

TELECOMMUNICATIONS CO OF CHILE
Form 20-F
May 01, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 20-F

(Mark One)

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g)
OF**

THE SECURITIES EXCHANGE ACT OF 1934

OR

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2007

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

OR

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF
THE SECURITIES EXCHANGE ACT OF 1934**

Commission File Number: 001-10579

Compañía de Telecomunicaciones de Chile S.A.

(Exact name of Registrant as specified in its charter)

Telecommunications Company of Chile

(Translation of Registrant's name into English)

Republic of Chile

(Jurisdiction of incorporation or organization)

Avenida Providencia 111

Santiago, Chile

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act

Title of each class	Name of each exchange on which registered
American Depositary Shares Series A Common Stock	New York Stock Exchange New York Stock Exchange*

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* Listed not for trading, but only in connection with the registration of American Depositary Shares, pursuant to the requirements of the Securities and Exchange Commission.

Securities registered or to be registered pursuant to Section 12(g) of the Act: **None**
Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: **None**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report:

Series A Common Stock	873,995,447
Series B Common Stock	83,161,638

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 (the Exchange Act) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days:

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

International Financial Reporting Standards as issued by the International

U.S. GAAP Accounting Standards Board Other

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.

Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

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CERTAIN TERMS AND CONVENTIONS

All references to Chile or the Republic are references to the Republic of Chile. All references to the Government are references to the Government of Chile. Unless otherwise specified, all references to Telefónica Chile or the Company are references to Compañía de Telecomunicaciones de Chile S.A., a publicly held stock corporation (*sociedad anónima abierta*) organized under the laws of Chile, and its subsidiaries. All references to Telefónica are references to Telefónica S.A., a publicly held stock corporation organized under the laws of the Kingdom of Spain that owned, directly and indirectly, 44.9% of the Company's ordinary shares at December 31, 2007. All references to Telefónica Group are references to Telefónica and its Latin American subsidiaries, including Telefónica Chile.

Unless otherwise specified, all references to \$, US\$, U.S. dollars and dollars are to United States dollars, references to Chilean pesos, pesos or Ch\$ are to Chilean pesos, references to UF are to Unidades de Fomento, a daily-indexed Chilean peso-denominated monetary unit that takes into account the effect of the Chilean inflation rate of the previous month, and references to UTM are to Unidad Tributaria Mensual, a monthly-indexed Chilean peso-denominated monetary unit that takes into account the effect of the Chilean inflation rate of the month before the previous month. All references to euros are to the common currency of the European Union. Unless otherwise specified, all references to U.S. GAAP are to generally accepted accounting principles in the United States, and all references to Ch GAAP or Chilean GAAP are to generally accepted accounting principles in Chile and the related rules of the Superintendencia de Valores y Seguros de Chile, SVS, or Chilean Securities and Exchange Commission.

PRESENTATION OF FINANCIAL INFORMATION

This Annual Report contains the audited consolidated balance sheets of Compañía de Telecomunicaciones de Chile S.A. and its Subsidiaries as of December 31, 2007 and 2006 and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 2007 (collectively, the Audited Consolidated Financial Statements or Financial Statements), which were audited by Ernst & Young Ltda. The Audited Consolidated Financial Statements have been prepared in accordance with Chilean GAAP, which differs in certain significant respects from U.S. GAAP. See Note 37 to the Audited Consolidated Financial Statements of the Company, included elsewhere in this Annual Report, for a description of the principal differences between Chilean GAAP and U.S. GAAP as they relate to the Company and a reconciliation to U.S. GAAP of net income and shareholders' equity for the periods and as of the dates covered thereby. As required by Chilean GAAP, the Company publishes its financial statements in Chilean pesos that are adjusted to reflect changes in purchasing power due to inflation. In accordance with the Securities and Exchange Commission rules and regulations, such price-level restatement has not been eliminated in the U.S. GAAP reconciliation of net income and shareholders' equity. Unless otherwise specified, financial data regarding the Company is presented herein in constant Chilean pesos of December 31, 2007 purchasing power. See Note 2(e) to the Audited Consolidated Financial Statements of the Company.

Merely for the convenience of the reader, translations of certain amounts into dollars at a specified rate have been included. Unless otherwise specified, or unless the context otherwise requires, the U.S. dollar equivalent for information in Chilean pesos is based on the exchange rate (the Observed Exchange Rate) reported by Banco Central de Chile (the Central Bank) that is computed, for any date, by averaging the exchange rates of the previous business day's transactions in Chile's Mercado Cambiario Formal (the Formal Exchange Market). On January 2, 2008, the Central Bank reported that the Observed Exchange Rate with reference to December 31, 2007, the last business day in 2007 for which an exchange rate was reported, was Ch\$496.89 per US\$1.00. Telefónica Chile does not represent that the Chilean peso or U.S. dollar amounts in this Annual Report actually represent, or could have been or could be converted into, U.S. dollars or Chilean pesos, as the case may be, at the rates indicated, or at any particular rate or at all. See Item 3. Key Information Exchange Rates for information regarding historical rates of exchange in Chile from January 1, 2003. Unless otherwise specified, references to the devaluation or the appreciation of the Chilean peso against the U.S. dollar are in nominal terms (without adjusting for inflation), based on the Observed Exchange Rates

for the relevant period.

The Company changed its presentation of consolidated revenues to respond to the Company's diversification with new bundled services. The Company now presents Broadband and Television revenues separately; the

remaining revenues from the group formerly known as Fixed Telecommunications are now presented in Voice, Fixed Network and Complementary Services. The presentation of previous years results was changed in order to reflect the current organization. See Item 5. Operating and Financial Review and Prospects Operating Results for more information.

FORWARD-LOOKING STATEMENTS AND ASSOCIATED RISKS

This Annual Report contains certain forward-looking statements within the meaning of Section 21E of the Exchange Act. Some of these forward-looking statements include forward-looking phrases such as anticipates, believes, could, estimates, expects, foresees, intends, may, should or will continue, or similar expressions, or negatives thereof or other variations on these expressions, or similar terminology, or discussions of strategy, plans or intentions. These statements also include descriptions in connection with, among other things:

- the Company's business development plans and strategies, including its asset growth, cost-saving and financing plans;
- new offerings of services and acquisitions of licenses, and anticipated demand related to such new services and licenses;
- the future impact of competition;
- economic and political developments in Chile;
- the effects of inflation and currency volatility on the Company's financial condition and results of operations;
- the outcome of regulatory proceedings in which the Company is involved, including its litigation with the State of Chile;
- the Company's unionized employees;
- trends affecting the Company's financial condition or results of operations; and
- regulations affecting the Company's business, including tariff decrees, new rulings, concession and licenses.

Such statements reflect the Company's current views regarding future events and are subject to certain risks, uncertainties and assumptions. Many factors could cause actual results, performance or achievements to be materially different from any future results, performance or achievements that forward-looking statements may express or imply, such as, for example:

- changes in regulations and laws;
- the Company's ability to implement its cost and expenses control plans and its investment program, including its ability to arrange financing where required;
- the nature and extent of future competition and technological development;
- political, economic and demographic developments in Chile; and

- other risks and uncertainties, some of which are described in more detail in Item 3. Key Information Risk Factors, Item 4. Information on the Company and Item 5. Operating and Financial Review and Prospects.

If one or more of these risks or uncertainties affects future events and circumstances, or if underlying assumptions do not materialize, actual results may vary materially from those described in this Annual Report as anticipated, believed, estimated or expected. The Company has no plans to update any industry information or forward-looking statements set out in this Annual Report and have no obligation to update any such statements.

PART I**ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION**A. Selected Financial Data**

The following table presents selected financial data as of December 31, 2007 and the four previous years. The Consolidated Financial Statements were prepared in accordance with Chilean GAAP, which differs in certain significant respects from U.S. GAAP. Note 37 to the Audited Consolidated Financial Statements provides a summary of significant differences between Chilean GAAP and U.S. GAAP as they relate to us, including the impact of such differences on the Company's net income and shareholders' equity. Net income and shareholders' equity in U.S. GAAP are also included in the selected financial data as a reference. The selected financial data should be read in conjunction with the Audited Consolidated Financial Statements and notes thereto, Item 5. Operating and Financial Review and Prospects and other financial information included herein.

The following selected consolidated financial data was affected by certain changes in the Company's corporate structure during the years presented. In particular, the data for 2004 reflects the divestiture and deconsolidation of the Company's mobile subsidiary Telefónica Móvil pursuant to its sale in July 2004.

