation and the alternative uses of this cash flow at all times.

These general principles are refined by other considerations and the application of specific variables, such as country risk in the broadest sense, tax efficiency and volatility in cash flow generation, when determining our financial structure.

Hedging policy

Derivatives policy emphasizes the following points:

- Derivatives based on a clearly identified underlying.
- Matching of the underlying to one side of the derivative.
- Matching the company contracting the derivative and the company that owns the underlying.
- Ability to measure the derivative s fair value using the valuation systems available to us.
- Sale of options only when there is an underlying exposure.
- Hedge accounting.

Table of Contents

Hedges can be of three types:

- Fair value hedges.
- Cash flow hedges, which can be set at any value of the risk to be hedged (primarily interest rate and foreign currency) or for a defined range through options.
- Hedges of a net investment in a foreign operation.

Hedges can comprise a combination of different derivatives. There is no reason to suppose management of accounting hedges will be static, with an unchanging hedging relationship lasting right through to maturity. Hedging relationships may change to allow appropriate management that serves our stated principles of stabilizing cash flows, stabilizing net financial income/expense and protecting our share capital. The designation of hedges may therefore be cancelled, before maturity, because of a change in the underlying, a change in perceived risk on the underlying or a change in market view. Derivatives included in these hedges may be reassigned to new hedges where they meet the effectiveness test and the new hedge is well documented. To gauge the efficiency of transactions defined as accounting hedges, we analyze the extent to which the changes in the fair value or in the cash flows attributable to the hedged item would offset the changes in fair value or cash flows attributable to the hedged risk using a linear regression model.

Risk management guidelines are issued by the Corporate Finance Department. This department may allow exceptions to this policy where these can be justified, normally when the market is too thin for the volume of transactions required or on clearly limited and small risks.

In 2009 the Company recognized a loss of 17 million euros for the ineffective part of cash flow hedges.

The breakdown of the Company s derivatives with counterparties not belonging to the Telefónica Group at December 31, 2009 and December 31, 2008 by type of hedge, their fair value at year-end and the expected maturity schedule is as follows:

		(Millions of euros)				
	Fair value at December 31	**Notional amount MATURITIES (*)**				
2009 Derivatives	**(**)**	**2010**	**2011**	**2012**	**Subsequent years**	**Derivatives**
Interest rate hedges	**(282)**	**3,023**	**(7)**	**4**	**(2,535)**	**485**
Cash flow hedges	145	1,769	1,239	500	3,024	**6,532**
Fair value hedges	(427)	1,254	(1,246)	(496)	(5,559)	**(6,047)**
Foreign currency hedges	**1,052**	**2,511**	**788**	**112**	**4,900**	**8,311**
Cash flow hedges	1,052	2,511	788	112	4,900	**8,311**
Fair value hedges						
Interest and exchange rate hedges	**37**	**224**		**89**	**95**	**408**
Cash flow hedges	37	224		89	95	**408**
Fair value hedges						
Hedge of net investment	**(300)**	**(1,977)**	**(907)**		**(818)**	**(3,702)**
Derivatives not designated as hedges	**(589)**	**4,943**	**287**	**275**	**(794)**	**4,711**
Interest rate	(298)	4,946	413	483	(1,770)	**4,072**
Foreign currency	(248)	157	(63)	(141)	976	**929**
Interest and exchange rate	(43)	(160)	(63)	(67)		**(290)**

Table of Contents

		(Millions of euros)				
		Notional amount MATURITIES (*)				
2008 Derivatives	**Fair value at December 31 (**)**	**2009**	**2010**	**2011**	**Subsequent years**	**TOTAL**
Interest rate hedges	**(611)**	**2,031**	**1,748**	**503**	**72**	**4,354**
Cash flow hedges	182	2,028	494	1,749	3,505	**7,776**
Fair value hedges	(793)	3	1,254	(1,246)	(3,433)	**(3,422)**
Foreign currency hedges	**543**	**891**	**2,380**	**788**	**3,689**	**7,748**
Cash flow hedges	543	891	2,380	788	3,689	**7,748**
Fair value hedges						
Interest and exchange rate hedges	**(17)**		**224**		**258**	**482**
Cash flow hedges	(17)		224		258	**482**
Fair value hedges						
Hedge of net investment	**(531)**	**(2,830)**	**(517)**	**(1,124)**	**(751)**	**(5,222)**
Derivatives not designated as hedges	**(853)**	**7,274**	**(614)**	**(1,182)**	**(164)**	**5,314**
Interest rate	(270)	8,569	(303)	(1,105)	(1,100)	**6,061**
Foreign currency	(381)	(875)	(145)	(12)	1,026	**(6)**
Interest and exchange rate	(202)	(420)	(166)	(65)	(90)	**(741)**

(*) For interest rate hedges, the positive amount is in terms of fixed payment. For foreign currency hedges, a positive amount means payment in functional vs. foreign currency.

(**) Positive amounts indicate payables.

(17) INCOME TAX

Pursuant to a Ministerial Order dated December 27, 1989, since 1990 Telefónica, S.A. has filed consolidated tax returns with certain Group companies. The consolidated Tax Group in 2009 comprised 40 companies. Included during the year were Telefónica Remesas, S.A. and Telefónica Internacional Wholesale Services II, S.L. In both cases, the companies were newly incorporated. Meanwhile, Telefónica Cable Menorca, S.A.U. merged with Telefónica Cable, S.A.U. and therefore was removed from the Tax Group.
Tax balances are as follows:

(Millions of euros)	**2009**	**2008**
Tax receivables:	**1,230**	**1,843**
Deferred tax assets:	***1,097***	***1,805***
Deferred income tax (income)	44	41
Other temporary differences, assets	410	567
Long-term tax loss carryforwards	443	356
Deductions and other	200	841
Current tax receivables (Note 10):	***133***	***38***
Withholdings	49	23
Corporate income tax payable	9	
VAT and Canary Islands general indirect tax refundable	75	15
Tax payable:	**186**	**581**
Deferred tax liabilities:	***37***	***559***
Deferred income tax (expense)	11	551
Other temporary differences, liabilities	26	8
Non-current payables to public administrations:	59	
Deferral of corporate income in tax in accordance with the 28th transitional provision of the income tax law	59	
Current payables to public administrations (Note 12):	***90***	***22***
Personal income tax withholdings	4	3
Corporate income tax payable	12	
Withholding on investment income, VAT and other	73	18
Social security	1	1

The Tax Group had tax loss carryforwards at December 31, 2009 amounting to 3,612 million euros. These losses must be applied within 15 years.

The balance at December 31, 2009 includes unused tax credits amounting to 443 million euros corresponding to unused tax losses of 1,475 million euros.

Unused tax loss carryforwards relate mainly to a negative adjustment made to the taxable base for corporate income tax at Telefónica Móviles, S.A. (now Telefónica, S.A.) in 2002, amounting to 2,137 million euros and resulting from the transfer of certain holdings acquired in previous years where the market value differed from the book value at which they were recognized.

The challenging of this adjustment, which was related to the tax inspection of financial years 2001 to 2004, completed in 2008, has not had an impact on the Company s financial statements. However, the use by the Group of the tax loss carryfoward is subject to a successful appeal before the Courts against the assessments arising from this inspection.

As head of the Telefónica Tax Group, in 2009 Telefónica, S.A. made payments on account of 2009 income tax amounting to 1,297 million euros.

17.1 Deferred tax assets and liabilities

The balances and movements in Deferred tax assets and Deferred tax liabilities for Telefónica, S.A. at December 31, 2009 and 2008 are as follows:

2009 *(Millions of euros)*	**Tax credits**	**Temporary differences, assets**	**Deductions**	**Total deferred tax assets**	**Deferred tax liabilities**
Balance at January 1	**356**	**608**	**841**	**1,805**	**559**
Arising in the year	2	137	33	172	
Reversal		(270)		(270)	(445)
Transfers to the Tax Group s net position	85	(21)	(674)	(610)	(77)
Other movements					
Balance at December 31	**443**	**454**	**200**	**1,097**	**37**

2008 *(Millions of euros)*	**Tax credits**	**Temporary differences, assets**	**Deductions**	**Total deferred tax assets**	**Deferred tax liabilities**
Balance at January 1	**380**	**629**	**1,390**	**2,399**	**1,646**
Arising in the year	971	1,863	47	2,881	139
Reversal	(33)	(608)		(641)	
Transfers to the Tax Group s net position	(962)		(568)	(1,530)	
Other movements		(1,276)	(28)	(1,304)	(1,226)
Balance at December 31	**356**	**608**	**841**	**1,805**	**559**

The main items for which Telefónica, S.A. recognizes temporary differences are the tax effects of impairment losses on some of its assets, principally investments in subsidiaries (see Note 8).

In accordance with article 12.3 of the revised Spanish Income Tax Law (TRLIS), as well as with transitional provision 29 of that law, taxable income declared in 2008 was reduced by 829 million euros in connection with the decline in value of investees.

Table of Contents

The reduction in goodwill of these companies, mainly O2 UK, O2 Germany, Telefónica Móviles México and Telefónica Móviles Argentina, up to December 31, 2008 amounted to 5,737 million euros.
In addition, at the 2009 year end, an increase of 586 million euros was provisionally incorporated in the Company s taxable income in connection with impairment of investees for tax purposes.
At December 31, 2009 2,181 million euros is pending inclusion for reversal of the adjustment in future periods.
In 2009 the variation in goodwill of investees amounts to 3,881 million euros and mainly relates to O2 UK, O2 Germany and Telefónica Móviles México.
17.2 Reconciliation of accounting profit to taxable income and income tax expense to income tax payable
The calculation of the income tax expense and income tax payable for 2009 is as follows:

(Millions of euros)	2009	**2008**
Accounting profit before tax	5,606	778
Permanent differences	(6,138)	(7,096)
Permanent differences arising from the first-time application of PGC 2007	205	82
Temporary differences:	(686)	3,086
Arising in the year	(1,052)	3,577
Arising in prior years	366	(491)
Tax result	**(1,013)**	**(3,150)**
Gross tax payable	(304)	(945)
Tax credits capitalized	(33)	(25)
Corporate income tax refundable	**(337)**	**(970)**
Temporary differences for tax valuation	206	(926)
Tax effect of first-time application of PGC 2007	(61)	(24)
Other effects	(445)	(12)
Corporate income tax accrued in Spain	**(637)**	**(1,932)**
Foreign taxes	(9)	10
Corporate income tax	**(646)**	**(1,922)**
Current income tax	(365)	(945)
Deferred income tax	(281)	(977)

The permanent differences relate mainly to changes in investment write-down provisions recorded by the Tax Group companies included in the consolidated corporate income tax return, to dividends received from Tax Group companies or foreign companies that meet certain requirements, and to the write-down provisions related to dividends paid by subsidiaries up to the amount of the dividend recorded as non-deductible income at Telefónica, S.A. and to non-deductible provisions.
In addition, they include as a permanent difference the decrease in income tax expense derived from the tax amortization of financial goodwill for foreign shareholding acquisitions made before December 21, 2007. This income of 584 million euros was recognized in 2009 after the European Commission released its decision regarding the legal action against the Kingdom of Spain in this respect (see Note 2 b).

Table of Contents

Within the scope of Law 4/2008 dated December 23, with respect to corporate income tax Telefónica, S.A. has elected to apply the provisions of the 29th transitional provisions of this law. In this respect, under the terms of this provision the Company has included two-thirds of the net tax impact of accounting adjustments arising from the first-time application of the new accounting principles. At December 31, 2009 a total of 205 million euros were pending inclusion in taxable income.

In 2009 and 2008, the Company capitalized 33 million euros and 25 million euros, respectively, of tax credits, mainly for donations to non-profit organizations and for double taxation relief. The cumulative amount at year end principally reflects deductions for export activities (approximately 200 million euros). In 2009, 673 million euros were applied in relation to deductions, and 150 million euros to double taxation for export activities.

In accordance with article 42 of the Spanish Income Tax Law RDL/2004 and having met the reinvestment requirement on February 6, 2006, in 2006 Telefónica, S.A. applied deductions for reinvestment of gains amounting to 1,809 million euros. This deduction mainly arose in connection with the sale of Telefónica Publicidad e Información, S.A. In 2007 and 2008 the Company also applied similar deductions of 18 million euros and 12 million euros, respectively, after meeting the reinvestment requirement on October 24, 2007.

17.3 On July 4, 2008, the tax inspection of Tax Group 24/90, of which Telefónica, S.A. is the parent company, was concluded. The taxes subject to review were corporate income tax for the years 2001 to 2004, VAT, tax withholdings and payments on account in respect of personal income tax, tax on investment income, property tax and non-resident income tax for the years 2002 to 2004.

In addition to the above, the Company has proposed additional adjustments to the tax amounts considered by Telefónica Móviles in 2002 (of 2,137 million euros) of approximately 346 million euros in the tax payable. In November 2009, Telefónica filed an appeal before the National Court of Justice to dispute the assessment derived from the tax audits, as the Company considered the tax returns to have been prepared in accordance with applicable tax legislation. Therefore, no liability for this issue was reflected in the financial statements.

No material liabilities arose as a result of the inspection of the other items and financial years, and the Company has not and will not file any appeal.

Telefónica, S.A. is open to inspection of all taxes since 2005. The Company does not expect that any additional material liabilities will arise from the years open to inspection.

Meanwhile, the Courts have yet to rule on the appeal filed in relation to the assessments arising from the inspection of corporate income tax for the years 1998 to 2000. These assessments, which were signed in disagreement in October 2004 and July 2005, gave rise to settlement agreements and imposed fines on Telefónica, S.A. The total amount appealed is 140 million euros, with no liability shown in the balance sheet.

In 2007, Telefónica, S.A. filed an administrative appeal before the National Court of Justice, requesting that the execution of the settlements and penalties appealed be suspended by providing the appropriate guarantees. Upon conclusion of the trial period, Telefónica presented in writing its conclusions on September 1, 2008.

Table of Contents

On February 22, 2010, Telefónica received the notification of the ruling by the National courts dated February 4, 2010, in which it partially expected the Company s allegations.

Telefónica is assessing the impacts, both positive and negative, of this ruling, and as it may appeal for an overturn in the Supreme Court, it does not expect this to give rise additional material liabilities.

In relation to the sale by Terra Networks, S.A. (now Telefónica, S.A.) of its stake in Lycos, Inc. in 2004, the Company began procedures to recognize a higher tax loss of up to 7,418 million euros because of measuring at acquisition value for tax purposes the market value of Lycos, Inc. shares received, rather than the book value at which they were recorded, in conformity with Article 159 of the Spanish Corporation Law. However, no accounting adjustments have been recorded until the Company receives a definitive ruling on this procedure.

(18) REVENUE AND EXPENSES

18.1 Revenue from operations

a) Rendering of services

In 2008, Telefónica, S.A. arranged contracts for the right to use the Telefónica brand with Group companies which use the license. The amount each subsidiary must recognize as a cost for use of the license is stipulated in the contract as a percentage of income obtained by the licensor. In 2009 and 2008, Rendering of services to group companies and associates included 369 million and 274 million euros, respectively, for this item.

Telefónica, S.A. has signed contracts, with effect from January 1, 2008, to provide management support services to Telefónica de España, S.A.U., Telefónica Móviles España, S.A.U., Telefónica O2 Holding, Ltd. and Telefónica Internacional, S.A.U. Revenue received for this concept in 2009 and 2008 amounted to 13 million and 25 million euros, respectively, recognized under Services rendered to group companies and associates.

In November 1990, Telefónica, S.A. and Telefónica Argentina, S.A. entered into a management agreement which regulates the consultancy and advisory services provided by Telefónica and the price of such services. Revenue received for this concept in 2008 amounted to 5 million euros, recognized under Services rendered to group companies and associates . This contract expired in 2008. Therefore, no revenue was recognized in this connection in 2009.

Operating revenues also include property rental income amounting to 40 million euros in 2009 and 41 million euros in 2008, mainly from the lease of office space in District C to several Telefónica Group companies (see Note 7).

Table of Contents

b) Dividends from group companies and associates

In compliance with the provisions of consultation No. 2 of BOICAC 79 on the accounting classification in individual financial statements of the revenue and expenses of a holding company and the determination of revenue, in 2009 Telefónica, S.A. classified under Revenue from operations the income from dividends of group companies and associates (see Note 2 b).

The detail of the main amounts received in 2009 and 2008 is as follows:

(Millions of euros)	**2009**	**2008**
Telefónica Móviles España, S.A.U.	2,602	2,486
Telefónica de España, S.A.U.	1,193	4,002
Telefónica O2 Europe, plc.	1,352	
Telefónica O2 Czech Republic, a.s.	340	267
Latin American Cellular Holding, B.V.	168	314
Other companies	108	66
Total	**5,763**	**7,135**

The amount of other companies includes dividends received in 2009 and 2008 from Telefónica, S.A. s shareholding in Portugal Telecom, S.G.P.S., amounting to 44 million and 46 million euros, respectively.

c) Interest income on loans to group companies and associates

In compliance with the provisions of consultation No. 2 of BOICAC 79 on the accounting classification in individual financial statements of the revenue and expenses of a holding company and the determination of revenue, in 2009 Telefónica, S.A. classified under Revenue from operations the interest income on loans to group companies and associates (see Note 2 b).

This heading includes the return obtained on loans made to subsidiaries to carry out their business (see Note 8.5). The breakdown of the main amounts is as follows:

(Millions of euros)	**2009**	**2008**
Telefónica Móviles México, S.A. de C.V.	215	259
Telefónica de España, S.A.U.	187	250
Telefónica Móviles España, S.A.U.	214	222
Other companies	46	138
Total	**662**	**869**

18.2 Non-core and other current operating revenues Group companies relates to revenues on centralized services that Telefónica, S.A., as head of the Group, provides to its subsidiaries. Telefónica, S.A. bears the full cost of these services and then charges each individual subsidiary for the applicable portion. The amount includes billings to Telefónica Móviles España, S.A.U., which amounted to 35 million euros and 41 million euros in 2009 and 2008, respectively, and to Telefónica de España, S.A.U., for 30 million and 28 million euros, respectively.

Table of Contents

18.3 Personnel expenses and employee benefits

The breakdown of Personnel expenses is as follows:

(Millions of euros)	2009	2008
Wages and salaries	129	144
Pension plans (Note 4.h)	11	6
Social security costs, and others	29	17
Total	**169**	**167**

Telefónica has reached an agreement with its staff to provide an Occupational Pension Plan pursuant to Legislative Royal Decree 1/2002, of November 29, approving the revised Pension Plans and Funds Law. The features of this Plan are as follows:

Defined contribution of 4.51% of the participating employees base salary. The defined contributions of employees transferred to Telefónica from other Group companies with different defined contributions (e.g. 6.87% in the case of Telefónica de España, S.A.U.) will be maintained.

Mandatory contribution by participants of a minimum of 2.2% of their base salary.

Individual and financial capitalization systems.

This fund was outsourced to Telefónica subsidiary, Fonditel Entidad Gestora de Fondos de Pensiones, S.A., which has added the pension fund assets to its Fonditel B fund.

At December 31, 2009, 1,535 employees had signed up for the plan (1,496 employees in 2008). This figure includes both employees contributing and those who have ceased to contribute to the plan, as provided for in Royal Decree 304/2004 approving the regulations for Pension Plans and Funds. The cost for the Company amounted to 2.73 million euros in 2009 and 2.75 million euros in 2008.

In 2006, a Pension Plan for Senior Executives, wholly funded by the Company, was created and complements the previous plan and involves additional defined contributions at a certain percentage of the executive s fixed remuneration, based on professional category, plus some extraordinary contributions depending on the circumstances of each executive, payable in accordance with the terms of the Plan.

Telefónica, S.A. has recorded costs related to the contributions to this executive plan of 7.7 million euros in 2009 (6 million euros in 2008).

In 2009, some executives left this Plan, leading to the reversal of part of the initial extraordinary contributions amounting to 0.5 million euros. Similarly, in 2008, some executives left this Pension Plan for Senior Executives, leading to the reversal of 3 million euros.

No provision was made for this plan as it has been fully externalized.

Table of Contents

The main share-based payment plan is the following:

Telefónica, S.A. share plan: Performance Share Plan (PSP)

At the General Shareholders Meeting of Telefónica, S.A. on June 21, 2006, its shareholders approved the introduction of a long-term incentive plan for managers and senior executives of Telefónica, S.A. and other Telefónica Group companies. Under this plan, selected participants who met the qualifying requirements were given a certain number of Telefónica, S.A. shares as a form of variable compensation.

The Plan was initially intended to last seven years. It is divided into five phases, each three years long, beginning on July 1 (the Start Date) and ending on June 30 three years later (the End Date). At the start of each phase the number of shares to be awarded to Plan beneficiaries is determined based on their success in meeting targets set. The shares are delivered, assuming targets are met, at the End Date of each phase. Each phase is independent from the others. The first started on July 1, 2006 (with shares delivered on July 1, 2009) and the fifth phase begins on July 1, 2010 (with any shares to be delivered from July 1, 2013).

Award of the shares is subject to a number of conditions:

- The beneficiary must continue to work for the company throughout the three years of the phase, subject to certain special conditions related to departures.
- The actual number of shares awarded at the end of each phase will depend on success in meeting targets and the maximum number of shares assigned to each executive. Success is measured by comparing the total shareholder return (TSR), which includes both share price and dividends offered by Telefónica shares, with the TSRs offered by a basket of listed telecoms companies that comprise the comparison group. Each employee who is a member of the plan is assigned at the start of each phase a maximum number of shares. The actual number of shares awarded at the end of the phase is calculated by multiplying this maximum number by a percentage reflecting their success at the date in question. This will be 100% if the TSR of Telefónica is equal to or better than that of the third quartile of the Comparison Group and 30% if Telefónica s TSR is in line with the average. The percentage rises linearly for all points between these two benchmarks. If the TSR is below average no shares are awarded.

June 30, 2009 marked the end of the first phase of this Plan, which entailed the following maximum number of shares allocated:

	Number of shares	Unit value	End date
1st phase July 1, 2006	6,530,615	6.43	June 30, 2009

Of this amount, the maximum number of shares corresponding to Telefónica, S.A. managers and executives is as follows:

	Number of shares	Unit value	End date
1st phase July 1, 2006	1,276,751	6.43	June 30, 2009

Table of Contents

With the maturity of the Plan, in July 2009 a total of 3,309,968 shares (corresponding to a total of 4,533,393 gross shares less a withholding of 1,224,610 shares prior to delivery) were delivered to Telefónica Group directors included in the first phase. The shares delivered were deducted from the Company s treasury shares in 2009 (see Note 11 1 a). The total net shares delivered to Telefónica, S.A. managers and executives were 1,240,834.

All the shares included in the first phase of the Plan were hedged with a financial instrument acquired in 2006. The cost of this instrument was 46 million euros, which in unit terms is 6.43 euros per share. At June 30, 2009, the bank with which the financial instrument was entered into delivered to Telefónica, S.A. the own shares contracted. These were accounted for as treasury shares.

The cost of the gross amount of shares delivered to the directors of each subsidiary was subsequently billed by Telefónica, S.A., as previously established, with a unit value of 6.43 euros per share. The tax obligations of the directors in each of their countries related to the increase in their personal income from the receipt of the incentive were met by each subsidiary and subsequently charged to Telefónica, S.A., which recognized the cost under Reserves for an amount of 21 million euros in 2009.

The maximum number of the shares issuable in each of the three outstanding phases at December 31, 2009 is as follows:

	Number of shares	Unit value	End date
2nd phase July 1, 2007	5,556,234	7.70	June 30, 2010
3rd phase July 1, 2008	5,286,980	8.39	June 30, 2011
4th phase July 1, 2009	6,356,597	8.41	June 30, 2012

Of the total number of shares, those corresponding to Telefónica, S.A. employees, by phase, are as follows:

	Number of shares	Unit value	End date
2nd phase July 1, 2007	1,102,711	7.70	June 30, 2010
3rd phase July 1, 2008	1,248,067	8.39	June 30, 2011
4th phase July 1, 2009	1,555,382	8.41	June 30, 2012

This plan is equity-settled via the delivery of shares to the executives, with a balancing entry for the 10 million euros of employee benefits expense recorded in 2009 (11 million euros in 2008) in equity, net of the related tax effect.

The cost of the shares granted to employees of Group subsidiaries is recognized under Reserves and amounted to 52 million euros in 2009 (52 million euros in 2008). As Telefónica, S.A. will reinvoice these amounts to its subsidiaries at the maturity of the phases, the related receivable is recognized under Other non-current financial assets (phases III and IV) and Other current financial assets (phase II) (see Note 8.6).

Table of Contents

For the sole purpose of ensuring the shares necessary at the end of the phase begun in 2008 (the third phase of the Plan), Telefónica, S.A. purchased an instrument from a financial institution that will deliver to Telefónica, at the end of the phase, a total of 2,500,000 shares, part of the shares necessary to settle the phase. This instrument is indexed to the success of the plan; i.e. the instrument has the features as the plan. The cost of the financial instrument was 25 million euros, equivalent to 9.96 euros per option (see Note 9.4.1).

For the fourth phase of the Plan, Telefónica, S.A. has acquired an instrument from a financial institution with the same features of the Plan, whereby at the end of the phase, Telefónica will obtain part of the shares necessary to settle the phase (4,000,000 shares). The cost of the financial instrument was 34 million euros, equivalent to 8.41 euros per option (see Note 9.4.1).

18.4 Average number of employees in 2009 and 2008 and number of employees at year-end:

2009	**Employees at 12/31/09**			**Average no. of employees in 2009**		
Professional category	**Women**	**Men**	**Total**	**Women**	**Men**	**Total**
General managers and chairmen		5	5		5	5
Directors	40	134	174	40	130	170
Managers	75	100	175	77	91	168
Project Managers	91	72	163	88	68	156
University graduates and experts	80	56	136	78	53	131
Administration, clerks, advisors	136	19	155	130	19	149
Total	**422**	**386**	**808**	**413**	**366**	**779**

2008	**Employees at 12/31/08**			**Average no. of employees in 2008**		
Professional category	**Women**	**Men**	**Total**	**Women**	**Men**	**Total**
General managers and chairmen		5	5		5	5
Directors	39	140	179	42	141	183
Managers	76	89	165	77	90	167
Project Managers	85	67	152	88	66	154
University graduates and experts	79	50	129	80	51	131
Administration, clerks, advisors	125	6	131	133	14	147
Total	**404**	**357**	**761**	**420**	**367**	**787**

18.5 External services

The items composing this heading are as follows:

(Millions of euros)	**2009**	**2008**
Rent	13	11
Repairs and maintenance	4	5
Independent professional services	107	96
Bank charges	45	49
Marketing and advertising	128	144
Utilities	14	11
Other expenses	53	52
Total	**364**	**368**

On December 19, 2007, Telefónica, S.A. signed a rental contract with a view to establishing the headquarters of the Telefónica Corporate University. The contract included construction and refurbishment of certain facilities by the lessor.

Table of Contents

On October 31, 2008, some of the facilities were partially accepted and thus the lease period commenced. The lease period is for 15 years (until 2023), renewable for another five. In addition to rent, the lessor charges the lessee community expenses. Future minimum rentals payable under non-cancellable leases at December 31, 2009 and 2008 are as follows:

	2009		2008	
(Millions of euros)	**Future minimum payments**	**Present value**	**Future minimum payments**	**Present value**
Up to one year	5	5	5	5
Between one and five years	20	17	20	17
More than five years	46	27	51	29
Total	**71**	**49**	**76**	**51**

18.6 Finance revenue

The items composing Finance revenue are as follows:

(Millions of euros)	**2009**	**2008**
Dividends from other companies	16	41
Interest received from loans to group companies		22
Other finance revenue	88	160
Total	**104**	**223**

Other finance revenue mainly includes interest income of 59 million euros (157 million euros in 2008).

18.7 Finance costs

The breakdown of Finance costs is as follows:

(Millions of euros)	**2009**	**2008**
Interest on borrowings from group companies and associates	1,717	2,652
Finance costs payable to third parties net of gains (losses) on interest rates of financial hedges	170	339
Other finance costs	1	36
Total	**1,888**	**3,027**

The breakdown by Group company of debt interest expenses is as follows:

(Millions of euros)	**2009**	**2008**
Telefónica Europe, B.V.	518	747
Telefónica Finanzas, S.A.	140	777
Telefónica Emisiones, S.A.U.	981	836
Other companies	78	292
Total	**1,717**	**2,652**

Finance costs with Telefónica Finanzas, S.A.U. related to current payables for specific cash needs. In 2009, there were not as many withdrawals of funds in this way, as a result of which the financial charge passed on from this subsidiary to Telefónica, S.A. decreased.

18.8 Exchange differences

The breakdown of exchange losses recognized in the income statement is as follows:

(Millions of euros)	**2009**	**2008**
On current operations	100	4
On loans and borrowings	439	1,521
On hedging derivatives	1,528	1,964
On other items	38	87
Total	**2,105**	**3,576**

The breakdown of exchange gains recognized in the income statement is as follows:

(Millions of euros)	**2009**	**2008**
On current operations	3	334
On loans and borrowings	511	650
On hedging derivatives	1,458	2,470
On other items	58	65
Total	**2,030**	**3,519**

The change in exchange gains and losses in 2009 was due mainly to fluctuations in the dollar/euro exchange rate, with the dollar falling 3.4% in the year (5.78% appreciation in 2008), and in the pound sterling/euro exchange, following a 7.25% appreciation by the pound in 2009 (23% depreciation in 2008), which was offset by the effect of hedges arranged for this purpose.

18.9 Impairment and gains (losses) on disposal of financial instruments

2009

In 2009, the values of the investments in group companies and associates were reviewed based on the calculations of their discounted cash flows. These reviews lead to a reversal of impairment losses amounting to 1,087 million euros. The main reversal relates to the pound s appreciation, leading to a reversal of the adjustment to the investment in Telefónica Europe, plc of 941 million euros.

In addition, in 2009 the entire impairment loss on Portugal Telecom, S.G.P.S., for 178 million euros, was reversed following the rebound in the share price on the Lisbon stock exchange.

Table of Contents

2008

At the end of 2008, Telefónica, S.A. tested its investments in group companies and associates for impairment (see Note 8.2). As a result, it recognized impairment losses of 3,769 million euros for the stake in Telefónica Europe, plc and 233 million euros for the stake in Telco, S.p.A.

In addition, an impairment loss of 178 million euros on the stake in Portugal Telecom was recognized in the income statement.

The impairment loss on the stake in Telefónica Europe, plc shown is after the impact of hedges of the net investment.

18.10 Change in fair value of financial instruments

As a result of the steady decline or over 40% of the value of the cost of the investment, in June 2009, Telefónica, S.A. took a 34 million euro write-down on the value of its shareholding in Zon Multimedia Serviços de Telecomunicaçoes e Multimedia, S.G.P.S., S.A. At December 31, 2009, it was not considered necessary to make any further write-downs in this respect.

Change in fair value of financial instruments held for trading and others includes the effect on profit and loss of trading derivatives and the inefficiency of cash flow hedges amounting to 23 million euros.

In 2008, this item included the result of the sale of the stake in Sogecable, S.A. (see Note 9.3).

(19) OTHER INFORMATION

a) Financial guarantees

At December 31, 2009, Telefónica, S.A. had provided financial guarantees for its subsidiaries and investees to secure their transactions with third parties amounting to 37,141 million euros (31,256 million euros in 2008). These guarantees are measured in the Company s financial statements as indicated in Note 4 m).

The main Group companies receiving these financial guarantees are:

- Telefónica Emisiones, S.A.U., in relation to guarantees given for issues of debentures and bonds in international markets, the outstanding carrying amount of which at December 31, 2009 was 24,533 million euros (16,827 million euros in 2008). In 2009, the Company issued debentures and bonds for a total amount of approximately 8,044 million euros (1,250 million euros in 2008).

Table of Contents

Telefónica Europe, B.V., in relation to guarantees given for debentures and bonds issues in international markets, the outstanding carrying amount of which at December 31, 2009 was 5,016 million euros (5,064 million euros in 2008), for the European commercial paper program, with an outstanding balance of 551 million euros (840 million euros in 2008), the syndicated loan granted by various institutions for the O2, plc acquisition, with an outstanding carrying amount of 3,079 million euros (4,187 million euros in 2008), and other guaranteed bank borrowings for 114 million euros (120 million euros in 2008). Changes in the year were mainly due to fluctuations in exchange rates and transactions with commercial paper.

Telefónica Emisiones, S.A.U. and Telefónica Europe, B.V. are wholly owned subsidiaries of Telefónica, S.A., which underwrites all their issues.

Telefónica Finanzas México, S.A. de C.V., in relation to guarantees given for the peso bonds in circulation, the outstanding carrying amount of which at December 31, 2009 was 617 million euros (617 million euros in 2008).

Telefónica Finance USA, LCC, in relation to the guarantee provided for the issue of preferred shares in 2002, the outstanding carrying amount of which was 1,954 million euros at December 31, 2009 (1,939 million euros in 2008).

Telefónica Finanzas, S.A.U. in relation to financing from the European Investment Bank for investment projects in Spain, which at December 31, 2009 had an outstanding carrying amount of 1,206 million euros (1,297 million euros in 2008): (a) in the mobile telecommunications network; (b) in the design, acquisition, construction and start-up of telephony equipment; and (c) in the Telefónica Group s research and development activities. In 2009, financing for a nominal amount equivalent to approximately 26 million euros matured (440 million euros in 2008).

b) Litigation

Telefónica is party to several lawsuits or proceedings that are currently in progress in the law courts and administrative and arbitration bodies of the various countries in which the Telefónica Group is present.

Considering the reports of the Company s legal advisors regarding these proceedings, it is reasonable to assume that this litigation or cases will not materially affect the financial position or solvency of Telefónica Group, regardless of the outcome.

Among unresolved cases or those underway in 2009, we would highlight the following:

1. Contentious proceedings in connection with the merger between Terra Networks, S.A. and Telefónica

On September 26, 2006, Telefónica was notified of the claim filed by former shareholders of Terra Networks, S.A. (Campoaguas, S.L., Panabeni, S.L. and others) alleging breach of contract in respect of the terms and conditions set forth in the Prospectus of the Initial Public Offering of shares of Terra Networks, S.A. dated October 29, 1999. This claim was rejected via ruling issued on September 21, 2009, and the appellants charged for the court costs. This ruling was appealed on December 4, 2009.