	2003	2004	2005	2006	2007	2007
	(in millions of constant Chilean pesos as of December 31, 2007, except ratios and share data)					(in millions of U.S. dollars)
Statement of Operations Data:						
<i>Chilean GAAP</i>						
Operating Revenues	946,438	798,488	636,779	619,917	632,572	1,273.1
Operating Costs and Expenses	(612,466)	(504,908)	(409,073)	(400,629)	(423,274)	851.8
Administrative and Selling Costs	(199,646)	(180,959)	(132,200)	(130,550)	(140,963)	283.7
Operating Results	134,326	112,619	95,505	88,738	68,335	137.5
Interest Income	8,240	10,549	8,755	4,765	7,173	14.4
Interest Expense, Net of Capitalized Interest	(71,316)	(61,406)	(32,350)	(20,922)	(18,910)	(38.1)
Price Level Restatement and Exchange Differences ⁽¹⁾	740	10,204	3,181	715	1,393	2.8
Other non-operating income, net ⁽⁷⁾	(26,249)	353,258	(10,828)	(16,469)	(24,375)	(49.1)

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Income before Income Taxes	45,744	425,223	64,264	56,826	43,960	88.5
Income Tax	(33,779)	(70,883)	(36,616)	(31,790)	(33,214)	(66.8)
Net Income (loss)	11,800	354,019	27,615	25,081	10,856	(21.8)
Dividends Paid ⁽²⁾	19,464	720,073	126,916	25,800	19,434	39.1
Chilean GAAP earnings (loss) per Share ⁽³⁾	12.33	369.87	28.85	26.20	11.34	0.02
Earnings per ADS ⁽⁴⁾	49.32	1,479.48	115.40	104.80	45.37	0.09
Dividends per Share ⁽⁵⁾	20.34	752.3	13.60	26.95	20.30	0.04
Dividends per ADS ⁽⁴⁾	81.34	3,009.22	530.39	107.82	81.22	0.16
Weighted Average Number of Shares Outstanding	957,157,085	957,157,085	957,157,085	957,157,085	957,157,085	

	2003	2004	2005	2006	2007	2007
	(in millions of constant Chilean pesos as of December 31, 2007, except ratios and share data)					(in millions of U.S. dollars)
Statement of Operations Data:						
U.S. GAAP						
Net Income (loss) in accordance with U.S. GAAP	32,775.3	22,788.1	50,042.0	43,705.9	35,988.9	72.4
Net income (loss) from continuing operations*	18,631.8	24,209.0	50,042.0	43,705.9	35,988.9	72.4
Net income (loss) from discontinuing operations*	14,143.5	(1,420.9)	-	-	-	-
Number of Shares	957,157,085	957,157,085	957,157,085	957,157,085	957,157,085	
Net Income (loss) in accordance with U.S. GAAP per Share	34.24	23.81	52.28	45.66	38.00	0.08
Net Income (loss) from continuing operations per Share	19.46	25.29	52.28	45.66	38.00	0.08
Net Income (loss) from discontinuing operations per Share	26.57076	(1.48212)	-	-	-	-
Balance Sheet Data:						
Chilean GAAP						
Current Assets	489,855	479,776	349,041	315,448	352,577	709.3
Property, Plant and Equipment, net	2,130,755	1,570,989	1,426,066	1,330,430	1,257,311	2,530.4
Other Assets	284,621	101,580	101,229	87,771	75,027	151.0
Total Assets	2,905,230	2,152,345	1,876,336	1,733,648	1,684,916	3,390.9
Total Long-Term Debt (including Current Maturities) ⁽⁸⁾	976,851	636,492	550,875	431,308	391,549	788.0
Total Shareholders Equity	1,502,393	1,118,843	1,014,943	967,417	906,534	1,824.4
U.S. GAAP						
Total Assets	2,932,804	2,157,075	1,876,029	1,744,700	1,704,464	3,430.3
Shareholders Equity	1,367,321	981,161	882,845	855,992	829,147	1,668.7
Paid in Capital	1,000,817	1,000,817	1,000,817	956,821	904,736	1,820.8
Other Data:						
Capital Expenditures ⁽⁶⁾	160,734	92,404	79,024	117,629	144,654	291.1

* The Company has revised its amounts previously presented under U.S. GAAP to reclassify its discontinued operations for the sale of Telefónica Móvil de Chile S.A. in 2004. These revised numbers are unaudited. Under Chilean GAAP, the Company is not required to restate or reclassify financial information presented in previous years to reflect significant divestitures. For purposes of U.S. GAAP, the Company is required to eliminate the results of operations of certain divested operations from those of its continuing operations in presenting its U.S. GAAP results. See Note 37 to the Audited Consolidated Financial Statements.

Monetary correction is the aggregate of purchasing power gain (loss) on indexation and gain (loss) on foreign currency transactions. See Item 5. Operating and Financial Review and Prospects Impact of Inflation.

- (2) Dividends paid represents the amount of dividends paid in the periods indicated.
- (3) Basic earnings (loss) per share have been computed using the weighted average number of shares outstanding during each period presented.
- (4) Calculated on the basis that each ADS represents four shares of Series A Common Stock.
- (5) Represents an amount equal to the interim dividends declared for each year and the final dividend for the preceding year declared in April of each year. See Item 8. Financial Information Dividend Policy and Dividends.
- (6) Represents the amount disbursed in each year, irrespective of the year in which the investment was made.
- (7) The Company recorded a non-operating gain associated with the sale of its subsidiary Telefónica Móvil de Chile S.A. to Telefónica Móviles (TEM) in July 2004.
- (8) Total Long-Term Debt (including Current Maturities) includes notes and accounts payable to related companies and capital lease obligations.

Exchange Rates

Chile's *Ley Orgánica Constitucional del Banco Central de Chile No. 18,840* (the Central Bank Act), enacted in 1989, liberalized the rules that govern the purchase and sale of foreign exchange in Chile. Prior to 1989, Chilean law authorized the purchase and sale of foreign exchange only in those cases explicitly authorized by the Central Bank.

The Central Bank Act empowers the Central Bank to determine whether certain purchases and sales of foreign exchange must be carried out in the Formal Exchange Market, a market formed by banks and other institutions authorized by the Central Bank for that purpose. The Central Bank has ruled that certain foreign exchange transactions (including those attendant to foreign investments) may be effected only in the Formal Exchange

Market. Banks and other institutions may purchase and sell foreign exchange in the Formal Exchange Market at such rates as they freely determine from time to time. The Central Bank reports an Observed Exchange Rate that is computed, for any date, by averaging the exchange rates of the previous business day's transactions in the Formal Exchange Market.

Since 1989, the Central Bank has also set a reference exchange rate known as the *dólar acuerdo* (Reference Exchange Rate) that is reset monthly, taking internal and external inflation into account, and is adjusted daily to reflect variations in the parities between the Chilean peso and each of the U.S. dollar, the euro and the Japanese yen.

The Central Bank Act authorized the Central Bank to carry out its transactions at rates within a specified band set around the Reference Exchange Rate. While the band was in place, the Central Bank generally carried out its transactions at the spot rate. When banks needed to buy or sell U.S. dollars from or to the Central Bank, the Central Bank made such sales at rates as high as the upper limit of the band, and such purchases at rates as low as the lower limit of the band. Banks generally carried out authorized transactions on the Formal Exchange Market at the spot rate, which usually fluctuated within the range of the band.

In order to keep fluctuations in the average exchange rate within the range of the band, the Central Bank of Chile in the past intervened by buying or selling foreign currency on the formal exchange market. On September 2, 1999, in order to allow for increased exchange rate flexibility, the Central Bank suspended its formal commitment to maintain the exchange rate within a specified band. The Central Bank may, however, still intervene in certain exceptional cases of exchange rate fluctuations to keep the average exchange rate within certain limits, and must inform the market of the reason for its intervention in each such event. Nonetheless, the Central Bank will continue to publish the Reference Exchange Rate as a reference for the market. Purchases and sales of foreign exchange that may be effected outside the Formal Exchange Market can be carried out in the *Mercado Cambiario Informal* (the Informal Exchange Market), a recognized currency market in Chile.

The following table sets forth the high, low, average and year-end Observed Exchange Rates for U.S. dollars for each year beginning with 2003 and for each of the past six months, as reported by the Central Bank. On April 13, 2008 the Observed Exchange Rate was Ch\$443.67 per US\$1.00.