2. *Claim before the Center for Settlement of Investment Disputes (ICSID) against the Argentine government*

   As a result of the enactment by the Argentine Government of Public Emergency and Exchange Rules Reform Law 25561, of January 6, 2002, Telefónica considered that the terms and conditions of the Share Transfer Agreement approved by Decree 2332/90 and the Pricing Agreement ratified by Decree 2585/91, both of which were executed by the Company with the Argentine government, had been affected appreciably, since the Law rendered ineffective any dollar or other foreign currency adjustment clauses, or indexation clauses based on price indexes of other countries, or any other indexation mechanism in contracts with the public authorities. The law also required that prices and rates derived from such clauses be denominated in pesos at an exchange rate of one Argentine peso to one US dollar.

   Accordingly, since negotiations with the Argentine Government were unsuccessful, on May 14, 2003, Telefónica filed a request for arbitration with the International Center for Settlement of Investment Disputes (ICSID) pursuant to the Agreement for the Promotion and Reciprocal Protection of Investments between the Argentine Republic and the Kingdom of Spain. On December 6, 2004, Telefónica filed the Memorial or claim with the ICSID, as well as the initial testimonies supporting the claim.

   On February 15, 2006, Telefónica de Argentina, S.A. signed a memorandum of understanding with the Argentine government as a prerequisite to reaching an agreement to renegotiate the transfer contract pursuant to the provisions of Article 9 of Law 25561. Among other issues, the memorandum of understanding envisaged the suspension for a certain period of all claims, appeals and demands planned or underway, based on events or measures taken as a result of emergency situation established by Law No. 25561 with regard to the Transfer Agreement and the license granted to Telefónica de Argentina, S.A.

   On August 21, 2009, after successive extensions of the period of suspension included in the memorandum of understanding, Telefónica and the Argentine government agreed to consider this arbitration proceeding concluded. As a result, both parties requested the ICSID Court to file the proceeding, which the court agreed to on September 24, 2009.
3. *Appeal against the European Commission ruling of July 4, 2007 against Telefónica de España s broadband pricing policy.*

   On July 9, 2007, Telefónica was notified of the decision issued by the European Commission imposing a fine of approximately 152 million euros for breach of April 82 of EC Treaty rules by charging unfair prices between whole and retail broadband access services. The ruling charged Telefónica with applying a margin squeeze between the prices it charged competitors to provide regional and national wholesale broadband services and its retail broadband prices using ADSL technology between September 2001 and December 2006.

Table of Contents

On September 10, 2007, Telefónica and Telefónica de España filed an appeal to overturn the decision before the Court of First Instance of the European Communities. The Kingdom of Spain, as an interested party, also lodged an appeal to overturn the decision. Meanwhile, France Telecom and the Spanish Association of Bank Users (AUSBANC) filed requests to intervene, to which Telefónica has submitted its comments.

4. *Appeal for judicial review against the ruling of the Central Economic-Administrative Tribunal* dated February 15, 2007 rejecting several economic-administrative claims filed by Telefónica against assessments from the National Inspection Office of the Spanish Treasury related to consolidated taxes in 1998, 1999 and 2000. See Note 17.3.

c) Commitments

Agreements with Portugal Telecom (Brazil)

In accordance with the agreements signed between the Telefónica Group and the Portugal Telecom Group governing their 50/50 joint venture, Brasilcel N.V., which groups together their cellular businesses in Brazil, the Portugal Telecom Group is entitled to sell to Telefónica, S.A., which is obliged to buy, its holding in Brasilcel, N.V. should there be a change in control at Telefónica or at any of its subsidiaries that hold a direct or indirect ownership interest in Brasilcel, N.V.

Similarly, Telefónica is entitled to sell to the Portugal Telecom Group, which be obliged to buy, its holding in Brasilcel, N.V. if there is a change of control at Portugal Telecom, S.G.P.S., S.A., at PT Móveis, S.G.P.S., S.A. or at any of their subsidiaries that hold a direct or indirect ownership interest in Brasilcel N.V.

The price in both cases will be determined on the basis of an independent appraisal (under the terms provided for in the definitive agreements) performed by investment banks, selected using the procedure established in these agreements. The related payment could be made, at the choice of the group exercising the put option, in cash or in shares of the wireless telephony operators contributed by the related party, making up the difference, if any, in cash.

Guarantee provided for Ipse 2000 S.p.A.

At December 31, 2009, the Telefónica Group had provided guarantees for the Italian company Ipse 2000 S.p.A. (holder of a UMTS license in Italy and in which the Company has a stake through Solivella B.V.) to ensure the amounts payable to the Italian government in connection with the grant of the license. The only payment pending at December 31, 2009, was the last of the 10 monthly payments scheduled.

In this respect, Telefónica (together with the other strategic partners of Ipse 2000, S.p.A) arranged a counterguarantee (cash collateral) for a bank which, in turn, issued a bank guarantee for the Italian authorities as security for the deferred payment of the UMTS license.

At December 31, 2009, the amount corresponding to the Telefónica, S.A. in this cash collateral was 86 million euros.

Table of Contents

Agreements with PRISA-SOGECABLE

On November 25, 2009, Telefónica signed an agreement with Promotora de Informaciones, S.A. (Prisa) and Sogecable, S.A.U. (Sogecable) for the acquisition of a 21% stake in DTS Distribuidora de Televisión Digital, S.A. (DTS), the company that will include the pay-TV services of Prisa Group (Digital+), for a firm value of 2,350 million euros.

Additionally, on the same date, Telefónica signed a shareholder agreement with Prisa and Sogecable for DTS (Shareholder agreement), which will come into effect following completion of the transaction and will establish, among other things, that in the event of a change in control at Telefónica, Sogecable will have the right to acquire from Telefónica, which will be obliged to sell, its stake in DTS. Similarly, in the event of a change of control at Prisa, Telefónica will have the right to buy from Sogecable, which will be obliged to sell, its stake in DTS. In both cases, the acquisition would be carried out at the real value of the shares based on an independent valuation by investment banks in accordance with the procedure stipulated in the agreement (see Not 21).

d) Directors and senior executives compensation and other benefits

The compensation of Telefónica, S.A. s directors is governed by Article 28 of the Bylaws, which states that the compensation amount that the Company may pay to all of its Directors as remuneration and attendance fees shall be fixed by the shareholders at the General Shareholders Meeting, which amount shall remain unchanged until and unless the shareholders decide to modify it. The Board of Directors shall determine the exact amount to be paid within such limit and the distribution thereof among the Directors. In this respect, on April 11, 2003, shareholders set the maximum gross annual amount to be paid to the Board of Directors at 6 million euros. This includes a fixed payment and fees for attending meetings of the Board of Director s advisory or control committees. In addition, the compensation provided for in the preceding paragraphs, deriving from membership on the Board of Directors, shall be compatible with other professional or employment compensation accruing to the Directors by reason of any executive or advisory duties that they perform for the Company, other than the supervision and collective decision-making duties inherent in their capacity as Directors.

Therefore, the compensation paid to Telefónica directors in their capacity as members of the Board of Directors, the Standing Committee and/or the advisory and control committees consists of a fixed amount payable monthly plus fees for attending the meetings of the Board s advisory or control committees. In this respect, it was also agreed that executive directors would not receive the fixed amounts established for their directorships, but only receive the corresponding amounts for discharging their executive duties as stipulated in their respective contracts.

Table of Contents

The following table presents the fixed amounts established for membership to Telefónica Board of Directors, Standing Committee and Advisory or Control committees (in euros).

Position	Board of Directors	Standing Committee	Advisory or Control Committees
Chairman	300,000	100,000	28,000
Vice Chairman	250,000	100,000	
Board member:			
Executive			
Proprietary	150,000	100,000	14,000
Independent	150,000	100,000	14,000
Other external	150,000	100,000	14,000

In addition, the amounts paid for attendance to each of the Advisory or Control Committee meetings is 1,250 euros. Total compensation paid to Telefónica directors for discharging their duties in 2009 amounted to 4,081,333 euros in fixed compensation and 252,500 thousand euros in fees for attending the Board Advisory or Control Committee meetings. It should also be noted that the compensation paid to Company directors sitting on the Boards of other Telefónica Group companies amounted to 1,791,104 euros. In addition, the Company directors who are members of the regional advisory committees, including the Telefónica Corporate University Advisory Council, received a total of 553,750 euros in 2009.

Table of Contents

The following table presents the breakdown by item of the compensation and benefits paid to Telefónica directors for discharging their duties in 2009 (in euros):

Board Members	Board of Directors	Standing Committee	Other Board Committees Fixed payment	Other Board Committees Attendance fees	TOTAL
Chairman					
Mr. César Alierta Izuel	300,000	100,000			400,000
Vice chairmen					
Mr. Isidro Fainé Casas	250,000	100,000			350,000
Mr. Vitalino Manuel Nafría Aznar	250,000		56,000	22,500	328,500
Members					
Mr. Julio Linares López					
Mr. José María Abril Pérez	150,000	100,000	14,000	1,250	265,250
Mr. José Fernando de Almansa Moreno-Barreda	150,000		56,000	21,250	227,250
Mr. José María Álvarez-Pallete López					
Mr. David Arculus	150,000		28,000	11,250	189,250
Ms. Eva Castillo Sanz	150,000		14,000	10,000	174,000
Mr. Carlos Colomer Casellas	150,000	100,000	56,000	16,250	322,250
Mr. Peter Erskine	150,000	100,000	56,000	25,000	331,000
Mr. Alfonso Ferrari Herrero	150,000	100,000	84,000	38,750	372,750
Mr. Luiz Fernando Furlán	150,000		14,000	3,750	167,750
Mr. Gonzalo Hinojosa Fernández de Angulo	150,000	100,000	98,000	42,500	390,500
Mr. Pablo Isla Álvarez de Tejera	150,000		84,000	16,250	250,250
Mr. Antonio Massanell Lavilla	150,000		65,333	28,750	244,083
Mr. Francisco Javier de Paz Mancho	150,000	100,000	56,000	15,000	321,000
TOTAL	**2,600,000**	**800,000**	**681,333**	**252,500**	**4,333,833**

In addition, the breakdown (in euros) of the total paid to executive directors Mr. César Alierta Izuel, Mr. Julio Linares López and Mr. José María Álvarez-Pallete López for discharging their executive duties by item is as follows:

ITEM	2009
Salaries	5,947,604
Variable compensation	8,058,179
Compensation in kind [(1)]	100,051
Contributions to pension plans	25,444

1) Compensation in kind includes life and other insurance premiums (general medical and dental insurance).

In addition, with respect to the Pension Plan for Senior Executives (see Note 18.3), the total amount of contributions made by the Telefónica Group in 2009 in respect of executive directors was 1,925,387 euros.

In relation to the Performance Share Plan approved at the General Shareholders Meeting of June 21, 2006 (see Note 18.3), the maximum number of shares corresponding to the second, third and fourth phases of the Plan will be given (on July 1, 2010, July 1, 2011 and July 1, 2012) to each of Telefónica s executive directors if all the terms established for such delivery are met, is as follows: For Mr. César Alierta Izuel, 116,239, 148,818 and 173,716 shares, respectively; for Mr. Julio Linares López, 57,437, 101,466 and 130,287 shares, respectively, for Mr. José María Álvarez-Pallete López, 53,204, 67,644 and 78,962 shares, respectively. Similarly, with respect to the execution of the first phase of the Plan in July 2009, since the Total Shareholder Return (TSR) of Telefónica was higher in this phase than the TSRs of companies representing 75% of the market cap of the comparison group, the beneficiaries received, in accordance with the general terms and conditions of the Plan, all the shares assigned to them as follows: to Mr. César Alierta Izuel, 129,183 shares; to Mr. Julio Linares López, 65,472 shares; and to Mr. José María Álvarez-Pallete López, 62,354 shares.

It should be noted that the external directors do not receive and did not receive in 2009 any compensation in the form of pensions or life insurance, nor do they participate in the share-based payment plans linked to Telefónica s share price.

In addition, the Company does not grant and did not grant in 2009 any advances, loans or credits to the directors, or to its top executives, thus complying with the requirements of the Sarbanes-Oxley Act passed in the U.S., which is applicable to Telefónica as a listed company in that market.

Meanwhile, the six senior executives of the Company, excluding those that are also members of the Board of Directors, received a total for all items in 2009 of 10,533,853 euros. In addition, the contributions by the Telefónica Group in 2009 with respect to the Pension Plan described in Note 18.3 for these directors amounted to 922,728 euros.

Furthermore, the maximum number of shares corresponding to the second, third and fourth phases of the Performance Share Plan assigned to all the Company senior executives for each of the periods is 130,911 shares for the second phase, 306,115 shares for the third phase and 394,779 shares for the fourth phase. Similarly, as explained above, these directors received a total of 284,248 shares in the first phase of the Plan.

Table of Contents

Detail of the equity investments in companies engaging in an activity that is identical, similar or complementary to that of the Company and the performance of similar activities by the Directors on their own behalf or on behalf of third parties.

Pursuant to Article 127 ter. 4 of the Spanish Corporation Law, introduced by Law 26/2003 of July 17, which amends Securities Market Law 24/1988 of July 28, and the revised Spanish Corporation Law, in order to reinforce the transparency of listed corporations, details are given below of the companies engaging in an activity that is identical, similar or complementary to the corporate purpose of Telefónica, S.A., in which the members of the Board of Directors own equity interests, and of the functions, if any, that they discharge in them, on their own behalf or on behalf of others.

Table of Contents

Name	Activity	Company	Position or functions	Stake %[1]
Mr. César Alierta Izuel	Telecommunications	Telecom Italia, S.p.A.	Director	
	Telecommunications	China Unicom (Hong Kong) Limited	Director	
Mr. Isidro Fainé Casas	Telecommunications	Abertis Infraestructuras, S.A.	Vice Chairman	<0.01%
Mr. Julio Linares López	Telecommunications	Telefónica de España, S.A.U.	Director	
	Telecommunications	Telefónica Móviles España, S.A.U.	Director	
	Telecommunications	Telefónica Europe, Plc.	Director	
	Telecommunications	Telecom Italia, S.p.A.	Director	
Mr. José Fernando de Almansa Moreno-Barreda	Telecommunications	Telefónica Internacional, S.A.U.	Director	
	Telecommunications	Telefónica del Perú, S.A.A.	Director	
	Telecommunications	Telefónica de Argentina, S.A.	Director	
	Telecommunications	Telecomunicaçoes de Sao Paulo, S.A.	Director	
	Telecommunications	Telefónica Móviles México, S.A. de C.V.	Director	
Mr. José María Álvarez-Pallete López	Telecommunications	Telefónica DataCorp, S.A.U.	Director	
	Telecommunications	Telefónica de Argentina, S.A.	Acting Director	
	Telecommunications	Telecomunicaçoes de Sao Paulo, S.A.	Director/Vice Chairman	
	Telecommunications	Telefónica Chile, S.A.	Acting Director	
	Telecommunications	Telefónica Móviles México, S.A. de C.V.	Director/Vice Chairman	
	Telecommunications	Colombia Telecomunicaciones, S.A. ESP	Director	
	Telecommunications	Telefónica del Perú, S.A.A.	Director	
	Telecommunications	Brasilcel, N.V.	Chairman of Supervisory Board	
	Telecommunications	Telefónica Móviles Colombia, S.A.	Acting Director	
	Telecommunications	Telefónica Larga Distancia de Puerto Rico, Inc.	Director	
	Telecommunications	Telefónica Móviles Chile, S.A.	Acting Director	
	Telecommunications	Portugal Telecom, S.G.P.S., S.A.	Director	

1 Shareholding of less than 0.01% of share capital

Table of Contents

Name	Activity	Company	Position or functions	Stake %[1]
Mr. David Arculus	Telecommunications	Telefónica Europe, Plc.	Director	
	Telecommunications	British Sky Broadcasting Group, Plc.		<0.01%
	Telecommunications	BT Group, Plc.		<0.01%
Mr. Peter Erskine	Telecommunications	Telefónica Europe, Plc.	Director	
Mr. Alfonso Ferrari Herrero	Telecommunications	Telefónica Internacional, S.A.U.	Director	
	Telecommunications	Telefónica Chile, S.A.	Acting Director	
	Telecommunications	Telefónica de Perú, S.A.A.	Director	
	Telecommunications	Telefónica Móviles Chile, S.A.	Director	
Mr. Luiz Fernando Furlán	Telecommunications	Telecomunicaçoes de Sao Paulo, S.A.	Director	
	Telecommunications	Telefónica Internacional, S.A.U.	Director	
Mr. Francisco Javier de Paz Mancho	Telecommunications	Atento Inversiones y Teleservicios, S.A.U.	Non-Executive Chairman	
	Telecommunications	Telefónica Internacional, S.A.U.	Director	
	Telecommunications	Telefónica de Argentina, S.A.	Director	
	Telecommunications	Telecomunicaçoes de Sao Paulo, S.A.	Director	

1 Shareholding of less than 0.01% of share capital

Pursuant to Article 114.2 of the Spanish Corporation Law, also introduced by Law 26/2003 of July 17, it is stated that in the year to which these annual financial statements refer, the directors, or persons acting on their behalf, did not perform any transactions with Telefónica or any other company in the Telefónica Group other than in the normal course of the Company s business or that were not on an arm s length basis.