	Observed Exchange Rates ⁽¹⁾ (Ch\$ per US\$)			
	Low ⁽²⁾	High ⁽²⁾	Average ⁽³⁾	Period-End
Year ended December 31, 2003	593.10	758.21	691.54	593.80
Year ended December 31, 2004	557.40	649.45	609.51	557.40
Year ended December 31, 2005	509.70	592.75	559.77	512.50
Year ended December 31, 2006	511.44	549.63	530.28	532.39
Year ended December 31, 2007	493.14	548.67	522.42	496.89
Month ended October 31, 2007	493.14	511.33	501.16	493.14
Month ended November 30, 2007	496.27	516.25	506.39	505.38
Month ended December 31, 2007	495.49	506.79	499.28	496.89
Month ended January 31, 2008	463.58	498.05	481.59	465.30
Month ended February 29, 2008	453.95	476.44	466.67	453.95
Month ended March 31, 2008	431.22	454.94	442.09	437.71
Month ended April 13, 2008	433.98	448.67	437.93	448.67

Source: Central Bank and Reuters Data Base

- (1) Reflects nominal pesos at historical values.
- (2) Exchange rates are the actual high and low for each period.
- (3) Corresponds to daily average rates during the period.

Telefónica Chile does not represent that the Chilean peso or U.S. dollar amounts referred to herein actually represent the amounts that were, could have been or could be converted into U.S. dollars or Chilean pesos, as the case may be, at the rates indicated, at any particular rate or at all.

The Central Bank regulates the international issuance by Chilean companies of non-peso-denominated debt, including, among other things, the repatriation and exchange for pesos of the foreign currency proceeds from such

offerings. See Item 10. Additional Information Exchange Controls and Other Limitations Affecting Security Holders.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

The following discussion should be read together with this Form 20-F, including the Audited Consolidated Financial Statements, and the notes thereto.

Risks Relating to the Company's Business

Regulation may adversely affect revenues in certain of Telefónica Chile's businesses.

Tariff regulation

The Chilean Government has historically regulated local telephony services in Chile. The *Comisión Resolutiva Antimonopolios* (the Chilean Antitrust Authority, now known as the *Tribunal de Libre Competencia*), a Chilean government agency responsible for making certain determinations relating to competitive conditions in the telecommunications industry, has determined that Telefónica Chile is a dominant operator of local telephony in many geographical areas of Chile. As a result, the Company is subject to tariff decrees that regulate certain rates and fees that the Company can charge for such local telephony services in most of the country. In accordance with the telecommunications law, all telecommunications operators are subject to regulation of their access charges (the charge to telecommunications operators for accessing another operator's network) which have been set at different levels depending on the operator. Consequently, costs of accessing different operators' networks differ. Regulatory changes in approved access charge rates may affect the revenues for local telephony and costs of interconnections to other local operators. Similarly, interconnections to local operators represent costs for the long distance and mobile businesses.

Tariff regulation may have a significant impact on Company revenues and its ability to compete in the marketplace, as the Company is required to charge the same tariff to all clients in a designated tariff area. See Item 4. Information on the Company Business Overview Licenses and Tariffs. In 2007, approximately 22% of Company revenues (including the regulated items in fixed charge, variable charge, access charges and public telephony) were from regulated business activities. The application of the local telephone tariffs, defined by Tariff Decree No. 169 for the period from 2004 to 2009, resulted in a minor impact in the 2004 and 2005 financial statements of Telefónica Chile. In contrast, the introduction of Tariff Decree No. 187 in May 1999 resulted in a reduction of approximately 25% in regulated revenues per line in the first year. Since 1999, the Company has sought administrative relief to correct what it believes are certain errors and illegalities in Tariff Decree No. 187. Upon denial of such relief, and having exhausted the administrative recourses available to it, in March 2002, Telefónica Chile filed a civil lawsuit for damages against the State of Chile, which is currently pending. The Company can give no assurance that future tariff decrees for fixed telephony will not have a material adverse effect on the results of operations or financial position, as such future tariff decrees could cause alterations in demand or traffic volume, or changes in the timing of traffic distribution from more expensive to less expensive time slots.

Other regulations

New regulations or changes in the existing regulatory model may adversely affect the Company's businesses. For instance, in 2006, the Undersecretary of Telecommunications, or Subtel, initiated a process of public inquiry for new regulations relating to IP telephony over broadband. The Company has participated in the public inquiry process and, together with other industry operators, has presented its opinion on this proposal. See Item 4. Information on the Company Business Overview Licenses and Tariffs. No assurance can be given that the

outcome of this or future regulations will not have a material adverse effect on the Company's results or financial position.

The Telecommunications Law also specifies certain causes for which an operator can be sanctioned through penalties or even the termination of its public or intermediate service license, if the operator is in violation of the law or does not comply with the terms and conditions to which the license is subject. If the holder believes that its license has been terminated unlawfully, the holder may appeal the termination in Chilean courts. If a license is terminated, the holder is barred from applying for any license for a period of five years. Any such sanctions could have a material adverse effect on the Company's results of operations or financial position.

Telefónica Chile faces intense competition.

Telefónica Chile faces intense competition in every aspect of its business, ranging from existing operators to new entrants. In addition, consolidation is leading to greater levels of competition.

In 2004, as part of recent M&A activity, two leading cable operators merged. The combined company now has approximately 66% of the paid television market and is also becoming a relevant player in broadband and fixed telephony. In the mobile telephony business, Telefónica Móviles (TEM) acquired Bellsouth in Chile and the mobile subsidiary of Telefónica Chile in 2004. In the same year, competition increased with the entry of new operators, primarily in the long distance and data transmission businesses. The Mexican operator Telmex, a data transmission operator, and América Móvil, a Telmex affiliate, entered the local mobile telephony market by acquiring Smartcom in August 2005. In 2007, Telmex also acquired ZAP, a local satellite television operator. Similarly, in September 2005, the local data transmission operator, GTD, acquired the local fixed operator Manquehue. See Item 4. Business Areas Market and Competition.

In the fixed local telephony market, Telefónica Chile competes with both mobile telephony and other fixed and cable telephony operators, which are not subject to the same tariff regulations as the Company and therefore may compete with different conditions. The Company's market share has declined from 82% in 2000 to 65% in 2007. In the long distance services market, Telefónica Chile competes with 15 other long distance operators and with mobile telephone operators in the domestic long distance market. As a result, the Company has faced intense pricing pressure and a decreasing trend in traffic, which may result in further price decreases and market share losses in the future. Telefónica Chile also faces increasing competition in broadband services and in pay television services as well. The development of new technologies, such as wireless accesses like WiMax or 3G, would increase competition in the market. See Item 4. Business Areas Market and Competition. Increased competition or the entrance of new competitors could adversely affect the Company's results of operations, financial condition or prospects.

Changes in technology could affect Telefónica Chile in ways it cannot predict.

The telecommunications industry as a whole has traditionally been, and is likely to continue to be, subject to rapid and significant changes in technology and the related introduction of new products and services. Although the Company believes that for the foreseeable future, existing and developing technologies will not materially adversely affect the viability or competitiveness of its telecommunications business, there can be no assurance as to the effect of such technological changes on the Company or that the Company will not be required to expend substantial financial resources on the development or implementation of new competitive technologies.

New services and technological advances may offer additional opportunities to compete against the Company on the basis of cost, quality or functionality. It may not be practicable or cost-effective for the Company to replace or upgrade its installed technologies in response to competitors' actions. Responding to such change may require the Company to devote substantial financial resources to the development, procurement or implementation of new

technologies and to write off obsolete assets relating to its existing technology. If the Company chooses to purchase or invest in the development of new telecommunications technology, there can be no assurance that such new products or services will not serve as a substitute to existing products and services offered by the Company. In the past, the Company has experienced such substitution with the introduction of mobile communications service, which has contributed to the declines in number of fixed lines, volume of traffic and in domestic long distance traffic.

Recent trends seen outside of Chile have shown an increased use of IP technology as a substitute for traditional voice services, which are often provided at lower prices. The Telecommunications Law requires a regulation to be

defined for these services to be offered to the public. Additionally, in 2006, Subtel initiated a process of public inquiry for new regulations relating to IP telephony over broadband. The Company has participated in the public inquiry process, together with other industry operators, and has presented its opinion on the proposal. See Item 4. Information on the Company Business Overview Licenses and Tariffs. Nevertheless, the use of this technology may serve as a substitute for the Company's local and long distance traffic together and increase pricing pressure.

As a result, if the Company chooses to introduce any such new telephony products or services, it can give no assurance that the benefits of such new products and services will not be materially offset by declines in existing products and services offered by the Company or that it will be permitted to participate in that business.

Labor relations may negatively impact Telefónica Chile.

As of December 31, 2007, approximately 60% of the Company's employees were union members. As of December 31, 2007, the Company had collective bargaining agreements in place with 22 unions.

The Company has taken steps to maintain stable labor relations, such as the contracts for periods from three to four years that were signed after a successful collective bargaining process, as well as the agreement between the Company and its employees in order to implement a new model of labor relations, which was designed to encourage a greater degree of participation and to address the interests of workers and management alike. As of December 31, 2007, 100% of unionized employees are under contract through at least 2008. However, the Company can provide no assurance that in the future it will be able to successfully negotiate new contracts on favorable terms, or that the unions involved in the negotiations will not choose to implement a labor strike or invoke Article 369 at such time. Article 369 of the Chilean Labor Code allows unions that are renewing labor agreements to freeze the conditions of the previous agreement for a period of 18 months.

The passage of new outsourcing legislation may adversely affect the Company's operating income.

New labor outsourcing legislation took effect in January 2007 that requires certain persons that the Company had treated as outsourced independent contractors to be treated as employees and, therefore, they would be entitled to certain benefits to which employees are entitled as a matter of Chilean law. As a result, approximately 800 workers that were formerly independent contractors were hired as internal employees during 2007. No assurance can be given that new legislation will not adversely affect the Company's results of operations or financial position.

Telefónica is the controlling shareholder of Telefónica Chile, and thus may determine the outcome of actions requiring shareholder approval.

Telefónica Internacional Chile S.A. owns 44.89% of the shares of Telefónica Chile. Telefónica Internacional Chile is a 99.9% owned subsidiary of Telefónica Chile Holding B.V., which in turn is indirectly wholly owned by Telefónica. Consequently, Telefónica may have the ability to determine the outcome of any actions requiring shareholder approval. See Item 10. Additional Information Memorandum and Articles of Association Shareholders Meetings and Voting Rights. In addition, Telefónica's equity stake in Telefónica Chile allows Telefónica to control the Company's Board of Directors. At the General Annual Shareholders Meeting held on April 13, 2007, Telefónica elected five of seven members of the Board of Directors.

The Company could be adversely affected if major suppliers fail to provide needed equipment and services on a timely basis.

The Company depends on suppliers for network infrastructure, equipment and services to satisfy its operating needs. Many suppliers rely heavily on labor; therefore, any work stoppage or labor relations problems affecting the

Company's suppliers could adversely affect the its operations. Suppliers may, among other things, extend delivery times, raise prices and limit supply due to their own shortages and business requirements. If these suppliers fail to deliver products and services on a timely basis that satisfies its customers' demands, the Company could be negatively affected. Similarly, interruptions in the supply of telecommunications equipment for networks could impede network development and expansion.

The Company's historical consolidated financial and operating results may not be indicative of future performance.

The Company has divested subsidiaries in the past years. See Item 4. Information on the Company History and Development of the Company Divestitures. In July 2004, the Company sold its mobile subsidiary, which provided 29.2% of operating revenues in the year ended December 31, 2003, and generated Ch\$13,467 million (historic value) in operating income during the same period. The sale of businesses results in the loss of their contributions to the Company's operating results. No assurances can be given that the Company will or will not divest of additional businesses in the future or that such divestitures will or will not affect the Company's results and access to financing. As a result, the Company's historical consolidated financial results for and as of the end of periods ending on or prior to these transactions may not be indicative of its future operating and financial performance.

The Company may not be successful in the development of new businesses or product innovation.

The Company cannot ensure the success of any new services, products or the development of new businesses in the telecommunications market or other markets, or their impact on the Company's results. This includes the Company's entrance into the pay television market in the year 2006.

Certain considerations related to platforms located in other countries.

The Company operates in Chile and most of its systems and platforms are located within Chile. Nevertheless, the Company also relies on shared platforms within the Telefónica Group and other equipment outside Chile in order to provide the pay television service. As a result, the Company cannot assure that volatility or unfavorable economic, political and social conditions outside Chile will not materially affect its ability to provide services.

The Company may not be able to refinance its outstanding indebtedness.

The Company's total financial debt as of December 31, 2007 amounted to Ch\$391,549 million (US\$788 million), with an average maturity of 2.6 years. Although in the past Telefónica Chile has relied substantially on public debt issuances and bank loans to meet its financing requirements, in recent years its main sources of liquidity have been cash flow generated from operations and cash flow resulting from savings associated with the refinancing of certain loans and sale of assets. The Company has continued in 2007 with the renegotiation of loans, lowering interest rates and extending maturities. As a result, the Company has similar amounts of debt maturing in each of the next five years, which are expected to be funded through cash flow generated from operations and refinancing. The Company cannot ensure that it will be able to arrange any potential financing to fund these maturities along with capital expenditures and dividends on acceptable terms. Refinancing of debt or increased levels of debt could have negative effects that include: difficulties in obtaining future financing; reductions in credit ratings issued by rating agencies; restrictions on cash flows or operations imposed by lenders; higher rates; and reduced flexibility to take advantage of or pursue other business opportunities.

A system failure could cause delays or interruptions of service, which could cause us to lose customers.

To provide effective service, the Company will need to continue to provide its customers with reliable service over its network. Some of the risks to the Company's network and infrastructure include:

- physical damage to access lines and networks;
- power surges or outages;

- software defects;
- disruptions beyond the Company's control; and
- disruptions due to changes in obsolete equipment.

The Company's operations also rely on a stable supply of utilities. Given recent instability of those supplies, including the supply of gas from Argentina and electricity rationing in Chile, the Company can not ensure that future

supply instability or interruptions will not impair its ability to procure required utility services in the future, which could adversely impact its operations.

Prolonged service interruptions could affect the Company's business. The Company relies heavily on its network equipment, telecommunications providers, data and software to support all of its functions. The Company relies on its networks and the networks of others for substantially all of its revenues. The Company is able to deliver services only to the extent that it can protect its network systems against damage from power or telecommunications failures, computer viruses, natural disasters, unauthorized access, theft of copper wires from external networks and other disruptions. While the Company endeavors to provide for failures in the network by providing backup systems and procedures, it cannot guarantee that these backup systems and procedures will operate satisfactorily in an emergency. Should the Company experience a prolonged failure, it could seriously jeopardize its ability to continue operations. In particular, should a significant service interruption occur, its ongoing customers may choose a different provider and its reputation may be damaged, reducing its attractiveness to new customers.

The Company may not be successful in currently pending legal proceedings.

The Company is a party to lawsuits and other legal proceedings in the ordinary course of its businesses, some of which have been pending for several years. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs and negatively impact our financial results. See Item 8. Financial Information Consolidated Statements and Other Financial Information Legal Proceedings.

Risks Relating to Chile

A downturn in the Chilean economy may adversely affect Telefónica Chile.

Nearly all of Telefónica Chile's customers are Chilean companies or individuals, and substantially all of Telefónica Chile's operations are located in Chile. For these reasons, the results of the Company's operations and its financial condition are sensitive to, and dependent upon, the level of economic activity in Chile. Historically, growth in the Chilean telecommunications industry has been tied to the state of Chile's economy, particularly levels of consumer spending and demand. An economic slowdown may negatively affect the Company's business through a decrease in demand and higher customer nonpayment levels.

The Company can give no assurance that Chile's economy will continue to grow in the future, nor can it give assurances that future developments in or affecting the Chilean economy will not impair its ability to proceed with its business plan or materially adversely affect its business, financial condition or results of operations.

Developments in other emerging markets or in the global telecommunications market may adversely affect Telefónica Chile.

Developments in the global telecommunications market and in other emerging markets, particularly in Latin America, may adversely affect the market for Telefónica Chile's securities and the availability of foreign capital in Chile. The Company cannot predict whether events in other markets will adversely affect the price of, or market for, its securities.

The Series A Common Stock of Telefónica Chile is a highly liquid stock in Chile, representing 3.3% of the local IPSA stock index, composed of the 40 stocks with the highest transaction volumes in the Santiago Stock Exchange, as of December 31, 2007. Therefore, the Company's stock price is affected more rapidly and to a higher degree than most other Chilean stocks by upturns or downturns in the domestic and international markets.