Table of Contents

e) Related-party transactions

The main transactions between Telefónica, S.A. and its significant shareholders are as follows:

Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and subsidiaries comprising the consolidated group:

Financing transactions arranged under market conditions, with approximately 237 million euros drawn down at December 31, 2009 (248 million euros at December 31, 2008).

Derivative transactions contracted under market conditions, for a total nominal amount of approximately 7,733 million euros at December 31, 2009 (6,770 million euros at December 31, 2008).

Time deposits on an arm s length basis for a total nominal amount of approximately 679 million euros at December 31, 2009 (213 million euros at December 31, 2008).

Guarantees granted by BBVA for approximately 0.2 million euros at December 31, 2009 (13 million euros at December 31, 2008).

Dividends and other benefits distributed to BBVA in 2009 for 287 million euros (279 million euros in 2008).

Caja de Ahorros y Pensiones de Barcelona, la Caixa, and subsidiaries comprising the consolidated group:

Financing transactions arranged under market conditions, with approximately 616 million euros drawn down at December 31, 2009 (646 million euros at December 31, 2008).

Derivative transactions arranged on an arm s length basis for a total nominal amount of approximately 800 million euros at December 31, 2009.

Time deposits on an arm s length basis for a total nominal amount of approximately 1,293 million euros at December 31, 2009 (368 million euros at December 31, 2008).

Dividends and other benefits distributed to La Caixa in 2009 for 260 million euros (237 million euros in 2008).

Group companies

Telefónica, S.A. is a holding company for various investments in companies in Latin America, Spain and the rest of Europe, which do business in the telecommunications, media and entertainment sectors.

The balances and transactions between the Company and these subsidiaries at December 31, 2009 and 2008 are detailed in the notes to these Individual Financial Statements.

Table of Contents

Directors and senior executives

In the financial year to which the accompanying annual financial statements refer, the directors and senior executives did not perform any transactions with Telefónica or any Telefónica Group company.

Compensation and other benefits paid to members of the Board of Directors and senior executives, as well as the detail of the equity interests held in companies engaging in an activity that is identical, similar or complementary to that of the Company and the performance of similar activities by the directors for their own account or for third parties, are detailed in this note to these financial statements.

f) Auditors fees

The fees paid in 2009 and 2008 to the various member firms of the Ernst & Young international organization, to which Ernst & Young, S.L. (the auditors of Telefónica, S.A. in 2009 and 2008) belongs, amounted to 3.32 million and 3.36 million euros, respectively, broken down as follows:

(Millions of euros)	2009	2008
Audit services	3.02	3.07
Audit related services	0.30	0.29
TOTAL	**3.32**	**3.36**

g) Environmental matters

As head of the Telefónica Group, Telefónica, S.A. engages in activities relating to the ownership of shares and the provision of financing and corporate advisory services to various Group companies. In view of the business activities in which the Company engages, it has no environmental liabilities, expenses, assets, provisions or contingencies that could have a significant effect on its equity, financial position and results. Consequently, the 2009 annual financial statements do not include specific details regarding environmental issues.

In line with its energy and climate change strategy, in 2008 Telefónica announced its commitment to reducing electricity consumption by 30% in its network and by 10% in its office by 2015. To do so, it created the Climate Change Office.

This Office, promoted by the Transformation Department and the Technical Secretariat to the Chairman s office, is responsible for ensuring that energy consumption and greenhouse gas emissions arising from the Company s activity are reduced, encouraging the development of services that enable the Company to be more efficient vis-à-vis its customers and other sectors, and for placing information and communication technologies (ICTs) at the heart of the Company s solution to combating climate change.

In addition to the Climate Change Office, Telefónica S.A. has a Projects Office, directed by Corporate Management for the Environment, set up to coordinate actions within the different areas of focus and to stimulate, facilitate and follow up on the projects included in the Group s environmental strategy.

Table of Contents

As a result, in line with the same strategy, Telefónica established the following environmental targets for the 2009 2011 period:

1. To implement the global environmental management system in half of operations.
2. To implement an Environmental Performance Index at 70% of the Group s companies.
3. To achieve environmental certification for District C.
4. To perform audits of the energy data at all Group operations and external verification of the carbon footprint.
5. To reduce electricity consumption in the networks by 30% between 2007 and 2015.
6. To reduce electricity consumption in offices by 10% between 2007 and 2015.
7. To design a renewable energy strategy in the Telefónica network.
8. To include the variable of energy efficiency in the decision-making for product purchases.

These objectives are global for the Group, although each Group company has its own environmental objectives directly related to its business.

h) Trade and other guarantees

The Company is required to issue trade guarantees and deposits for concession and spectrum tender bids and in the ordinary course of its business. No significant additional liabilities in the accompanying financial statements are expected to arise from guarantees and deposits issued.

(20) CASH FLOW ANALYSIS

Profit before tax in 2009 amounted to 5,606 million euros (see the income statement), adjusted by items recognized in the income statement that did not require an inflow or outflow of cash in 2009.

These adjustments mainly relate to:

Reversals of impairments to investments in Group companies, associates and other investments for 1,087 million euros (expense in 2008 of 4,182 million euros).

Declared dividends as income in 2009 for 5,763 million euros (7,135 million euros in 2008), interest accrued on loans granted to subsidiaries of 662 million euros (869 million euros in 2008) and a net financial loss of 1,870 million euros (-2,856 million euros in 2008), adjusted initially to include only movements related to cash inflows or outlooks during the year under Other cash flows from operating activities.

Table of Contents

Other cash flows from operating activities amounted to 8,382 million euros in 2009 (8,448 million euros in 2008). The main items included are:

a) Net interest paid: Payments of net interest and other financial expenses amounted to 974 million euros (2,644 million euros in 2008), including:

interest paid to external credit entities of 49 million euros (2,120 million euros in 2008), and interest paid to Group companies of 925 million euros (1,404 million euros in 2008). The main interest payments in 2009 were to Telefónica Emisiones, S.A.U., for 770 million euros, and to Telefónica Europe, B.V., for 499 million euros.

b) Dividends received:

The main receipts relate to:

(Millions of euros)	**2009**	**2008**
Telefónica de España, S.A.U.	2,993	2,202
Telefónica Móviles España, S.A.U.	2,601	2,697
Telefónica O2 Europe, plc.	1,350	2,487
Telefónica O2 Czech Republic, a.s.	438	455
Other dividends received	402	407
Total	**7,784**	**8,248**

The interim dividend charged against 2008 profit by Telefónica de España, S.A.U. for 1,800 million euros pending collection at December 31, 2008 was collected in 2009.

c) Income tax collected: Telefónica, S.A. is the parent of its consolidated Tax Group (see Note 17) and therefore it is liable for filing income tax with the Spanish Treasury. It subsequently informs companies included in the Tax Group of the amounts payable by them**.** In 2009 the amount recognized under this item mainly related to payments on account totaling 1,297 million euros, less collections from subsidiaries in the Tax Group, mainly from:

Telefónica Móviles España, S.A.U.: 1,488 million euros, of which 999 million euros are for the payment of corporate income in 2008 and 489 million euros for payments on account of corporate income in 2009. In 2008, a receipt of 1,087 million euros of 2007 corporate income tax was recognized.

Telefónica de España, S.A.U.: 1,214 million euros, of which 709 million euros are for the payment of corporate income in 2008 and 505 million euros for payments on account of corporate income in 2009. In 2008, a receipt of 1,972 million euros was recognized, 997 million euros and 975 million euros for 2006 and 2007 corporate income tax, respectively.

Table of Contents

Payments on investments under Cash flows used in investing activities included a total payment of 1,403 million euros (2,983 million euros in 2008) mainly due to the delivery of funds to finance other Group companies. The amounts recognized in 2008 were as follows:

Capital increases: Telefónica Móviles Colombia, S.A. for 155 million euros and Telefónica O2 Europe, Ltd. for 224 million euros (see Note 8.1).

Cancellation of interest-bearing debt of Telefónica de España, S.A.U. for 1,042 million euros.

Delivery of funds to finance other Group companies of 1,562 million euros. The main delivery of funds was to Telefónica Internacional, S.A.U. for 1,134 million euros.

In addition, Proceeds from disposals includes the repayment of loans granted by Telefónica, S.A. to subsidiaries, the most significant amounts of which were received from Telefónica de España, S.A.U., (1,095 million euros), Telefónica Internacional, S.A.U. (509 million euros), and Inversiones Móviles Chile (234 million euros).

In 2008, the main proceeds recognized under this heading came from Telefónica Internacional, S.A.U. (942 million euros), Telefónica de España, S.A.U. (698 million euros), Telefónica O2 Ireland, Ltd. (115 million euros) and Telefónica Móviles México, S.A. de C.V. (107 million euros). Also included are amounts received from third parties for the sale of Sogecable, S.A. and shares of Portugal Telecom, S.G.P.S. (see Notes 9.3 and 8.1, respectively).

Cash flows from financing activities includes the following:

i. Payments for equity instruments of 311 million euros (2,224 million in 2008), relating to the net amount of treasury shares acquired in 2009 less the sale of treasury shares to Telefónica Internacional, S.A.U. in the transaction described in Note 11.1 d.

ii. Payments of financial liability instruments, which mainly includes net movements in the Company s current accounts with Telefónica Finanzas, S.A.U.

iii. Payments of dividends for 4,557 million euros (4,165 million euros in 2008) (see movements in Note 11.1 d).

(21) EVENTS AFTER THE REPORTING PERIOD

The following events regarding the Company took place between the balance sheet date and the date of preparation of the accompanying financial statements:

On January 11, 2010, Telco, S.p.A. (Telco) arranged a 1,300 million euro loan with Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A., Société Générale, S.p.A. and Unicredito, S.p.A, maturing on May 31, 2012, part of which is secured with part of its Telecom Italia, S.p.A. shares. The lending banks have granted Telco shareholders a call option on the Telecom Italia, S.p.A. shares to which they could be entitled as a result of the potential execution of the pledge.

In line with the commitments assumed by Telco shareholders, on December 22, 2009, the rest of Telco s financing needs with respect to debt maturities were met with a bridge loan granted by shareholders Telefónica, Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for approximately 902 million euros, and a bank bridge loan granted by Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for the remaining 398 million euros.

The financing from the bridge loans was substituted with a bond subscribed by Telco s shareholder groups, on a pro-rate basis in accordance with their interests in the company, on February 19, 2010 for 1,300 million euros.

On December 3, 2009, Telefónica s subsidiary in Germany, Telefónica Deutschland GmbH (Telefónica Deutschland), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH (HanseNet). The purchase price agreed by the parties was based on the firm value of 900 million euros, subject to a series of adjustments upon completion of the transaction.

The purchase and sale was subject to compliance with a series of conditions, including approval of the transaction by the pertinent competition authorities, which was obtained on January 29, 2010. The transaction was completed in February 2010; hence the outstanding payment commitment was fulfilled.

On February 16, 2010, having complied with the terms established in the agreement dated December 3, 2009 by the parties, the Telefónica Group completed the acquisition of 100% of the shares of HanseNet. The final amount paid out was approximately 912 million euros.

On January 25, 2010, Telefónica Emisiones, S.A.U. repaid at maturity the bonds issued on July 25, 2006 under the bond issuance program EMTN registered with the London Stock Exchange for an aggregate amount of 1,250 million euros.

On January 29, 2010, Telefónica, S.A. made a voluntarily repayment ahead of schedule of 500 million euros on the 6,000 million euro syndicated loan arranged on June 28, 2005 and amended on February 13, 2009 to extend the maturity of 4,000 million euros from June 28, 2011 by one year for 2,000 million euros and two years for the other 2,000 million euros.

On February 11, 2010, Telefónica, S.A. made a voluntarily repayment ahead of schedule of 500 million euros on the 6,000 million euro syndicated loan arranged on June 28, 2005 and amended on February 13, 2009 to extend the maturity of 4,000 million euros from June 28, 2011 by one year for 2,000 million euros and two years for the other 2,000 million euros.

On February 12, 2010, Telefónica, S.A. arranged long-term financing for an amount of 472 million US dollars at fixed rates with a guarantee of the Swedish Export Agency (EKN) to acquire network equipment from a Swedish service provider. This financing entailed three tranches: tranche A, for 232 US dollars maturing on November 30, 2018, tranche B, for 164 million US dollars maturing on April 30, 2019, and tranche C, for 76 million US dollars maturing on November 30, 2019.

Amendment to the agreements signed with Prisa and Sogecable following the purchase of a stake in Digital+ by Gestevisión Telecinco, S.A. Following the signing on the agreement between Prisa and Gestevisión Telecinco, S.A. (Telecinco) for the sale by Prisa to Telecinco of a 22% stake in Digital+, on January 29, 2010, Telefónica and Prisa signed a new agreement raising the percentage stake to be acquired by Telefónica from 21% to 22%. Meanwhile, following the agreement reached between Prisa and Telecinco, Telefónica has undertaken to renegotiate the terms of the Shareholder Agreement to reflect the shareholder structure of Digital+ following the acquisition of a stake in the company by Telecinco.

The estimated total investment to be made by Telefónica, after deduction of the net debt, will be around 495 million euros, of which approximately 230 million euros will be covered by the assumption by the buyer of subordinated loan between Telefónica de Contenidos, S.A.U. (creditor) and Sogecable (debtor).

This acquisition is subject, among other conditions, to the obtainment of the appropriate regulatory authorizations.

(22) ADDITIONAL NOTE FOR ENGLISH TRANSLATION

These financial statements were originally prepared in Spanish. In the event of discrepancy, the Spanish-language version prevails.

These financial statements are presented on the basis of accounting principles generally accepted in Spain. Consequently, certain accounting practices applied by the Company may not conform with generally accepted principles in other countries.

Table of Contents

APPENDIX I
Details of subsidiaries,
associates and investees
at December 31, 2009

Table of Contents

DETAILS OF SUBSIDIARIES, ASSOCIATES AND INVESTEES AT DECEMBER 31, 2009 (millions of euros)

Name and corporate purpose	% Ownership Direct	% Ownership Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	Profit (loss) For the year	Gross carrying amount
Telefónica Europe plc (UK) (1) *Wireless communications services operator* *Wellington Street, Slough, SL1 1YP*	100.00%		13,470	91,691	1,352	987	3,479	26,153
Telefónica Internacional, S.A. (SPAIN) *Investment in the telecommunications industry abroad* *Gran Vía, 28 - 28013 Madrid*	100.00%		2,839	32,783		78	547	8,132
Telefónica Móviles España, S.A.U. (SPAIN) *Wireless communications services provider* *Plaza de la Independencia, 6 - Pta. 5 - 28001 Madrid*	100.00%		423	498	2,602	3,154	2,190	5,775
Telefónica de España, S.A.U. (SPAIN) *Telecommunications service provider in Spain* *Gran Vía, 28 - 28013 Madrid*	100.00%		1,024	1,919	1,193	4,254	2,829	3,034
Telefónica Móviles México, S.A. de C.V. (MEXICO) (1) *Holding company* *Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, Mexico D.F. CP.05349*	100.00%		1,960	(1,692)		336	57	2,557
Telefónica de Contenidos, S.A.U. (SPAIN) *Organization and operation of multimedia service-related activities and businesses* *Don ramón de la Cruz, 84 4ª Pta.- 28006 - Madrid*	100.00%		1,865	(1,672)		(22)	(1)	2,242
Latin American Cellular Holdings, B.V. (NETHERLANDS) (*) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%			1,586	168		1,011	1,669
Telefónica Datacorp, S.A.U. (SPAIN) *Telecommunications service provider and operator*	100.00%		700	65		(6)	1	1,343

Gran Vía, 28 - 28013 Madrid

Table of Contents

Name and corporate purpose	% Ownership Direct	Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	For the year	Gross carrying amount
Telefónica Móviles Argentina Holding, S.A. (ARGENTINA) *Holding company* *Ing Enrique Butty 240, piso 20-Capital Federal-Argentina*	100.00%		317	358		509	278	1,142
Inversiones Telefónica Móviles Holding, Ltd. (CHILE) *Holding company* *Miraflores, 130 - 12º Santiago de Chile*	100.00%		752	224			185	741
Ecuador Cellular Holdings, B.V. (NETHERLANDS) (*) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%			107			4	581
Atento Inversiones y Teleservicios, S.A. (SPAIN) *Telecommunications service provider* *C/ Santiago de Compostela, 94 - 28.035 Madrid*	100.00%		24	132		(10)	7	372
O2 (Europe) Ltd. (UK) *Wireless communications services operator* *Wellington Street, Slough, SL1 1YP*	100.00%		1,239	6,445			19	8,744
Telefónica Centroamérica de Guatemala Holdings, S.A. (GUATEMALA) *Holding company* *Bulevar Los Próceres 5-56 Zona 10, Unicentro nivel 10 Guatemala City*	100.00%		197	(66)	13	48	36	238
Ecuador Cellular Holdings, B.V. (NETHERLANDS) (*) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%			40	14		23	238
Telefónica Móviles El Salvador Holding, S.A. de C.V. (EL SALVADOR) *Holding company* *Alameda Roosvelt y Avenida Sur. Torre Telefónica nivel 10 - San Salvador*	100.00%							161