The Company can give no assurance that negative developments in Latin America or other emerging markets will not occur or that such negative developments would not adversely affect the securities markets in which the Company's securities trade or affect the Company's access to sources of financing.

An increase in inflation may adversely affect Telefónica Chile.

Chile has experienced high levels of inflation in the past. High levels of inflation in Chile could adversely affect the Chilean economy and Telefónica Chile's financial condition and results of operations. The rate of inflation as

measured by changes in the Chilean consumer price index in the years 2003, 2004, 2005, 2006 and 2007 was 1.1%, 2.4%, 3.7%, 2.6% and 7.4%, respectively.

Generally, high levels of inflation will adversely affect the Company's financial condition to the extent that, during any given period:

- the Company's average domestic inflation-indexed liabilities exceed its average domestic inflation-indexed assets;
- the Company's average monetary assets exceed its average monetary liabilities; or
- the Company is unable to transfer increased inflation-indexed costs such as labor and supplies to customers.

Any significant increase in the level of inflation in the future may adversely affect the performance of the Chilean economy and the operating results of the Company.

Currency devaluations and foreign exchange fluctuations may adversely affect Telefónica Chile.

Volatility of the value of the Chilean peso against the U.S. dollar could adversely affect the Company's financial condition and results of operations. In 2003, 2004 and 2005, the peso recorded a nominal appreciation against the U.S. dollar of 17.4%, 6.1% and 8.1%, respectively, versus the prior year. During 2006, the peso experienced a nominal devaluation of 3.9%. In 2007, the Chilean peso experienced a nominal appreciation of 12.2% against the U.S. dollar. The main drivers of exchange rate volatility in recent years have been the substantial devaluations in other Latin American markets, mainly Brazil, as well as general uncertainty and trade imbalances in global markets. In 2003, 2004, 2005 and 2007, Chilean peso appreciation was driven by improvement in Chilean economic indicators together with weakness in the U.S. dollar. The value of the Chilean peso against the U.S. dollar may continue to fluctuate significantly in the future. See Item 3. Key Information Selected Financial Data Exchange Rates.

Historically, a significant portion of the Company's indebtedness has been denominated in U.S. dollars, while a substantial part of its revenues and operating expenses has been denominated in pesos. If the peso's value declines against the dollar, Telefónica Chile will need more pesos to repay the same amount of dollar-denominated debt. As a result, fluctuations in the Chilean peso to U.S. dollar exchange rate may affect the Company's financial condition and results of operations. As of December 31, 2007, 63.8% of the Company's interest-bearing debt was denominated in U.S. dollars and was fully hedged against exchange rate variations between the peso and the U.S. dollar through financial instruments such as forward exchange agreements and cross-currency swaps. The remainder of the Company's interest-bearing debt is UF or peso denominated and therefore not subject to exchange rate risk. The Company's hedging policy against foreign exchange fluctuations is disclosed in Item 11. Quantitative and Qualitative Disclosures About Market Risk Risk of Variations in Foreign Currency Exchange Rates.

Risks Relating to the Company's ADSs

Controls on foreign investment and repatriation of investments in Chile may adversely impact a holder of the Company's ADSs' ability to obtain and dispose of the shares of the Company's common stock underlying its ADRs.

Equity investments in Chile by persons who are not Chilean residents are generally subject to exchange control regulations that restrict the repatriation of investments and earnings from Chile. The Company's ADSs are subject to an ADR foreign investment contract among us, the depositary and the Central Bank of Chile which is intended to grant holders of the Company's ADSs and the depositary access to Chile's formal exchange market. See Item 3. Key

Information Exchange Rates. Pursuant to current Chilean law, the Company's ADR foreign investment contract may not be amended unilaterally by the Central Bank of Chile. However, the Company cannot make any assurances that additional Chilean restrictions applicable to holders of its ADSs, the disposition of underlying shares of its common stock or the repatriation of the proceeds from the disposition of the underlying common stock could not be imposed in the future, nor can the Company assess the duration or impact of the restrictions if imposed. If for any reason, including changes to the Company's ADR foreign investment contract or Chilean law, the depositary is unable to convert Chilean pesos to U.S. dollars, investors would receive dividends or other distributions in Chilean

pesos. Transferees of shares of the Company's common stock withdrawn from the ADR facility will not be entitled to access to the formal exchange market unless the withdrawn shares are redeposited with the depositary.

The relative illiquidity and volatility of Chilean securities markets could adversely affect the price of the Company's ADSs and common stock.

Chilean securities markets are substantially smaller and less liquid than the major securities markets in the United States. In addition, Chilean securities markets may be affected materially by developments in other emerging markets, particularly in other countries in South America. The low relative liquidity of the Chilean market may impair the ability of holders of ADSs to sell shares of its common stock withdrawn from the ADS program into the Chilean market in the amount and at the price and time they wish to do so.

Holders of ADSs may be unable to exercise preemptive rights.

The *Ley de Sociedades Anónimas* (Law No. 18,046), the *Reglamento de Sociedades Anónimas* (Chilean Corporations Law) and applicable regulations require that whenever the Company issues new common stock for cash, the Company grants preemptive rights to all of its shareholders (including holders of ADSs), giving them the right to purchase a sufficient number of shares to maintain their existing ownership percentage. Such an offering would not be possible unless a registration statement under the U.S. Securities Act of 1933, as amended, were effective with respect to such rights and common stock or an exemption from the registration requirements thereunder were available.

Since the Company is not obligated to elect to make a registration statement available with respect to such rights and the common stock, holders of ADSs may not be able to exercise their preemptive rights. If a registration statement is not filed or an applicable exemption is not available, the depositary will sell holders' preemptive rights and distribute the proceeds thereof if a premium can be recognized over the cost of any such sale.

Holders of ADSs may have fewer and less well-defined shareholders' rights than with shares of a company in the United States.

The Company's corporate affairs are governed by its *estatutos*, or bylaws, and the laws of Chile. Under such laws, the Company's shareholders may have fewer or less well defined rights than they might have as shareholders of a corporation incorporated in a U.S. jurisdiction.

Foreign Exchange risks may adversely affect the U.S. dollar amount of dividends payable to holders of the Company's ADSs.

Chilean trading in the shares of the common stock underlying ADSs is conducted in pesos. The Company's depositary bank will receive cash distributions that the Company makes with respect to the shares underlying the ADSs in pesos. The depositary will then convert such pesos to U.S. dollars at the then prevailing exchange rate to make dividend and other distribution payments in respect to ADSs. If the Chilean peso depreciates against the U.S. dollar, the value of the ADSs and the distributions ADS holders receive from the depositary may decrease.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

Telefónica Chile is a corporation organized under the Chilean Corporations Law. Telefónica Chile was incorporated on November 18, 1930 and has a duration through August 10, 2068. The address and telephone numbers of the Company's registered office and the Company's agent in the United States are as follows:

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Compañía de Telecomunicaciones de Chile S.A.
Avenida Providencia 111
Santiago, Chile
Telephone: (562) 691 2020

CT Corporation System
111 Eighth Avenue
New York, New York 10011
Telephone: (800) 624-0909

Telephone service in Chile commenced in 1880 with the formation of Compañía de Teléfonos Edison in Valparaíso. In 1927, the International Telephone and Telegraph Corporation (ITT) acquired the Chile Telephone

Company, which had 26,205 telephones in operation at the time. In 1930, the Company was formed as a stock company named Compañía de Teléfonos de Chile S.A. In 1971, the Chilean Government intervened to take management control of the Company, and in 1974, the Chilean Government's *Corporación de Fomento de la Producción* (Corfo) acquired 80% of the total shares issued by the Company, then held by ITT.

In August of 1987, Corfo announced that it would reduce its shareholdings and privatize the Company by selling approximately 30% of Corfo's shares in the Company. In January of 1988, 151 million shares of Series A Common Stock of the Company were transferred to Bond Chile. After giving effect to a capital increase in an April 1988 offering and other additional purchases of Series A Common Stock and Series B Common Stock of the Company, Bond Chile owned approximately 50% of the then issued and outstanding capital stock of the Company.

In April of 1990, TISA, a subsidiary of Telefónica, indirectly acquired the stock of Bond Chile and thus all of Bond Chile's interest in the Company. Bond Chile then changed its name to Telefónica Internacional Chile S.A.