Name and corporate purpose	% Ownership Direct	Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	For the year	Gross carrying amount
Telefónica Móviles Puerto Rico, Inc. (PUERTO RICO) *Ownership of shareholdings in cellular operators in Puerto Rico* *Metro Office Park Calle Edificio #17, Suite 600 - 00968 Guaynabo*	100.00%		116	(116)				110
Ateseco Comunicación, S.A. (SPAIN) (2) *Dormant company* *Gran Vía, 28 - 28013 Madrid*	100.00%		6	20		(1)	(1)	80
Terra Networks Asociadas, S.L. (SPAIN) *Holding company* *Gran Vía, 28 - 28013 Madrid*	100.00%		7	(29)		1	3	64
Guatemala Cellular Holdings, B.V. (NETHERLANDS) (*) *Holding company* *Strawinskylaan 3105, Atium 7th, Amsterdam*	100.00%			6	5		4	30
Taetel, S.L. (SPAIN) *Acquisition, ownership and disposal of shares and stakes in other companies* *Gran Vía, 28 - 28013 Madrid*	100.00%		28	6	1			28
Telefónica Gestión de Servicios Compartidos España, S.A. (SPAIN) *Management and administrative services rendered* *Gran Vía, 28 - 28013 Madrid*	100.00%		8	19		8	14	24
LE Holding Corporation (USA) *Holding company* *Corporation Trust Center, 1209 Orange Street Wilmington, Delaware 19801*	100.00%		N/D	N/D		N/D	N/D	19
Telefónica Capital, S.A. (SPAIN) *Finance company* *Gran Vía, 28 - 28013 Madrid*	100.00%		7	75		(2)	(1)	18

Table of Contents

	% Ownership					Profit (loss)		Gross carrying
Name and corporate purpose	**Direct**	**Indirect**	**Capital**	**Reserves**	**Dividends received**	**From operations**	**For the year**	**amount**
Lotca Servicios Integrales, S.L. (SPAIN) *Holding and operation of aircraft and aircraft leases* *Gran Vía, 28 - 28013 Madrid*	100.00%		17					17
Comet, Compañía Española de Tecnología, S.A. (SPAIN) *Promotion of business initiatives and holding of real estate assets* *Villanueva, 2 duplicado planta 1ª Oficina 23 - 28001 Madrid*	100.00%		5	3				14
Telefónica Finanzas, S.A.U. (TELFISA) (SPAIN) *Integrated cash management, consulting and financial support for Group companies* *Gran Vía, 30 - 4ª Plta. - 28013 Madrid*	100.00%		3	29		(1)	10	13
Telefónica Móviles Soluciones y Aplicaciones, S.A. (CHILE) *IT and communications services provider* *Avenida del Cóndor Nº720, piso 4, comuna de Huechuraba, Santiago de Chile*	100.00%		10	(1)		1	1	11
Centro de Investigación y Experimentación de la Realidad Virtual, S.L. (SPAIN) *Design of communications products* *Vía de Dos Castillas, 33 - Comp. Ática Ed. 1, 1ª Plta. Pozuelo de Alarcón - 28224 Madrid*	100.00%			N/D		N/D	N/D	10
Telefónica Ingeniería de Seguridad, S.A. (SPAIN) *Security services and systems* *Condesa de Venadito, 1 - 28027 Madrid*	100.00%		1	2		(2)		9
Telefónica Investigación y Desarrollo, S.A.U. (TIDSA) (SPAIN) *Telecommunications research activities and projects* *Emilio Vargas, 6 - 28043 Madrid*	100.00%		6	51		1	(1)	6
Venturini España, S.A. (SPAIN)	100.00%		3					4

Printing, graphic arts and direct marketing
Avda. de la Industria, 17 Tres Cantos - 28760 Madrid

Name and corporate purpose	% Ownership Direct	Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	For the year	Gross carrying amount
Telfisa Global, B.V. (NETHERLANDS) *Integrated cash management, consulting and financial support for Group companies* *Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam*	100.00%			2		(1)	1	2
Telefónica de Centroamérica, S.L. (SPAIN) (3) *Dormant company* *Gran Vía, nº 28, 28013 Madrid*	100.00%							1
Terra Networks Marocs, S.A.R.L. (MOROCCO) (2) *Dormant company* *332 Boulevard Brahim Roudani, Casablanca*	100.00%			N/D		N/D	N/D	
Terra Networks Serviços de Acceso a Internet e Trading Ltd. (PORTUGAL) (2) *Dormant company* *Avda. Arriaga, 73-2º andar, sala 212 - Freguesia de Se, Concelho do Funchal (Madeira)*	100.00%			N/D		N/D	N/D	
Fisatel Mexico, S.A. de C.V. (MEXICO) *Boulevard Manuel Avila Camacho, 24 - 16ª Plta. Lomas de Chapultepec - 11000 Mexico D.F.*	100.00%			1				
Telefónica Participaciones, S.A. (SPAIN) *Issuance of preferred securities and/or other debt financial instruments* *Gran Vía, 28 - 28013 Madrid*	100.00%							
Telefónica Emisiones, S.A.U. (SPAIN) *Issuance of preferred securities and/or other debt financial instruments* *Gran Vía, 28 - 28013 Madrid*	100.00%			1		(2)	1	
Telefónica Europe, B.V. (NETHERLANDS) *Fund raising in capital markets* *Strawinskylaan 1259 ; tower D ; 12th floor 1077 XX Amsterdam*	100.00%			5	2	(1)	2	

93

Table of Contents

	% Ownership		Share		Dividends	Profit (loss) From		Gross carrying
Name and corporate purpose	**Direct**	**Indirect**	**capital**	**Reserves**	**received**	**operations**	**For the year**	**amount**
Telefónica Internacional USA Inc. (USA) *Financial advisory services* *1221 Brickell Avenue suite 600 - 33131 Miami Florida*	100.00%			1				
Omicron Ceti, S.L. (SPAIN) (3) *Dormant company* *José Abascal 28013 Madrid*	100.00%		N/D	N/D		N/D	N/D	
Telefónica International Wholesale Services II, S.L. (SPAIN) *Telecommunications service provider and operator* *Ronda de la Comunicación, s/n 28050 Madrid*	100.00%					(1)		
Casiopea Reaseguradora, S.A. (LUXEMBURG) *Reinsurance* *6D, route de Trèves, L-2633 Senningerberg, Luxemburg*	99.97%	0.03%	4	205		6	22	3
Telefónica Telecomunicaciones México, S.A. de C.V. (MEXICO) *Holding company* *Prolongación Paseo de la Reforma 1200 Col. Cruz Manca, Mexico D.F. CP.05349*	94.90%							
Telefónica International Wholesale Services, S.L. (SPAIN) *International services provider* *Gran Vía, 28 - 28013 Madrid*	92.51%	7.49%	230	8		16	15	213
Seguros de Vida y Pensiones Antares, S.A. (SPAIN) *Life insurance, pensions and health insurance* *Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid*	89.99%	10.01%	51	47		1	1	59
Corporation Real Time Team, S.L. (SPAIN) *Internet design, advertising and consulting* *Claudio Coello, 32, 1º ext. Madrid*	87.96%	12.04%		N/D		N/D	N/D	12

Table of Contents

	% Ownership				Dividends	From	Profit (loss)	Gross carrying
Name and corporate purpose	**Direct**	**Indirect**	**Capital**	**Reserves**	**received**	**operations**	**For the year**	**amount**
Telefónica International Wholesale Services America, S.A. (URUGUAY) *Provision of high bandwidth communications services* *Luis A. de Herrera, 1248 Piso 4 - Montevideo*	76.85%	23.15%	562	(220)		(14)	(15)	325
Telefonica O2 Czech Republic, a.s. (CZECH REPUBLIC) (1) (4) *Telecommunications service provider* *Olsanska 55/5 - Prague 3, 130 34*	69.41%		1,073	1,278	340	570	441	3,428
Comtel Comunicaciones Telefónicas, S.A. (VENEZUELA) *Holding company* *Av. Francisco de Miranda, Edif. Parque Cristal, Torre Oeste, Piso 14*	65.14%	34.86%						
Telefónica Móviles Panamá, S.A. (PANAMA) *Wireless telephony services* *Edificio Magna Corp. Calle 51 Este y Avda Manuel Maria Icaza, Panama City*	56.32%	43.69%	52	41	15	57	40	301
Aliança Atlântica Holding B.V. (NETHERLANDS) *Holder of 5,225,000 Portugal Telecom, S.A. shares* *Strawinskylaan 1725 1077 XX Amsterdan*	50.00%	43.99%	40	11	2		3	21
Brasil Celular, N.V. (NETHERLANDS) (1) *Joint Venture and holding company for wireless communications services* *Strawinskylaan 3105 - 1077ZX Amsterdam*	50.00%			5,802		651	163	2,106
MobiPay Internacional, S.A. (SPAIN) *Provision of payment services through wireless telephony* *Avenida de Europa 20, Alcobendas, Madrid*	50.00%		4	(5)				5
Telefónica Móviles Colombia, S.A. (COLOMBIA) (1)	49.42%	50.58%		698		69	(12)	272

Wireless operator
Calle 100, Nº 7-33, Piso 15,
Bogotá,Colombia

95

Name and corporate purpose	% Ownership Direct	% Ownership Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	Profit (loss) For the year	Gross carrying amount
Telefónica Móviles del Uruguay, S.A. (URUGUAY) *Wireless communications and services operator* *Constituyente 1467 Piso 23, Montevideo 11200*	32.00%	68.00%	6	86		56	44	13
Pléyade Peninsular, Correduría de Seguros y Reaseguros del Grupo Telefónica, S.A. (SPAIN) *Distribution, promotion or preparation of insurance contracts, operating as a broker* *Avda. General Perón, 38 Master II - 17ª P. - 28020 Madrid*	16.67%	83.33%		2	1	3	3	
Telefónica Móviles Argentina, S.A. (ARGENTINA) (1) *Holding company* *Ing Enrique Butty 240, piso 20-Capital Federal-Argentina*	15.40%	84.60%	317	358	7	509	278	139
Telefónica Móviles Guatemala, S.A. (GUATEMALA) *Provision of wireless, wireline and radio paging communications services* *Bulevar Los Próceres 20-09 Zona 10. Edificio Iberoplaza. Guatemala City*	13.60%	86.38%						38
Telefónica Gestión de Servicios Compartidos, S.A. (ARGENTINA) *Management and administrative services rendered* *Av. Ing. Huergo 723 PB Buenos Aires*	4.99%	95.00%		1				
OMTP Limited (Open Mobile Terminal Platform) (UK)	2.04%		N/D	N/D		N/D	N/D	N/D
Telefónica de Argentina, S.A. (1) *Telecommunications service provider* *Av. Ingeniero Huergo, 723, PB Buenos Aires*	1.80%	98.20%	624	(338)		232	116	23
Telefónica Brasil Sul Celular Participaçoes, Ltda. (BRAZIL) (5) *Holding company* *Avda. Martiniano de Carvalho, 851, 20 andar, parte Sao Paulo, Sao Paulo*	1.12%	98.79%						1

Table of Contents

	% Ownership					Profit (loss)		Gross carrying
Name and corporate purpose	Direct	Indirect	Capital	Reserves	Dividends received	From operations	For the year	amount
Telefónica del Perú, S.A.A. (PERU) (1) (4) *Operator of local, domestic and international long distance telephony services in Peru* *Avda. Arequipa, 1155 Santa Beatríz Lima*	0.16%	98.18%	2,962	(2,292)		152	197	2
Telcel, C.A. (VENEZUELA) (1) *Wireless operator* *Av. Francisco de Miranda, Edif Parque Cristal, Caracas 1060*	0.08%	99.92%	905	1,503		1,291	598	124
Telefónica Factoring España, S.A. (SPAIN) *Factoring* *Pedro Teixeira, 8 28020 Madrid*	50.00%		5	2	2	6	4	3
Telco, S.p.A. (ITALY) *Holding company* *Galleria del Corso, 2 Milan*	46.18%		3,588	(106)		(2)	(60)	2,314
Telefónica Factoring México, S.A. de C.V. SOFOM ENR (MEXICO) *Factoring* *Mexico City*	40.50%	9.50%	2					1
Telefónica Factoring Perú, S.A.C. (PERU) *Factoring* *Lima*	40.50%	9.50%	1	1				1
Telefónica Factoring Colombia, S.A. (COLOMBIA) *Factoring* *Bogota*	40.50%	9.50%	1					1
Telefónica Factoring Do Brasil, Ltd. (BRAZIL) *Factoring* *Avda. Paulista, 1106 Sao Paulo*	40.00%	10.00%	1		2	(1)	8	1

Table of Contents

Name and corporate purpose	% Ownership Direct	% Ownership Indirect	Capital	Reserves	Dividends received	Profit (loss) From operations	Profit (loss) For the year	Gross carrying amount
Torre de Collçerola, S.A. (SPAIN) *Operation of a telecommunications mast and technical assistance and consulting services* *Ctra. Vallvidrera-Tibidabo, s/nº - 08017 Barcelona*	30.40%		6					2
Portugal Telecom, S.G.P.S., S.A. (PORTUGAL) (1) (4) (6) *Holding company* *Avda. Fontes Pereira de Melo, 40 - 1089 Lisbon*	8.51%	1.49%	27	506	44	769	372	642
Amper, S.A. (SPAIN) (1) (4) (6) *Development, manufacture and repair of telecommunications systems and equipment and related components* *Torrelaguna, 75 - 28027 Madrid*	6.10%		29	342	2	1	(6)	12
ZON Multimedia Serviços de Telecomunicaçoes e Multimédia, SGPS, S.A. (PORTUGAL) (4) *Multimedia business* *Avda. 5 de Outubro, 208 - Lisbon*	4.80%	0.66%	3	323		31	49	103
Banco Bilbao Vizcaya Argentaria, S.A. (SPAIN) (1) (4) (6) *Banking* *San Nicolás, 4 - 48005 Bilbao (Vizcaya)*	0.98%		1,837	23,981	13	15,378	4,179	559
Other investments	N/A		N/A	N/A		N/A	N/A	13

TOTAL GROUP COMPANIES AND JOINT VENTURES	70,667
TOTAL ASSOCIATES	2,965
TOTAL NON-CURRENT FINANCIAL INVESTMENTS	687

(1) Consolidated data

(2) Dormant company

(3) Company in liquidation

(4) Companies listed on international stock exchanges at December 31, 2009.

(5) Data under local GAAP

(6) Data as of September 2009.

N/D *No data available*

N/A *Not applicable*

(*) *Data as of December 31, 2008.*

Table of Contents

ECONOMIC RESULTS

Against a complex backdrop, the Telefónica Group s commercial and financial results in 2009 underscore the benefits of its unique profile: extensive business diversification, operating integration in key markets, strong competitive positioning in main markets, proven capacity to deliver and financial strenght.

We continued to increase our customer base, measured in terms of total accesses, by 2.1% to 264.6 million accesses at December 31, 2009 from 259.1 million accesses at December 31, 2008. This growth from December 31, 2008 to December 31, 2009 was primarily driven by a 3.3% increase in mobile accesses, a 8.2% increase in broadband accesses and a 9.8% increase in pay TV accesses, which more than offset our 5.4% loss of fixed telephony accesses and 28.5% loss of narrowband accesses as these technologies continue to be substituted by customers for mobile and broadband technologies, respectively.

By access type, we increased **mobile accesses** by 3.3% to 202.3 million (no longer including 9.0 million accesses of Medi Telecom, which we sold in December 2009) at December 31, 2009 from 195.8 million at December 31, 2008 (including approximately 4.0 million accesses of Telemig, which we incorporated in April 2008). Contributions to mobile net adds from December 31, 2008 to December 31, 2009, by country, were Brazil (6.8 million additional mobile accesses), Mexico (2.1 million additional mobile accesses), Germany (1.3 million additional mobile accesses) and Argentina (1.1 million additional mobile accesses) and the United Kingdom (1.0 million additional mobile accesses), and with negative mobile net adds of 1.0 million mobile accesses in Colombia.

We also increased **broadband accesses** by 8.2% to 13.5 million at December 31, 2009 from 12.5 million at December 31, 2008. We increased our number of broadband accesses from December 31, 2007 to December 31, 2009 primarily as a result of robust demand for Duo and Trio bundles, including broadband, pay TV and fixed telephony, which have made a significant contribution to the development of the broadband market and to increased customer loyalty. From December 31, 2008 to December 31, 2009, we increased broadband accesses by 4.4% in Spain to 5.5 million, by 5.9% to 6.4 million in Latin America and by 37.1% to 1.6 million in Europe. At December 31, 2009, in Spain 88% of our broadband accesses were included in Duo or Trio bundles, while in Latin America the weight of packaged products continued to grow, with 56% of broadband accesses bundled in Duo and Trio bundles at the same date. This growth in broadband accesses more than offset the continued decrease in narrowband accesses from 2.7 million accesses at December 31, 2007 to 2.0 million accesses at December 31, 2008 to 1.4 million accesses at December 31, 2009.

Finally, we increased **pay TV accesses** by 9.8% to 2.5 million at December 31, 2009 from 2.3 million at December 31, 2008. The continued growth in pay TV accesses from December 31, 2007 to December 31, 2009 was primarily as a result of further market penetration in the areas in which this service is available, which as of December 31, 2009, included Spain, the Czech Republic, Peru, Chile, Colombia, Brazil and Venezuela, and the success of bundling this service with others.

During 2009 and the beginning of 2010 several factors have surfaced with respect to the Venezuelan economy that have led us to reconsider the accounting treatment that the Telefónica Group previously applied in the translation of the financial statements of our subsidiaries in that country, and the recoverability of our financial investments in there. Key among these factors are: the inflation index reached in 2009 and the cumulative inflation index over the last three years, restrictions in the official foreign exchange market, and the devaluation of the bolivar fuerte on January 8, 2010. Consequently, according to IFRS, the Venezuelan economy should be considered as hyperinflationary for 2009. This fact has had no impact in Telefónica, S.A. s 2009 standalone financial statements though it has had impact in Telefónica Group s consolidated financial statements as of December 31, 2009.

Results of Telefónica, S.A.

Telefónica, S.A. obtained net profit of 6,252 million euros in 2009. Highlights of the 2009 income statement include:

- Growth in revenue from operations because most of the contracts signed in 2008 for use of the Telefónica brand entailing royalties stipulated an increasing percentage for the years 2008 to 2011. The 2009 income statement included 369 million euros of revenue from royalties for use of the brand (274 million in 2008).

- In accordance with provisions of BOICAC Nº 79, the following items were reclassified from Revenue from operations in 2009:
  - Dividends received from group companies and associates, of which the largest came from Telefónica O2 Europe, plc. (1,352 million euros), Telefónica de España, S.A.U. (1,193 million euros) and Telefónica Móviles España (2,602 million euros).
  - Interest income on loans to group companies and associates, the main amounts of which relate to interest from Telefónica Móviles México, S.A. de C.V. (215 million euros), Telefónica de España, S.A.U. (187 million euros) and Telefónica Móviles España, S.A.U. (214 million euros).
- Net financial expense totaled 1,870 million euros in 2009, compared to 2,856 million in 2008. This was mainly due to finance costs with group companies and associates, of which the largest came from Telefónica Europe, B.V., (518 million euros) and Telefónica Emisiones, S.A.U. (981 million euros).

Investment activity

2009

In 2009, Telefónica, S.A. did not carry out any significant capital increases in subsidiaries:

On June 11, 2009, Telefónica, S.A. recognized the capitalization of part of the loans granted in prior years and the accrued interest payable to Telefónica Móviles México, S.A. de C.V. for 1,381 million euros.

Table of Contents

On June 5, 2009 and November 2, 20009, Telefónica, S.A. contributed to its subsidiary Latin American Cellular Holding, S.A. receivables in favor of Telcel, C.A. amounting to 58 million strong Venezuelan bolivars (19 million euros) and 49 million strong bolivars (15 million euros) for this company to subsequently make payments on the loan granted to it by Telcel, C.A.

In December 2009, following approval by the *Comisión Nacional de Valores de la República Argentina* (CNV), the Argentine securities regulatory, Telefónica, S.A. acquired shares representing 1.8% of the share capital of Telefónica de Argentina, S.A. held by minority shareholders. The total investment amounted to 23 million euros.

Investments classified as available for sale increased by 197 million euros in 2009 thanks to the recovery in the share prices of Banco Bilbao Vizcaya Argentaria, S.A. and Amper, S.A. The after-tax impact had a balancing entry in Equity Net unrealized gains (losses) reserve.

At June 30, 2009, Telefónica, S.A. took a 34 million euro impairment loss on its shareholding in Zon Multimedia, S.G.P.S. as a result of the steady decline in its market price, estimating that it would not be recoverable. This impairment was recognized in the income statement under Gain (loss) on available-for-sale financial assets recognized in the period.

2008

On May 9, 2008, Telefónica, S.A. announced its decision to accept the takeover bid launched by Promotora de Informaciones, S.A. (PRISA) for Sogecable, S.A. This disposal added 11 million euros to the Company s income statement.

Investments classified as available for sale declined by 273 million euros in 2008 due to falls in the share prices of Banco Bilbao Vizcaya Argentaria, S.A., Amper, S.A. and Zon Multimedia Serviços de Telecomunicaçoes e Multimedia, S.G.P.S., S.A. The after-tax impact had a balancing entry in Equity Net unrealized gains (losses) reserve.

Table of Contents

RESEARCH, DEVELOPMENT AND INNOVATION

Telefónica remains firmly committed to technological innovation as a core means to generating sustainable competitive advantages, anticipating market trends and the differentiation of our products. Through the introduction of new technologies and the development of new products and business processes, we see to become a more effective, efficient and customer-oriented Group.

Telefónica has developed an open innovation model for the management of technological innovation that helps to improve the application of the results of technical research in the commercial services, focusing on certain applied research activities aligned with Telefónica s strategy. This model fosters open innovation initiatives such as the creation of a venture capital fund, business collaboration forums, etc. It also promotes the use of knowledge developed at technology centers, universities and start-ups, for example, and encourages innovation in collaboration with other agents that will become technology partners, including customers, universities, public administrations, suppliers, content providers and other companies.

We believe that we cannot rely solely on acquired technology in our quest to differentiate our products from those of our competitors and to improve our market positioning. We also believe that it is important to encourage research and development initiatives in an effort to achieve the desired level of differentiation and to foster other innovation activities. Our R&D policy is designed to:

- develop new products and services in order to win market share;
- boost customer loyalty;
- drive revenue growth;
- enhance management;
- improve business practices; and
- increase the quality of our infrastructure services to improve customer service and reduce costs.

In 2009, the technological innovation projects undertaken focused on profitable innovation, process efficiency, creation of new revenue streams, customer satisfaction, consolidation of new markets and technological leadership. Our technological innovation activities were closely integrated, especially in our strategy of creating value through broadband, IP networks, wireless communication networks and new generation fiber optic networks and services. In addition, projects were undertaken to promote the information society, new services focused on new internet business models, advanced user interfaces, mobile television and other broadband services. These lines of initiative, among others, were built on the basis of rapid identification of emerging technologies that could have a relevant impact on our businesses, and the testing of these technologies in new services, applications and platform prototypes.

In 2009, we developed new operational and business support systems and improved existing systems.

Table of Contents

FINANCING

The main financing transactions in 2009 carried out by Telefónica, S.A. or guaranteed by Telefónica, S.A. were as follows:

On February 13, 2009, Telefónica, S.A. executed, with a group of participating banks in the 6,000 million euro syndicated line of credit dated June 28, 2005 maturing on June 28, 2011, an extension of 4,000 million euros, rescheduling 2,000 million euros for 2012 and another 2,000 million euros for 2013.

Under Telefónica Emisiones, S.A.U. s European Medium Term Note (EMTN), Telefónica, S.A. guaranteed the issues of debt instruments for a global amount equivalent to 6,482 million euros, with the following features:

Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
02-03-09	02-03-14	2,000,000,000	EUR	5.431%
04-01-09	04-01-16	1,000,000,000	EUR	5.496%
06-03-09	04-01-16	500,000,000	EUR	5.496%
06-02-09	06-02-15	400,000,000	EUR	3-month Euribor + 1.825%
11-10-09	11-11-19	1,750,000,000	EUR	4.693%
12-10-09	12-10-22	650,000,000	GBP	5.289%
12-23-09	12-23-14	100,000,000	EUR	3-month Euribor + 0.70%

Under Telefónica Emisiones, S.A.U. s debt issue program registered with the United States Securities Exchange Commission (SEC), Telefónica, S.A. guaranteed the issues of debt instruments for a global amount equivalent to 2,250 million dollars (equivalent to approximately 1,562 million euros), with the following features:

Issue date	Maturity date	Amount (nominal)	Currency of issue	Coupon
07-06-09	07-15-19	1,000,000,000	USD	5.877%
07-06-09	01-15-15	1,250,000,000	USD	4.949%

2008

Telefónica, S.A. guaranteed the issue held on June 12, 008 of 1,250 million euros of bonds maturing on June 12, 2013 by Telefónica Emisiones, S.A.U. This issue was made under the terms and conditions established in Telefónica Emisiones, S.A.U. s European Medium Term Note (EMTN) program registered on July 8, 2005 with the London Stock Exchange.

Table of Contents

TRANSACTIONS WITH TREASURY SHARES

At December 31, 2009 and 2008, Telefónica, S.A. held the following treasury shares:

		Euros per share		Market	
	No. of shares	Acquisition price	Trading price	Value (1)	%
Treasury shares at 12/31/09	6,329,530	16.81	19.52	124	0.13868%

(1) *Millions of euros*

		Euros per share		Market	
	No. of shares	Acquisition price	Trading price	Value (1)	%
Treasury shares at 12/31/08	125,561,011	16.68	15.85	1,990	2.66867%

(1) *Millions of euros*

The movement in treasury shares of Telefónica, S.A. in 2009 and 2008 is as follows:

	No. of shares
Treasury shares at 12/31/07	**64,471,368**
Acquisitions	129,658,402
Disposals	(68,759)
Share cancellation	(68,500,000)
Treasury shares at 12/31/08	**125,561,011**
Acquisitions	65,809,222
Disposals	(40,730,735)
Delivery PSP Phase I	(3,309,968)
Share cancellation	(141,000,000)
Treasury shares at 12/31/09	**6,329,530**

The amount paid to acquire own equity instruments in 2009 and 2008 was 1,005 million and 2,225 million euros, respectively.

On October 16, 2009, Telefónica, S.A. sold 40.7 million treasury shares to Telefónica Internacional, S.A.U. under an agreement entered into between the Telefónica Group and China Unicom Hong Kong Limited. On October 21, 2009, this agreement was executed with the mutual share exchange between Telefónica Internacional, S.A.U. and China Unicom amounting to 1,000 million dollars. The treasury shares were sold to Telefónica Internacional, S.A.U. at a price of 766 million euros.

Treasury shares sold in 2009 and 2008 amounted to 766 million and 1 million euros, respectively.

At December 31, 2009, Telefónica, S.A. held call options on 150 million treasury shares. At December 31, 2008, Telefónica, S.A. held put options on 6 million treasury shares.

Table of Contents

RISKS AND UNCERTAINTIES FACING THE COMPANY

The Telefónica Group s business is conditioned by a series of intrinsic risk factors that affect exclusively the Group, as well as a series of external factors that are common to businesses of the same sector. The risks described below are the most important, but not the only ones we face.

Group related risks

Country risk (investments in Latin America). At December 31, 2009, approximately 35.7% of the Group s assets were located in Latin America. In addition, around 40.6% of its revenues from operations for 2009 were derived from its Latin American operations. The Group s investments and operations in Latin America (including the revenues generated by these operations, their market value, and the dividends and management fees expected to be received from them) are subject to various risks linked to the economic, political and social conditions of these countries, including risks related to the following:

- government regulation or administrative polices may change unexpectedly and negatively affect our interests in such countries;
- currencies may be devalued or may depreciate or currency restrictions and other restraints on transfer of funds may be imposed;
- the effects of inflation or currency depreciation may lead certain of its subsidiaries to a negative equity situation, requiring them to undertake a mandatory recapitalization or commence dissolution proceedings;
- governments may expropriate or nationalize assets or increase their participation in the economy and companies;
- governments may impose burdensome taxes or tariffs;
- political changes may lead to changes in the economic conditions and business environment in which it operates; and
- economic downturns, political instability and civil disturbances may negatively affect the Telefónica Group s operations in such countries.

For instance, throughout 2009 and in the early part of 2010, certain factors affecting the Venezuelan economy have had an impact on the accounting treatment applied with respect to the Group s subsidiaries in that country, notably the level of inflation reached in 2009 and the cumulative inflation rate over the last three years, restrictions to the official foreign exchange market and the devaluation of the bolivar on January 8, 2010. As a result, in accordance with IFRS, Venezuela must be considered a hyperinflationary economy in 2009, which has had a series of impacts on the Group s consolidated financial statements for 2009 and will on 2010. A more detailed description of this issue is included in Note 2 to the Telefónica Group s 2009 financial statements.

In addition, the Telefónica Group s operations are dependent, in many cases, on concessions and other agreements with existing governments in the countries in which it operates. These concessions and agreements, including their renewal, could be directly affected by economic and political instability, altering the terms and conditions under which it operates.

Table of Contents

Management of foreign currency and interest rate risk. The Telefónica Group s business is exposed to various types of market risk in the normal course of its business, including the impact of changes in interest rates or foreign currency exchange rates, as well as the impact of changes of credit risk in its treasury operations or in some structured financed transactions it enters. The Telefónica Group employs risk management strategies to manage this risk, in part through the use of financial derivatives, such as foreign currency forwards, currency swap agreements and interest rate swap agreements. If the financial derivatives market is not sufficiently liquid for the Group s risk management purposes, or if it cannot enter into arrangements of the type and for the amounts necessary to limit its exposure to currency exchange-rate and interest-rate fluctuations, or if its banking counterparties fail to deliver on their commitments due to lack of solvency or otherwise, such failure could adversely affect its financial position, results of operations and cash flow. Also, Telefónica s other risk management strategies may not be successful, which could adversely affect its financial position, results or operations and cash flow. Finally, if the rating of its counterparties in treasury investments or in its structured financed transactions deteriorates significantly or if these counterparties fail to meet their obligations to the Company, the Telefónica Group may suffer loss of value in its investments, incur in unexpected losses and/or assume additional financial obligations under these transactions. Such failure could adversely affect the Telefónica Group s financial position, results of operations and cash flow.

Current global economic situation. The Telefónica Group s business is impacted by general economic conditions and other similar factors in each of the countries in which it operates. The current adverse global economic situation and uncertainty about the economic recovery may negatively affect the level of demand of existing and prospective customers, as customers may no longer deem critical the services offered by the Group. Other factors that could influence customer demand include access to credit, unemployment rates, consumer confidence and other macroeconomic factors. Specifically, in this respect the continuation of recession in Spain, according to the forecasts contained in the Spanish economic ministry s Stability Program for 2009-2013, could have an adverse affect on the Telefónica Group s results in Spain.

In addition, there could be other possible follow-on effects from the economic crisis on the Group s business, including insolvency of key customers or suppliers. A loss of customers or a reduction in purchases by its current customers decline in sales could have an adverse effect on the Telefónica Group s financial position, results of operations and cash flow and may ultimately affect its ability to meet its growth targets.

Dependence on external sources of financing. The performance, expansion and improvement of networks, the development and distribution of the Telefónica Group s services and products require a substantial amount of financing. Mover, the Telefónica Group s liquidity and capital resource requirements may increase if the Company participates in other fixed line or wireless license award processes or makes acquisitions. There are also other major capital recourse requirements relating to, among other things, the development of distribution channels in new countries of operations and the development and implementation of new technologies.

If its ability to generate cash flow were to decrease, whether due to the ongoing economic and financial crisis or otherwise, the Telefónica Group may need to incur additional debt or raise other forms of capital to support its liquidity and recourses requirements for the sustained development and expansion of its business.

The current situation of financial markets in terms of liquidity, cost of credit and volatility has improved since the second half of 2008. However, there are still uncertainties surrounding the pace of the economic recovery, the health of the international banking system, the increasing concerns regarding the burgeoning deficits of some governments, etc. which could affect the normal development of financial markets. Worsening conditions in international financial markets due to any of these factors may make it more difficult and expensive for the Telefónica Group to refinance its debt or take on additional debt if necessary.

In addition, its capacity to raise capital in the international capital markets would be impaired if its credit ratings were downgraded, whether due to decreases in its cash flow or otherwise. Further, current market conditions make it more challenging to renew unused bilateral credit facilities.

The current financial crisis could also make it more difficult and costly for the Company s current shareholders to launch rights issues or ask key investors for equity investments, even if further funds were needed for the Company to pursue its business plans.

Risks associated with relationships with venturers. The mobile business in Brazil is conducted through a 50/50 joint venture company, Brasilcel, N.V., jointly controlled by Telefónica and Portugal Telecom, S.G.P.S., S.A. (Portugal Telecom). Since it has less than a controlling interest in this joint venture, Telefónica does not have absolute control over the venture s operations. As a result, there is an inherent risk for management or operational disruptions whenever an agreement between the Company and its partners arises.

Therefore, Telefónica must cooperate with Portugal Telecom to implement and expand its business strategies and to finance and management the operations of the venture. If Telefónica does not manage to obtain the cooperation of Portugal Telecom or if a disagreement or deadlock arises it may not achieve the expected benefits from its interest in this joint venture, such as economies of scale and opportunities to achieve potential synergies and cost savings.

Risks related to our industry

Highly competitive markets. The Telefónica Group faces significant competition in all of the markets in which it operates. Therefore, it is subject to the effects of actions by competitors in these markets. These competitors could:

- offer lower prices, more attractive discount plans or better services or features;
- develop and deploy more rapidly new or improved technologies, services and products;
- launch bundle offerings of one type of service with others;
- in the case of the mobile industry, subsidize handset procurement; or
- expand and extend their networks more rapidly.

Furthermore, some of these competitors in certain markets have, and some potential competitors may enjoy, in certain markets, competitive advantages, including the following:

- greater brand name recognition;
- greater financial, technical, marketing and other resources;
- dominant position or significant market power;
- better strategic alliances;
- larger customer bases; and
- well-established relationships with current and potential customers.

To compete effectively with these competitors, the Telefónica Group needs to successfully market its products and services and to anticipate and respond to various competitive factors affecting the relevant markets, such as the introduction of new products and services by its competitors, pricing strategies adopted by its competitors, changes in consumer preferences and in general economic, political and social conditions. The Telefónica Group s inability to effectively compete could result in price reductions, lower revenues, under-utilization of the Group s services, reduced operating margins and loss of market share. Any of these circumstances could negatively affect the Telefónica Group s financial position, results of operations and cash flow.