The Company's July 1990 international offering of American Depositary Shares (ADSs) reduced Telefónica Internacional Chile's ownership to 44.45% of the Company's issued and outstanding capital stock. Subsequently, payments made by third parties for subscribed but unpaid shares further reduced Telefónica Internacional Chile's ownership to 43.6% until 2003. In 1999, the Company launched its new brand name, Telefónica CTC Chile. Since the purchase of an additional 1.3% in July 2004, Telefónica Internacional Chile's ownership stake in the Company has been and remains 44.9% .

In accordance with Chilean Decree-Law 3,500, the Company has amended its *estatutos* (bylaws) to prohibit any shareholder from owning more than 45% of Telefónica Chile's capital stock in order to enable all Chilean pension fund managers (AFPs) to invest in Telefónica Chile.

An extraordinary shareholders' meeting held on April 20, 2006 approved the modification of the Company's brand name to Telefónica Chile . The legal name of the Company has not changed.

The Company's website address is www.telefonicachile.cl.

Mergers, Acquisitions and New Subsidiaries

During the last three years, Telefónica Chile has not participated in any merger or acquisition activities material to the business. However, during 2006 and 2007, the Company has reorganized its subsidiaries in the following manner:

- In January 2006, 100% ownership of Tecnonáutica was transferred from Telefónica Internet Empresas S.A. (TIE) to Telefónica Chile. Following this transfer, the subsidiary changed its name to Telefónica Multimedia and expanded its line of business to pay television services.
- Also in January 2006, ownership of TIE was transferred from Telefónica Empresas to Telefónica Chile.
- In March 2006, CTC Equipos was absorbed by Telefónica Chile.
- Also in March 2006, Telefónica Chile's long distance subsidiaries, Telefónica Mundo and Globus, merged to form a new subsidiary called Telefónica Larga Distancia. In June 2006, as part of this merger process, a payment of Ch\$674 million (historical) was made to 2,375 shareholders of Telefónica Mundo who exercised their right of withdrawal.

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- In September 2007, Telefónica Chile acquired the remaining outstanding stock of TIE, equivalent to 0.0005%, at book value.
- In November 2006, TIE sold its participation in Telepeajes de Chile S.A. to Telefónica Gestión de Servicios Compartidos de Chile, S.A. (t-gestiona), a Telefónica Chile subsidiary. On the same date, t- gestiona purchased a third party s participation, achieving 99.99% ownership of Telepeajes de Chile S.A. Finally, Telepeajes de Chile S.A. changed its name to Instituto Telefónica Chile and a new and unique line of business in training was adopted.

- On December 20, 2007, the Board of Directors agreed to the dissolution of TIE, transferring all its assets and liabilities to the Company, which is its legal continuer.

Divestitures

- On July 3, 2000, the Company sold: (i) its 40% ownership interest in cable television operator Metrópolis Intercom; (ii) 100% of its wholly owned subsidiary Compañía de Telecomunicaciones de Chile Plataforma Técnica Red Multimedia S.A., which provided installation and maintenance services for the cable television network, and (iii) the cable television network. The sales price for the entire transaction amounted to the Chilean peso equivalent of US\$270 million, of which the equivalent of US\$250 million was paid on October 2, 2000 and the equivalent of the remaining US\$20 million was paid on July 4, 2005.
- On March 24, 2004, Telefónica Chile agreed to sell its 9% ownership interest in Publiguías to Telefónica Publicidad e Información S.A. (TPI), a subsidiary of Telefónica S.A. The sale agreement was signed on April 26, 2004 for a sale price of US\$14.8 million, equivalent to Ch\$10,505 million. The transaction resulted in a positive impact of Ch\$5,754 million after taxes (US\$8.9 million) on the Company's financial results in 2004.
- On May 18, 2004, the Board of Directors of Telefónica Chile agreed to recommend to shareholders the approval of the offer made by Telefónica Móviles S.A. (TEM), a 92.44%-controlled subsidiary of Telefónica S.A, to acquire 100% of the Company's subsidiary, Telefónica Móvil de Chile S.A. In addition to recommending the sale to shareholders, the Board considered the offer made by TEM and recommended that Management request fairness opinions. These fairness opinions were prepared by JP Morgan and ABN AMRO and confirmed that the price of the transaction was fair to Telefónica Chile shareholders. The transaction required two-thirds shareholder approval at an extraordinary shareholders' meeting held on July 15, 2004. Sixty-nine and one-tenth percent of total shares outstanding approved the sale for US\$1,058 million, equivalent to Ch\$761,540 million, in addition to Ch\$192,762 million (US\$263 million) for all amounts owed by Telefónica Móvil de Chile S.A. to Telefónica Chile. The sale generated an after-tax profit of Ch\$344,830 million (equivalent to US\$592.3 million as of December 31, 2005). Additionally, as approved in the extraordinary shareholders' meeting and as part of the transaction, the Company paid, on August 31, 2004, an extraordinary gross dividend of Ch\$452 per share (US\$2.5074 per ADR), charged against accumulated retained earnings, and a gross interim dividend of Ch\$150 per share (US\$0.835808 per ADR) with a charge to net income. The total amount paid in connection with both dividends was approximately US\$800 million. Mobile telephony offered attractive growth rates and represented 29.2% of total revenues as of December 31, 2003, and 32.1% of the Company's operating revenues during the first six months of 2004. However, it was a capital-intensive business, with a high market penetration near 60% at time of sale and it faced intense competition which resulted in a low level of profitability for the business. The sale agreement restricted the Company from participating in the mobile telephony business for a period of two years from the date of the sale. Additionally, as part of the sale of Telefónica Móvil de Chile S.A., the Company reached agreements with creditors regarding the following obligations:
 - i) Syndicated and bilateral loans totaling US\$647 million that imposed a limit on the sale of assets equal to or above 5% of the Company's consolidated assets. The Company obtained waivers of this limit from 28 national and international banks, increasing the limit on the sale of assets to equal to or above 15% of the Company's consolidated assets.
 - (ii) Series F local bonds for a total of US\$23 million that contained a prohibition on the sale of such assets equal to 20% or more of total assets. The terms of the bonds were modified with 84.5% approval from the bondholders.

Capital Expenditures

Capital expenditures disbursed by the Company in 2005, 2006 and 2007 amounted to, respectively, Ch\$79,024 million (US\$149.1 million historic value as of December 31, 2005), Ch\$117,629 million (US\$204.7 million as of December 31, 2006) and Ch\$144,654 million (US\$291 million as of December 31, 2007). The Company has been steadily adjusting its capital expenditures in local telephony and using its available installed capacity to expand service, rather than investing in new lines. During 2007, the Company focused its investment primarily on

consolidating business growth, especially in broadband and digital television. Together, these investments consumed 51% of the year's capital expenditures. In the fixed telecommunications business, investments were used for line commercialization efforts and to maximize the use of installed capacity, focusing on network deployment in areas of real estate development. The investment plan for the year also emphasized initiatives designed to update network infrastructure by replacing old equipment and introducing new generation technologies, with a view to attaining high service-quality standards with more stable and flexible platforms. Additional emphasis was placed on simplifying the processes and systems that support tools for the Company's business, technical and administrative management.

Since January 2001, all capital expenditures made by the Company have been on projects located within Chile. Capital expenditures have been financed substantially with cash flow generated from operations.

B. Business Overview

The Company provides a broad range of telecommunications and other services throughout Chile, including:

- local telephone service and broadband;
- domestic long distance service (DLD) and international long distance service (ILD);
- data transmission;
- dedicated lines (direct lines dedicated to a customer's exclusive use);
- terminal equipment sales and leasing;
- public telephone service;
- interconnection services (connecting calls from long distance, mobile and local telephone networks to Telefónica Chile's local telephone network);
- security systems services (alarm monitoring through telephone lines);
- value-added services (including the sale of telephone numbers, such as 600, 700 and 800 numbers for toll calls, to providers of telephone-based services, and the provision of supplementary services and direct dialing); and
- pay television services.

The Company provides all of its fixed telephony services through its own digital telecommunications network, including local telephone service and interconnection services. In addition, the Company's subsidiary Telefónica Larga Distancia S.A. (Telefónica Larga Distancia) provides substantially all of its domestic and international long distance services with its own equipment and long distance network.

Chilean law currently requires companies to obtain licenses from the government before providing many telecommunications services. Telefónica Chile holds licenses to provide local telephone service and data transmission services throughout Chile. The Company also holds licenses to provide long distance service throughout Chile and internationally through its subsidiary Telefónica Larga Distancia. In addition, Telefónica Chile, through Telefónica Empresas, holds nationwide public service data transmission licenses for an indefinite term.