Highly regulated markets. As a multinational telecommunications company that operates in regulated markets, the Telefónica Group is subject to different laws and regulations in each of the jurisdictions in which it provides services and in which supranational (e.g. the European Union), national, state, regional local authorities intervene to varying degrees and as appropriate. Depending on whether the Company has a dominant position or not in these markets, the regulations in some countries are particularly strict. In this respect, the regulatory authorities regularly intervene in both the wholesale and retail offering and pricing of the Telefónica Group s products and services.

Furthermore, they could also adopt regulations or take other actions that could adversely affect the Telefónica Group, including revocation of or failure to renew any of its licenses, changes in the spectrum allocation or the grant of new licenses, authorizations or concessions to competitors to offer services in a particular market. They could also adopt, among others, measures or additional requirements to reduce roaming prices and fixed mobile termination rates, force Telefónica to provide third-party access to its networks and impose economic fines for serious breaches. Such regulatory actions or measures could place significant competitive and pricing pressure on the Group s operations, and could have a material adverse effect on the Telefónica Group s financial position, results of operations and cash flow.

In addition, since the Telefónica Group holds a leading market share in many of the countries where in operates, the Group could be affected by regulatory actions of antitrust or competition authorities. These authorities could prohibit certain actions, such as making further acquisitions or continuing to engage in particular practices or impose fines or other penalties on the Company, which, if significant, could result in loss of market share and/ or in harm to future growth of certain businesses.

Specifically, the regulatory landscape in Europe will change as a consequence of the recent approval of the European Union s new common regulatory framework, which must be transposed into national law by Member States by June 2011. The regulatory principles established for Europe suggest that the new frameworks in each Member State could result in increased regulatory pressure on the local competitive environment.

This framework supports the adoption of measures by national regulators, in specific cases and under exceptional conditions, establishing the functional separation between the wholesale and retail businesses of operators with significant market power and vertically integrated operators, whereby they would be required to offer equal wholesale terms to third-part operators that are not integrated. The new framework is also likely to strengthen consumer protection, network integrity and data privacy measures. The Company may also face new regulatory initiatives in the area of mobile termination rates and the provision of audiovisual content and services.

In some European countries, the Telefónica Group may also face increased pressure from regulatory initiatives aimed at reallocating spectrum rights of use and changing the policies regarding spectrum allocation which could lead to new procedures for awarding spectrum in Europe.

Finally, the recommendation on the application of the European regulatory policy to next-generation broadband networks being drawn up by the European Commission could play a key role in the incentives for operators to invest in net fixed broadband networks in the short and medium term, thus affecting the outlook for the business and competition in this market segment.

Services are provided under licenses or concessions. Most of Telefónica s operating companies require licenses, authorizations or concessions from the governmental authorities of the various countries. These licenses, authorizations and concessions specify the types of services Telefónica is permitted to offer under each circumstance.

The terms of its licenses, authorizations and concessions are subject to review by regulatory authorities in each country and to possible interpretation, modification of termination by these authorities. Moreover, authorizations, licenses and concessions, as well as their renewal terms and conditions, may be directly affected by political and regulatory factors.

The terms of these licenses, authorization and concessions and the conditions of the renewals of such licenses, authorizations and concessions vary from country to country. Although license, authorization and concession renewal is not usually guaranteed, most licenses, authorizations and concessions do address the renewal process and terms, with most depending on the degree of fulfillment of the commitments assumed. As licenses, authorizations and concessions approach the end of their terms, the Telefónica Group intends to pursue their renewal to the extent provided by the relevant licenses, authorizations or concessions, though the Group can not guarantee that it will always complete this process successfully.

Many of these licenses, authorizations and concessions are revocable for public interest reasons. The rules of some of the regulatory authorities with jurisdiction over the Telefónica Group s operating companies require them to meet specified network build-out requirements and schedules. In particular, Telefónica s existing licenses, authorizations and concessions typically require it to satisfy certain obligations, including, among others, minimum specified quality standards, service and coverage conditions and capital investment. Failure to comply with these obligations could result in the imposition of fines or revocation or forfeiture of the license, authorization or concession. In addition, the need to meet scheduled deadlines may require Telefónica Group operators to expend more resources than otherwise budgeted for a particular network build-out.

Markets subject to constant technological development. The Telefónica Group s future success depends, in part, on its ability to anticipate and adapt in a timely manner to technological changes. New products and technologies are constantly emerging, while existing products and services continue to develop. This need for constant technological innovation can render obsolete the products and services the Telefónica Group offers and the technology it uses, and may consequently reduce the revenue margins obtained and require investment in the development of new products, technology and services. In addition, the Company may be subject to competition in the future from other companies that are not subject to regulation as a result of the convergence of telecommunications technologies. As a result, it may be very expensive for the Telefónica Group to develop the products and technology it needs in order to continue to compete effectively with new or existing competitors. Such increased costs could adversely affect the Telefónica Group s financial position, results of operations and cash flow.

The Telefónica Group must continue to upgrade its existing mobile and fixed line networks in a timely and satisfactory manner in order to retain and expand its customer base in each of its markets, to enhancing its financial performance and to satisfy regulatory requirements. Among other things, the Telefónica Group could be required to upgrade the functionality of its networks to achieve greater service customization, to increased coverage of some of its markets, or expand and maintain customer service, network management and administrative systems.

Many of these tasks are not entirely under the Telefónica Group s control and could be constrained by applicable regulation. If the Telefónica Group fails to execute these tasks efficiently, its services and products may become less attractive to new customers and the Company may lose existing customers to its competitors, which would adversely affect the Telefónica Group s financial position, results of operations and cash flow.

Limitations on spectrum capacity could curtail growth. Telefónica s mobile operations in a number of countries may rely on the availability of spectrum. The Company s failure to obtain sufficient or appropriate capacity and spectrum coverage, and, albeit to a lesser extent, the related cost of obtaining this capacity could have an adverse impact on the quality of our services and on its ability to provide new services, adversely affecting its business, financial position, results of operations and cash flow.

Table of Contents

Supplier failures. The Telefónica Group depends upon a small number of major suppliers for essential products and services, mainly network infrastructure and mobile handsets. These suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. Further, these suppliers may be adversely affected by current economic conditions. If these suppliers fair to deliver products and services on a timely basis, this could have an adverse impact on the Telefónica Group s businesses and the results of its operations. Similarly, interruptions in the supply of telecommunications equipment for its networks could impede network development and expansion, which in some cases could adversely affect the Telefónica Group s ability to satisfy its license terms and requirements.

Risks associated with unforeseen network interruptions. Unanticipated network interruptions as a result of system failures whether accidental or otherwise, including due to network, hardware or software failures, which affect the quality of or cause an interruption in the Telefónica Group s service, could lead to customer dissatisfaction, reduced revenues and traffic, costly repairs, fines or other types of measures by regulators and could harm the Telefónica Group s reputation. Telefónica attempts to mitigate these risks through a number of measures, including backup systems and protective systems such as firewalls, virus scanners and building security. However, these measures are not effective under all circumstances and it is not possible to foresee every incident or action that could damage or interrupt the Telefónica Group s networks. Although the Telefónica Group carries business interruption insurance, its insurance policy may not provide coverage in amounts sufficient to compensate it for any losses it may incur.

Certain studies suggest that electromagnetic radio emissions are harmful. Over the last few years, the debate about the alleged potential effects of radio frequency emissions on human health has hindered the deployment of the infrastructures necessary to ensure quality of service.

Institutions and organizations, such as the World Health Organization, have stated that exposure to radio frequency emissions generated by mobile telephony, within the limits established, has no adverse effects on health. In fact, a number of European countries, including Spain among others, have drawn up complete regulations reflecting the Recommendation of the Council of the European Union dated July 12, 1999. These add planning criteria for new networks, thus ensuring compliance with the limits on exposure to radio frequency emissions.

Whether or not other research or studies conclude there is a link between radiofrequency emissions and health, popular concerns about radio frequency emissions may discourage the use of mobile communication devices and may result in significant restrictions on both the location and operation of cell sites, either or both of which could have a detrimental impact on the Telefónica Group s mobile companies and consequently on its financial position, results of operations and cash flow. While the Telefónica Group is not aware of any evidence confirming a link between radio-frequency emissions and health problems and it continues to comply with good practices codes and relevant regulations, there can be no assurance of what future medical research may suggest.

Risk of asset impairment. The Telefónica Group reviews on an annual basis, or more frequently where the circumstances require, the value of each of its assets and subsidiaries, to asses whether the carrying values of such assets and subsidiaries can be supported by the future cash flows expected, including, in some cases synergies included in acquisition cost. The current economic environment and its development in the short and medium term, as well as changes in the regulatory, business or political environment may result in the need to introduce impairment changes in its goodwill, intangible assets or fixed assets. Though the recognition of impairments of items of property, plant and equipment, intangible assets and financial assets results in a non-cash charge on the income statement, it could adversely affect the Telefónica Group s results of operations.

Other risks

Litigation and other legal proceedings. The Telefónica Group is party to lawsuits and other legal, proceedings in the ordinary course of its business, the final outcome of which is generally uncertain. Litigation and regulatory proceedings are inherently unpredictable. An adverse outcome in, or any settlement of, these or other proceedings (including any that may be asserted in the future) could result in significant costs and may have a material adverse effect on the Telefónica Group s business, financial position, results of operations and cash flow.

Table of Contents

TREND EVOLUTION

We are an integrated diversified telecommunications group that offers a wide range of services, mainly in Spain, Europe, and Latin America. Our activity is based upon providing fixed and mobile services, Internet and data, pay TV and value added services, among others. In addition, our holdings in China Unicom and Telecom Italia create opportunities for strategic alliances that reinforce our competitive position, scale and efficiency.

Our business is impacted by general economic conditions and other similar factors in each of the countries in which we operate. This fact may negatively affect the level of demand of existing and prospective customers, as our services may not be deemed critical for these customers.

As a multinational telecommunications company that operates in regulated markets, we are subject to different laws and regulations in each of the jurisdictions in which we provide services. We can expect the regulatory landscape to change in Europe as a consequence of the revised regulations resulting from the implementation of the review of the common regulatory framework currently in place in the European Union. In addition, we may also face pressure from regulatory initiatives in some European countries regarding tariffs, the reform of rights of spectrum use and allocation, issues related to the quality of service, and the regulatory treatment of new broadband infrastructure deployments.

We face intense competition in most of our markets, and we are therefore subject to the effects of actions taken by our competitors. The intensity of the competition may deepen, having an impact on tariff structures, consumption, market share and commercial activity, which could result in decreases in current and potential customers, revenues and profitability.

However, we are in a strong competitive position in most of the markets where we operate. We intend to continue to seek and take advantage of growth opportunities, such as by boosting both fixed and mobile broadband services and by furthering the development of services beyond connectivity, information technology services and related businesses. We seek to lead the industry by anticipating trends in the new digital environment.

We will continue transforming our operating model to increase our operational efficiency and capture the synergies arising from our integrated approach to businesses, processes and technologies and will maintain a regional approach to tackle this transformation more efficiently. At the same time, we will continue to be strongly committed to technological innovation as a key tool for achieving sustainable competitive advantages, anticipating market trends and differentiating our products. We continually seek to become a more efficient and customer-oriented Group, by introducing new technologies and developing new products and business processes.

In Spain, we will continue to intensify our commercial focus on offering higher quality services, by increasing the effectiveness of our sales channels and further improving our networks to increase customer satisfaction. We will seek to strengthen relations with our customers through targeted commercial offerings. We will boost mobile and fixed broadband growth and bundling services more effectively, taking into account the different geographical areas. Efficiency will continue to play a very important role in all areas of management, both in commercial and operational areas, including systems, networks and processes.

Table of Contents

In Latin America, our strategy is based on a regional model that captures growth and efficiency of scale without losing sight of the local management of the client. The mobile business will continue to play a fundamental role as an engine of regional growth. That is why we continue to further improve the capacity and coverage of our networks, adapting our distribution network to enhance the quality of our offer both in voice and data in order to keep and attract high value customers. With regard to the fixed telephony business, we will encourage the increase of broadband speed and expand the supply of bundled services. We will further advance efficiency, in operational and commercial terms, and attempt to achieve further synergies by implementing global, regional and local projects.

In Europe, customers will remain at the center of our strategy and management priorities in the region. With the objective of offering our customers the best value, we will boost the mobile and fixed broadband services to strengthen our market position. Various initiatives will be implemented to improve our operating efficiency.

In summary, in the context of continued economic uncertainty, intense competition and regulatory pressure on pricing, Telefónica will continue strengthening its business model to make it more efficient and capture the synergies arising from the integrated approach of businesses, processes and technologies, while focusing even more on the client.

Table of Contents

EVENTS AFTER THE REPORTING PERIOD

The following events regarding the Company took place between the reporting date and the date of preparation of the accompanying financial statements:

On January 11, 2010, Telco, S.p.A. (Telco) arranged a 1,300 million euro loan with Intesa Sanpaolo, S.p.A., Mediobanca, S.p.A., Société Générale, S.p.A. and Unicredito, S.p.A. maturing on May 31, 2012, part of which is secured with Telecom Italia, S.p.A. shares. The lending banks have granted Telco shareholders a call option on the Telecom Italia, S.p.A. shares that they may be entitled to receive as a result of the potential execution of the pledge.

In line with the commitments assumed by Telco shareholders, on December 22, 2009, the rest of Telco s financing needs with respect to debt maturities were met with a bridge loan granted by shareholders Telefónica, Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for approximately 902 million euros, and a bank bridge loan granted by Intesa Sanpaolo, S.p.A. and Mediobanca, S.p.A., for the remaining 398 million euros.

The financing from the bridge loans was substituted with a bond subscribed by Telco s shareholder groups, on a pro-rate basis in accordance with their interests in the company, on February 19, 2010 for 1,300 million euros.

On December 3, 2009, Telefónica s subsidiary in Germany, Telefónica Deutschland GmbH (Telefónica Deutschland), signed an agreement to acquire all of the shares of German company HanseNet Telekommunikation GmbH (HanseNet). The purchase price agreed by the parties was based on the firm value of 900 million euros, subject to a series of adjustments upon completion of the transaction.

The purchase and sale was subject to compliance with a series of conditions, including approval of the transaction by the pertinent competition authorities, which was obtained on January 29, 2010. The transaction was completed in February 2010; hence the outstanding payment commitment was fulfilled.

On February 16, 2010, having complied with the terms established in the agreement dated December 3, 2009 by the parties, the Telefónica Group completed the acquisition of 100% of the shares of HanseNet. The final amount paid out was approximately 912 million euros.

On January 25, 2010, Telefónica Emisiones, S.A.U. repaid at maturity the bonds issued on July 25, 2006 under the bond issuance program (EMTN) registered with the London Stock Exchange for an aggregate amount of 1,250 million euros.

Table of Contents

On January 29, 2010, Telefónica, S.A. made a voluntarily repayment ahead of schedule of 500 million euros on the 6,000 million euro syndicated loan arranged on June 28, 2005 and amended on February 13, 2009 to extend the maturity of 4,000 million euros from June 28, 2011 by one year for 2,000 million euros and two years for the other 2,000 million euros.

On February 11, 2010, Telefónica, S.A. made a voluntarily repayment ahead of schedule of 500 million euros on the 6,000 million euro syndicated loan arranged on June 28, 2005 and amended on February 13, 2009 to extend the maturity of 4,000 million euros from June 28, 2011 by one year for 2,000 million euros and two years for the other 2,000 million euros.

Table of Contents

On February 12, 2010, Telefónica, S.A. arranged long-term financing for an amount of 472 million US dollars at fixed rates with a guarantee of the Swedish Export Agency (EKN) to acquire network equipment from a Swedish service provider. This financing entailed three tranches: tranche A, for 232 million US dollars maturing on November 30, 2018, tranche B, for 164 million US dollars maturing on April 30, 2019, and tranche C, for 76 million US dollars maturing on November 30, 2019.

Amendment to the agreements signed with Prisa and Sogecable following the purchase of a stake in Digital+ by Gestevisión Telecinco, S.A. Following the signing on the agreement between Prisa and Gestevisión Telecinco, S.A. (Telecinco) for the sale by Prisa to Telecinco of a 22% stake in Digital+, on January 29, 2010, Telefónica and Prisa signed a new agreement raising the percentage stake to be acquired by Telefónica from 21% to 22%. Meanwhile, following the agreement reached between Prisa and Telecinco, Telefónica has undertaken to renegotiate the terms of the Shareholder Agreement to reflect the shareholder structure of Digital+ following the acquisition of a stake in the company by Telecinco.

The estimated total investment to be made by Telefónica, after deduction of the net debt, will be around 495 million euros, of which approximately 230 million euros will be covered by the assumption by the buyer of subordinated loan between Telefónica de Contenidos, S.A.U. (creditor) and Sogecable (debtor). This acquisition was subject, among other conditions, to the obtainment of the appropriate regulatory authorizations.

DISCLOSURES REQUIRED UNDER ARTICLE 116 BIS OF THE SPANISH SECURITIES MARKET LAW

Disclosures required under Article 116.bis of the Spanish Securities Market Law:

a.- Capital structure.