Moreover, the Chilean Government sets the maximum prices, fees and charges that Telefónica Chile may charge for certain services, including local telephone service, public telephones, interconnection services and related administrative services, unbundled network services, and line connections. The regulation applies to the Company's fixed monthly charge, variable charge, connections and other installations, access charges for rural companies, the number for information services through an operator, access charges and interconnection, and public telephones. In 2007, approximately 22% of Telefónica Chile's total operating revenues were generated through the provision of services subject to tariff regulation. The Chilean Government does not currently regulate the prices that Telefónica

Chile charges for its other products and services, including, among others, long distance, data transmission, broadband, pay television, value-added services, directory advertising, and sales and leasing of terminal equipment.

Telecommunications Products and Services

The Company's primary business focus in 2007 was on marketing its Duo and Trio voice, broadband and television bundles, whose main feature is the flexibility given to customers to choose the services they desire according to their specific interests. In other words, customers may build their own service bundles with the number of voice minutes, the broadband speed and the television plan that suits their personal preferences. As of December 31, 2007, 54% of all Company customers had subscribed to more than one product with Telefónica Chile compared to 41% in 2006. The main products and services offered by the Company are described below:

Telephone Service (Voice)

The Company provides basic telephone services to its customers over the public telephone network in two forms:

Regulated Plans

Regulated plans include telephone line service (fixed monthly charge) and variable charges that includes local traffic defined as measured local service (MLS) and traffic from local lines to Internet and mobile telephones (local tranche).

Minute Plans (Tariff Flexibility Plans)

In order to mitigate the adverse impact of regulation and the decrease in traffic and other negative factors affecting fixed-line revenues, Telefónica Chile has focused on offering various non-regulated services over its local network infrastructure, thus adding value to existing fixed lines and mitigating the decrease in revenues per line. Starting in 2004, as an alternative to the regulated plan, the Company began to market Flexible Plans (see Regulatory Framework below) such as: (i) *Planes de Minutos* (minute plans), consisting of telephone service with a certain number of minutes for a monthly charge; (ii) *Línea Económica* (Economy Line), consisting of a monthly amount from which customer calls are deducted, allowing for additional calls to be placed using prepaid cards; (iii) *Línea Súper Económica* (Super Economy Line), which enables customers to make calls for a certain number of minutes through prepaid cards charged on a monthly basis; and (iv) bundled services, such as broadband plus minute plans.

During 2007, 439,224 new fixed lines were connected, a 14.4% and 22.6% increase in new line connections as compared to 2006 and 2005, respectively, and 475,648 lines were disconnected, a 21.9% decrease compared with 2006 and a 38.0% increase compared with 2005. As a result, lines in service under fixed telephony as of December 31, 2007 totaled 2,179,205, representing a decrease of 1.6% as compared to December 31, 2006 and a decrease of 10.7% as compared to December 31, 2005. Of the 2,179,205 lines in service as of December 31, 2007, 11% were corporations, 18% were small business and professional clients, 69% were residential and 2% were wholesalers.

The following table sets forth certain fixed-line performance and line connection information for the periods indicated.

For the year ended December 31,

	2003	2004	2005	2006	2007
Lines installed	3,037,267	3,043,379	3,007,432	3,021,487	3,032,522

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Fixed lines in service	2,416,779	2,427,364	2,440,827	2,215,629	2,179,205
Average fixed lines in service	2,558,291	2,406,266	2,451,356	2,332,634	2,185,823
Lines per 100 inhabitants ⁽¹⁾	16.1	15.0	15.1	13.4	13.1
Number of new lines connected	308,266	343,318	358,088	384,003	439,224
Number of lines disconnected	578,182	332,733	344,625	609,201	475,648
Defects per line (annual average) ⁽²⁾	0.35	0.40	0.44	0.54	0.52
Local traffic (in millions of minutes) ⁽³⁾	15,178	13,759	12,012	9,643	8,395

(1) Telefónica Chile fixed lines per 100 inhabitants. Population figures until 2005 are presented according to projections from the 2002 Census. Population figures for following years are based on internal estimates: 16.5 million and 16.7 million inhabitants as of December 2006 and 2007, respectively.

(2) Defects refer to any technical problems occurring in telephone lines, ADSL and equipment as well as in the Company's external plant and central switches.

(3) As of February 1, 2000, per-second billing was implemented.

Over the past four years, Telefónica Chile's fixed line traffic has decreased, mainly due to customers' greater use of mobile services and electronic communications.

As of December 31, 2007, 1,483,340 lines, which is more than a 12% increase compared with 2006, have been signed up for flexible tariff plans in accordance with Decree No. 742, which provides regulations governing the terms on which dominant local public telephony service operators may provide alternative plans and joint offers, representing 68.1% of the Company's total lines in service and thus significantly contributing to the growth of the fixed-line market. Revenues from the new flexible plans represent 20.5% of consolidated revenues compared with 15.7% in 2006.

Although the effective rates charged for flexible tariff plans are less than those charged in traditional plans, these types of products allow the Company to use the available capacity of the network to be more competitive.

ADSL Broadband Services

Telefónica Chile offers broadband ADSL technology to residential customers, small and medium enterprises customers and corporate clients, as well as to Internet Service Providers (ISPs) as resellers.

Although broadband service is currently primarily used for high-speed Internet access, it also allows the Company to offer customers other services, such as virtual private networks (VPNs), security systems with remote monitoring from anywhere in the world (Viginet), e-learning, wireless connections, connections to a second computer, intranet IP telephony (voice over IP) for corporate customers and multimedia applications. The broadband service also allows the provision of value-added services, including online antivirus and firewall protection, parental controls for Internet, and computer technical support, both remote and in-home.

In 2007, broadband showed strong growth as a result of the Company's bundling, flexibility and segmentation strategy, achieving an increase of 30.1% of total accesses by the end of the year. And as a result, the Company held first place with 50% market share. This growth has permitted the development of new services and content, with broadband serving as the primary gateway into Chilean households. In this context, various business initiatives were undertaken during the year, including a change in the ISP model under which Telefónica Chile became its own ISP for its customers, who in the past could obtain Internet connections only through other companies. The result is unified management and service, providing customers with a single contact point for all their needs, in addition to significant efficiencies due to process simplification. Value-added broadband services were also improved, with home wireless access promotions and computer security packages. In addition, the hotspot platform was enhanced through an alliance with Movistar, a mobile telephone operator, enabling customers to surf the web using the mobile data network and Telefónica Chile's hotspots with the same product.

As of December 31, 2007, ADSL connections totaled 644,522, representing an increase of 30.0% and 105.1% with respect to 2006 and 2005, respectively, of which 81% were residential customers, 16% were small businesses and professional clients, 2% were wholesalers and 1% were corporate clients. The following table sets forth the number of

ADSL connections in service as of the dates indicated:

	As of December 31,				
	2003	2004	2005	2006	2007
ADSL connections in service	125,262	200,794	314,177	495,479	644,522
ADSL/Lines in service	5.2%	8.3%	12.9%	22.4%	29.6%

In 2007, revenues from broadband were Ch\$101,632 million (US\$204.5 million), which represents 16.1% of total consolidated revenues. Revenues from broadband have grown by 54.4% and 116.0% compared to 2006 and 2005, respectively.

Digital Television

On June 14, 2006, Telefónica Chile launched its pay satellite television service with a flexible marketing format unique to the local market.

Telefónica Chile was the first company to provide flexible pay television. Customers pay for what they watch, which means that the services are tailored to the interests and budget of each home. The plan is known as the Telefónica digital television offering, and it offers an entry-level plan for Ch\$9,900, including a selection of the channels in greatest demand such as Disney Channel, Discovery Kids, Discovery Channel, Cartoon Network, TNT, Sony, Warner, ESPN football channel and Fox. For a variety of prices, the customer has the opportunity to add an assortment of thematic or premium movie plans, family, sports and premiere film channels under this format.

The service provides national coverage and offers additional services to customers, which include, among others, parental control, an on-screen programming guide, program reminders, access to pay-per-view service and a thematic search feature. In order to provide this service, the Company invested in information technology systems and software as well as equipment for installation in customers' homes, such as satellite receivers and set-top boxes. In addition, the Company incurred costs associated with satellite transmission services and content acquisition. After one year of offering this service, the Company launched broadband television service (IPTV), starting a gradual deployment of this project by initially providing service only to a limited number of clients as a trial. The service is offered in areas where the Company's network counts with the required technological infrastructure in Santiago. This service constitutes part of the digital television flexible contents offer, and includes interactive functionalities like video on demand (VoD), by which clients have available a wide and diverse range of films, series and audiovisual content from a digital library with more than 200 hours of content. Telefónica Chile is the first Latin American company to provide this technology. Moreover, in September 2007, the personal video recorder (PVR) service was launched, which allows users to record programs and pause, forward and rewind live programming.