At December 31, 2009, the share capital of Telefónica was 4,563,996,485 euros, represented by 4,563,996,485 fully paid ordinary shares of a single series, par value of 1 euro each, all recorded under the book-entry system.

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

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

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

b.- Restrictions on the transfer of securities.

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

c.- Significant shareholdings.

The table below lists shareholders who, at December 31, 2009, to the best of the Company s knowledge, had significant direct or indirect shareholdings in the Company as defined in Royal Decree 1362/2007 implementing the Spanish Securities Markets Law 24/1998 as it relates to the need for transparent information on issuers whose securities are listed for trading in an official secondary market or other regulated market of the European Union:

	Total		Direct shareholding		Indirect holding	
	%	Shares	%	Shares	%	Shares
BBVA (1)	5.54	252,999,646	5.54	252,999,646		
La Caixa (2)	5.17	235,973,505	0.01	253,024	5.16	235,720,481
Capital Research and Management Company (3)	3.16	144,578,826	0	0	3.16	144,578,826
Blackrock, Inc. (4)	3.88	177,257,649	0	0	3.88	177,257,649

(1) Based on the information contained in Banco Bilbao Vizcaya Argentaria, S.A. s 2009 Annual Report on Corporate Governance at December 31, 2009.

(2) Based on information provided by Caja de Ahorros y Pensiones de Barcelona, La Caixa as at December 31, 2009 for the 2009 Annual

Report on Corporate Governance. The 5.16% indirect shareholding in Telefónica is owned by Criteria CaixaCorp, S.A.

(3) According to notification sent to the Spanish national securities commission, the CNMV, dated May 20, 2009.

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

Table of Contents

d.- Restrictions on voting rights.

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

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

e.- Agreements between shareholders.

In accordance with the provisions of article 112, section 2 of the Securities Market Law 24/1988, of July 28, on October 22, 2009, the Company notified the CNMV in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per this article. By virtue of these clauses, Telefónica may not, while the strategic alliance agreement is effective, offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited. In addition, China Unicom (Hong Kong) Limited undertakes not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica s voting share capital (excluding intragroup transfers). At the same time, both parties have assumed similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

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

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

Appointment, reappointment and ratification.

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

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

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

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

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

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

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

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

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

Termination of appointment or removal.

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

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

a) If they leave the executive post by virtue of which they sat on the Board or when the reasons for which they were appointed cease to apply.

b) If their circumstances become incompatible with their continued service on the Board or prohibit them from serving on the Board for one of the reasons specified under Spanish law.

c) If they are severely reprimanded by the Appointments, Compensation and Good Governance Committee for failure to fulfill any of their duties as Director.

d) If their continued presence on the Board could affect the credibility or reputation of the Company in the markets or otherwise threaten the Company s interests.

Table of Contents

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

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

Amendments to the Company Bylaws.

The procedure for amending the Bylaws is governed by Article 144 of the Spanish Corporation Law and requires any change to be approved by shareholders at the Shareholders Meeting with the majorities stated in Article 103 of the same law. Article 14 of Telefónica s Bylaws upholds this principle.

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

Powers of Directors.

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

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

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

Powers to issue shares.

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

Also, at the General Shareholders Meeting of May 10, 2007, the Board of Directors was authorized under Articles 153.1.b) and 159.2 of the Spanish Corporation Law to issue bonds exchangeable for or convertible into shares in the Company, this power being exercisable one or several times within a maximum of five years of that date. The Board of Directors has not exercised this power to date.

Table of Contents

Powers to buy back shares.

At the General Shareholders Meeting of Telefónica of June 23, 2009, the Board of Directors was authorized, in accordance with articles 75 and following of the Spanish Corporation Law, to buy back its own shares either directly or via companies belonging to the Group. This authorization was granted for 18 months from that date and includes the specific limitation that at no point may the nominal value of treasury shares acquired, added to those already held by Telefónica and those held by any of the subsidiaries that it controls, exceed the maximum legal percentage at any time (currently 10% of Telefónica s share capital).

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

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

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

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

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

Table of Contents

ANNUAL REPORT ON CORPORATE GOVERNANCE
LISTED LIMITED COMPANIES

ISSUERS S IDENTIFICATION DETAILS DATE OF FINANCIAL YEAR END: 12/31/09
TAX ID CODE: A28015865
Company name: TELEFÓNICA, S.A.

124

Table of Contents

ANNUAL CORPORATE GOVERNANCE REPORT FOR LISTED LIMITED COMPANIES

For a better understanding of the model and its subsequent preparation, please read the instructions provided at the end before filling it out.

A OWNERSHIP STRUCTURE

A.1 Complete the following table on the company s share capital.

Date of last modification	Share capital ( )	Number of shares	Number of voting rights
12/28/09	4,563,996,485.00	4,563,996,485	4,563,996,485

Indicate whether different types of shares exist with different associated rights.

No

A.2 List the direct and indirect holders of significant ownership interests in your organisation at year-end, excluding directors:

Name or corporate name of shareholder	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Banco Bilbao Vizcaya Argentaria, S.A.	252,999,646	0	5.543
Caja de Ahorros y Pensiones de Barcelona, la Caixa	253,024	235,720,481	5.170
Capital Research and Management Company	0	144,578,826	3.168
Blackrock, Inc.	0	177,257,649	3.884

Name or corporate name of indirect shareholder	Through: name or corporate name of direct shareholder	Number of direct voting rights	% of total voting rights
Caja de Ahorros y Pensiones de Barcelona, la Caixa	Criteria CaixaCorp, S.A.	235,720,481	5.165
Blackrock, Inc.	Blackrock Investment Management (UK)	177,257,649	3.884

Table of Contents

Indicate the most significant movements in the shareholder structure during the year.

A.3 Fill in the following tables on company directors holding voting rights through company shares:

Name or corporate name of director	Number of direct voting rights	Number of indirect voting rights (*)	% of total voting rights
Mr. César Alierta Izuel	3,966,186	78,000	0.089
Mr. Isidro Fainé Casas	434,021	0	0.010
Mr. Vitalino Manuel Nafría Aznar	11,300	0	0.000
Mr. Julio Linares López	251,394	1,840	0.006
Mr. Alfonso Ferrari Herrero	571,364	18,999	0.013
Mr. Antonio Massanell Lavilla	2,286	0	0.000
Mr. Carlos Colomer Casellas	564	63,190	0.001
Mr. David Arculus	10,500	0	0.000
Mr. Francisco Javier de Paz Mancho	26,115	0	0.001
Mr. Gonzalo Hinojosa Fernández de Angulo	85,476	436,000	0.011
Mr. José Fernando de Almansa Moreno-Barreda	19,349	0	0.000
Mr. José María Abril Pérez	300	18,402	0.000
Mr. José María Álvarez-Pallete López	196,835	1,036	0.004
Mr. Luiz Fernando Furlán	4,100	0	0.000
Ms. María Eva Castillo Sanz	58,450	0	0.001
Mr. Pablo Isla Álvarez de Tejera	8,601	0	0.000
Mr. Peter Erskine	69,259	0	0.002

Table of Contents

% of total voting rights held by the Board of Directors 0.139

Complete the following tables on share options held by directors:

Name or Corporate name of director	Number of direct share options	Number of indirect share options	Equivalent number of shares	% of total Voting rights
Mr. César Alierta Izuel	438,773	0	438,773	0.010
Mr. César Alierta Izuel 2	10,200,000	0	0	0.223
Mr. Julio Linares López	289,190	0	289,190	0.006
Mr. Alfonso Ferrari Herrero	485,000	0	0	0.011
Mr. Carlos Colomer Casellas	50,982	0	0	0.001
Mr. José María Álvarez- Pallete López	199,810	0	199,810	0.004

A.4 Indicate, as applicable, any family, commercial, contractual or corporate relationships between owners of significant shareholdings, insofar as these are known by the company, unless they are insignificant or arise from ordinary trading or exchange activities:

A.5 Indicate, as applicable, any commercial, contractual or corporate relationships between owners of significant shareholdings, and the company and/or its group, unless they are insignificant or arise from ordinary trading or exchange activities:

Name or company name of related party	Type of relationship	Brief description
Banco Bilbao Vizcaya Argentaria, S.A.	Corporate	Joint shareholding with Telefónica Móviles España, S.A.U. in Mobipay España, S.A. Joint shareholding with Telefónica, S.A. in Mobipay Internacional, S.A.

A.6 Indicate whether any shareholders agreements have been notified to the company pursuant to article 112 of the Securities Market Act (Ley del Mercado de Valores). Provide a brief description and list the shareholders bound by the agreement, as applicable:

Yes

% of share capital affected:

0.87%

127

Table of Contents

Breif description of the agreement:

In accordance with the provisions of article 112, section 2 of the Securities Market Act 24/1988, of July 28, on October 22, 2009, the Company notified the Spanish national securities commission, the CNMV, in writing that on September 6, 2009 it had entered into a mutual share exchange agreement between Telefónica and China Unicom (Hong Kong) Limited, whose clauses 8.3 and 9.2 are considered a shareholder agreement as per this article. By virtue of these clauses, Telefónica may not offer, issue or sell a significant number of its shares or any convertible security or security that confers the right to subscribe or acquire a significant number of shares of Telefónica, S.A. to any of the main competitors of China Unicom (Hong Kong) Limited, while the strategic alliance agreement is in force. In addition, China Unicom (Hong Kong) Limited undertakes not to sell, use or transfer, directly or indirectly, for a period of one year its share in Telefónica s voting share capital (excluding intragroup transfers). At the same time, both parties have assumed similar obligations with respect to the share capital of China Unicom (Hong Kong) Limited.

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

Members of the shareholder s agreement:

China Unicom (Hong Kong) Limited

Telefónica, S.A.

Indicate whether the company is aware of the existence of any concerted actions among its shareholders. Give a brief description as applicable:

No

Expressly indicate any amendments to or termination of such agreements or concerted actions during the year:

A.7 Indicate whether any individuals or bodies corporate currently exercise control or could exercise control over the company in accordance with article 4 of the Spanish Securities Market Act. If so, identify:

No

A.8 Complete the following tables on the company s treasury shares:

At year-end:

Number of shares held directly	Number of shares held indirectly (*)	% of total share capital
6,329,530	0	0.139

(*) Through:

Total:	0

128

Table of Contents

Give details of any significant changes during the year, in accordance with Royal Decree 1362/2007:

Date of notification	Total number of direct shares acquired	Total number of indirect shares acquired	% of total share capital
07/06/09	53,374,599	0	1.136

Gain/(loss) on treasury shares sold during the year (thousands of euros) 102

A.9 Give details of the applicable conditions and time periods governing any resolutions of the General Shareholders Meeting authorising the Board of Directors to purchase and/or transfer the treasury shares.

At the General Shareholders Meeting of Telefónica of June 23, 2009, shareholders renewed the authorization granted, by the General Shareholders s Meeting itself, on April 22, 2008 for the derivative acquisition of treasury shares, either directly or through Group companies, in the terms literally transcribed below:

To authorize, pursuant to the provisions of Section 75 et seq. and the first additional provision, paragraph 2, of the Spanish Companies Act [Ley de Sociedades Anónimas, or LSA for its initials in Spanish], the derivative acquisition by Telefónica, S.A. either directly or through any of the subsidiaries of which it is the controlling company- at any time and as many times as it deems appropriate, of its own fully-paid in shares through purchase and sale, exchange or any other legal transaction.

The minimum price or consideration for the acquisition shall be equal to the par value of the shares of its own stock acquired, and the maximum acquisition price or consideration for the acquisition shall be equal to the listing price of the shares of its own stock acquired by the Company on an official secondary market at the time of the acquisition.

Such authorization is granted for a period of 18 months as from the date of this General Shareholders Meeting and is expressly subject to the limitation that the par value of the Company s own shares acquired pursuant to this authorization added to those already held by Telefónica, S.A. and any of its controlled subsidiaries shall at no time exceed the maximum amount permitted by the Law at any time, and the limitations on the acquisition of the Company s own shares established by the regulatory Authorities of the market on which the shares of Telefónica, S.A. are traded shall also be observed.

It is expressly stated for the record that the authorization granted to acquire shares of its own stock may be used in whole or in part to acquire shares of Telefónica, S.A. that it must deliver or transfer to directors or employees of the Company or of companies of its Group, directly or as a result of the exercise by them of option rights, all within the framework of duly approved compensation systems referencing the listing price of the Company s shares.

To authorize the Board of Directors, as broadly as possible, to exercise the authorization granted by this resolution and to implement the other provisions contained therein; such powers may be delegated by the Board of Directors to the Executive Commission, the Executive Chairman of the Board of Directors, the Chief Operating Officer or any other person expressly authorized by the Board of Directors for such purpose.

To deprive of effect, to the extent of the unused amount, the authorization granted under Item III on the Agenda by the Ordinary General Shareholders Meeting of the Company on April 22, 2008.

Table of Contents

A.10 Indicate, as applicable, any restrictions imposed by Law or the company s bylaws on exercising voting rights, as well as any legal restrictions on the acquisition or transfer of ownership interests in the share capital.

Indicate whether there are any legal restrictions on exercising voting rights:

No

Maximum percentage of legal restrictions on voting rights a shareholder can exercise	0

Indicate whether there are any restrictions included in the bylaws on exercising voting rights.

Yes

Maximum percentage of restrictions under the company s bylaws on voting rights a shareholder can exercise	10.000

Description of restrictions under law or the company s bylaws on exercising voting rights

In accordance with Article 21 of the Company By-Laws, no shareholder may cast a number of votes in excess of 10 percent of the total voting capital existing at any time, regardless of the number of shares held by such shareholder. In determining the maximum number of votes that each shareholder may cast, only the shares held by each such shareholder shall be computed, and those held by other shareholders that have granted their proxy to the first-mentioned shareholder shall not be computed, without prejudice to the application of the aforementioned limit of 10 percent to each of the shareholders that have granted a proxy.

The limitation established in the preceding paragraphs shall also apply to the maximum number of votes that may be collectively or individually cast by two or more shareholder companies belonging to the same group of entities, as well as to the maximum number of votes that may be cast by an individual or corporate shareholder and the entity or entities that are shareholders themselves and which are directly or indirectly controlled by such individual or corporate shareholder.

Indicate if there are any legal restrictions on the acquisition or transfer of share capital:

No

A.11 Indicate whether the General Shareholders Meeting has agreed to take neutralisation measures to prevent a public takeover bid by virtue of the provisions of Act 6/2007.

No

If applicable, explain the measures adopted and the terms under which these restrictions may be lifted:

Table of Contents

B COMPANY MANAGEMENT STRUCTURE

B.1 Board of directors

B.1.1. List the maximum and minimum number of directors included in the bylaws.

Maximum number of directors	20
Minimum number of directors	5

B.1.2. Complete the following table with board members details:

Name or corporate name of director	Representative	Position on the board	Date of first appointment	Date of last appointment	Election procedure
Mr. César Alierta Izuel		Chairman	01-29-1997	05-10-2007	Vote at General Shareholders Meeting
Mr. Isidro Fainé Casas		Vice Chairman	01-26-1994	06-21-2006	Vote at General Shareholders Meeting
Mr. Vitalino Manuel Nafría Aznar		Vice Chairman	12-21-2005	06-21-2006	Vote at General Shareholders Meeting
Mr. Julio Linares López		Chief Operating Officer	12-21-2005	06-21-2006	Vote at General Shareholders Meeting
Mr. Alfonso Ferrari Herrero		Director	03-28-2001	06-21-2006	Vote at General Shareholders Meeting
Mr. Antonio Massanell Lavilla		Director	04-21-1995	06-21-2006	Vote at General Shareholders Meeting
Mr. Carlos Colomer Casellas		Director	03-28-2001	06-21-2006	Vote at General Shareholders Meeting
Mr. David Arculus		Director	01-25-2006	06-21-2006	Vote at General Shareholders Meeting
Mr. Francisco Javier de Paz Mancho		Director	12-19-2007	04-22-2008	Vote at General Shareholders Meeting
Mr. Gonzalo Hinojosa Fernández de Angulo		Director	04-12-2002	05-10-2007	Vote at General Shareholders Meeting
Mr. José Fernando de Almansa Moreno-Barreda		Director	02-26-2003	04-22-2008	Vote at General Shareholders Meeting
Mr. José María Abril Pérez		Director	07-25-2007	04-22-2008	Vote at General Shareholders Meeting
Mr. José María Álvarez-Pallete López		Director	07-26-2006	05-10-2007	Vote at General Shareholders Meeting
Mr. Luiz Fernando Furlán		Director	01-23-2008	04-22-2008	Vote at General Shareholders Meeting
Ms. María Eva Castillo Sanz		Director	01-23-2008	04-22-2008	Vote at General Shareholders Meeting
Mr. Pablo Isla Álvarez de Tejera		Director	04-12-2002	05-10-2007	Vote at General Shareholders Meeting
Mr. Peter Erskine		Director	01-25-2006	06-21-2006	Vote at General Shareholders Meeting

Total number of directors	17

Table of Contents

Indicate any Board members who left during this period.

Name or corporate name of director	Status of the director at the time	Leaving date

B.1.3. Complete the following tables on Board members and their respective categories:

EXECUTIVE DIRECTORS

Name or corporate name	Committee proposing	Post held in