The pay television service is provided by the Telefónica Multimedia Chile S.A. subsidiary, and it is marketed in bundles: Dúo, combining television and fixed telephony and Trío, combining television, fixed telephony and broadband service. About 15% of the Company's total clients have subscribed to the television service.

Growth is achieved by providing flexibility to customers, who can purchase a convenient service tailored to their interests and budgets. As of December 31, 2007, after only 18 months of operation, the Company had 219,916 pay television customers, representing a 17% market share and making it the second-largest pay television operator in the country.

Other Additional Services

Prepaid Services

Prepaid services have supported the development of flexible plans. The prepaid service known as *Tarjeta Línea Propia* (TLP) allows customers to have their own versatile, portable virtual line, while controlling and managing their telecommunications expenses. Users can make calls from any fixed telephone, public phone or enabled mobile phone, and surf the web on a broadband connection using Wireless Fidelity (Wi-Fi) or through dialup access. Additionally, the TLP allows customers to charge the Super Economy Line. Moreover, in addition to the physical TLP, this year the Company began selling an electronic version. As of December 31, 2007, 15.8 million TLPs were sold at Ch\$1,000

each, representing a decrease of 1.2% over 2006 and an increase of 5.3% over 2005. The total number of prepaid lines reached 360,558 in 2007, which is practically unchanged with respect to 2006 and represents a decrease of 32.5% from 2005.

Public Telephones (Payphones)

Telefónica Chile offers public telephony services and is responsible for the installation and operation of its own public telephones on public roadways and in indoor areas, the marketing of public telephone equipment to private third parties and fixed telephony installation. Currently, the public telephony market in Chile is made up of seven

operators and numerous private parties. Telefónica Chile has a market share of approximately 33% of payphones. The revenues in this business area are generated by traffic on public phones owned by the Company, the management of its own call centers, maintenance agreements for indoor installations, and post-sales maintenance and business support services provided to third parties such as owners of public telephones purchased from the Company.

As of December 31, 2007, the Company had installed a total of 9,626 smart public telephones, representing a decrease of 3.7% from 2006 and 4.3% from 2005, which allow the use of coins or prepaid cards to make calls. As of December 31, 2007, the Company had installed 10,459 licensee telephones and community lines, representing a decrease of 0.6% from 2006 and 20.5% from 2005, located inside buildings and communities which allow calls to 800 numbers, prepaid card calls and the use of the automatic collect call service. Revenues from public telephony in 2007 were Ch\$8,439 million (US\$17.0 million), which represents 1.3% of total consolidated revenues and a decrease of 21.1% and 21.6% with respect to 2006 and 2005 public telephony revenues, respectively.

Alarm Monitoring and Security Services

Telefónica Chile, through its subsidiary Teleemergencia, offers alarm monitoring services to residential customers and SMEs through telephone and/or cell phone connection to a security platform manned by qualified personnel. Teleemergencia is the second-largest alarm monitoring company in the domestic market, according to client numbers, with broad coverage at the national level.

In 2007, Teleemergencia developed a variety of monitoring plans with value-added services which allow customers to choose the plan that best suits their needs. As of December 31, 2007, the business had 49,616 customers, a decrease of 9.8% from 2006 and 18.9% from 2005. Revenues from Teleemergencia in 2007 were Ch\$8,125 million (US\$16.4 million), which represents 1.3% of total consolidated revenues and a decrease of 14.3% and 8.3. % with respect to 2006 and 2005.

Value-Added Services

Telefónica Chile markets value-added services to its fixed telephone service customers. Such services include caller ID (incoming and call waiting), voice mail, call waiting, call forwarding, control of outbound traffic to mobile phones, and information and entertainment services (600 and 700 numbers).

Telephone Directories

Under a business agreement with Impresora y Comercial Publiguías S.A. (Publiguías), Telefónica Chile receives a percentage of the revenues generated by Yellow Pages and White Pages advertising sales. This agreement was renewed in June 2006 for a five-year period with automatic two-year renewals. Publiguías prints and distributes telephone directories from the customer database provided by Telefónica Chile.

Long Distance

The Company provides a broad offering of domestic and international long distance services, including public and private voice, data and video services, through its subsidiary Telefónica Larga Distancia. The LD services and products provided by the Company are not subject to tariff regulation. The LD business segment also includes the rental of Telefónica Larga Distancia's LD network to other telecom operators, such as other LD carriers with and without their own networks, as well as mobile companies, including Telefónica Móvil, which was sold by Telefónica Chile in July 2004, and ISPs. Telefónica Larga Distancia, like many other LD operators, has a business area dedicated to international businesses. This area is involved in negotiating settlement rates and volumes for incoming and outgoing international traffic with different international operators, as well as establishing agreements for the

intermediation of international traffic among LD carriers.

During 2007, the Company recorded an increase of 0.2% in Domestic LD (DLD) traffic compared to 2006 and a decrease of 9.8% compared to 2005 due to the growing use of mobile telephones, e-mail and Internet, and the increase in lines blocked for LD calls. On the other hand, in terms of International LD (ILD) business, traffic increased 8.8% compared to 2006 and increased 12.1% compared to 2005, primarily owing to the increased competition in prices for ILD destinations.

The following table sets forth traffic information for DLD and ILD telephone traffic carried by Telefónica Larga Distancia for the periods indicated.

	2003	2004	2005	2006	2007
DLD traffic (in millions of minutes)	647	664	602	542	543
Outgoing ILD traffic (in millions of minutes)	64	67	66	68	74

The business continues to face major challenges as a result of increased penetration by the mobile industry, which is replacing long distance telephone service. In addition, there has been a significant shift in the way Chileans communicate towards e-mail and the Internet. As a result, the Company's strategy has been to maximize installed capacity and to create innovative product plans that generate traffic, ensure customer loyalty and allow it to lead the industry. In 2007, the Company launched two unlimited minute plans aimed at residential customers *Países sin Límites* (Unlimited Countries) and *Llamadas sin Límites* (Unlimited Calls) as well as the *Directo a Casa* (Direct to Home) plan that allows customers to call home at a fixed monthly fee from any public telephone in Telefónica Chile's public telephone network located anywhere in the country.

In addition, to improve the return on domestic and international LD network capacity, the Company is serving other telecommunications operators' voice transport and capacity needs, including intermediary service companies with and without their own networks, mobile companies and ISPs.

In 2007, revenues from LD were Ch\$58,435 million (US\$117.6 million), which represent 9.2% of total consolidated revenues. Revenues from LD decreased by 7.7% and 8.1% compared to 2006 and 2005, respectively.

The main sales channels through which the Company offers its long distance products and services are direct telemarketing sales campaigns conducted by third parties. The Company also uses third-party call centers to sell DLD and ILD traffic plans and other products, such as prepaid cards.

Corporate Customer Communications and Data

The corporate communications business, through the Telefónica Empresas subsidiary, has the mission of providing a comprehensive response to the communications needs of the larger and more complex organizations established in Chile. Clients of Telefónica Empresas include government ministries, public institutions, associations, and large corporations, both national and international, that are involved in a broad range of economic activities.

Communications play an essential role in the mission-critical processes of these clients. For this reason, the services provided by Telefónica Empresas are subject to continuous challenges, which include increasing capacity, availability and quality standards, and the need for progressive convergence and integration of different technologies. By integrating technologies, this company delivers solutions that add value to its clients' businesses, meeting their requirements more efficiently.

One of the primary services provided by Telefónica Empresas is data transmission, mainly through IP based services. In some cases, circuit-based solutions and value-added services are delivered through data links such as Frame Relay and ATM. Telefónica Empresas also provides corporate clients with basic telephony solutions, advanced solutions, private IP telephony and IP Centrex solutions based on the Next Generation Network infrastructure. In addition to providing a range of solutions such as PABX, videoconferencing and point-to-point data circuits, Telefónica Empresas offers advanced telecommunications solutions in the form of consulting projects, professional services and outsourcing. Also, Telefónica Empresas has a data center where client equipment and information can be

housed, helping clients protect business continuity by providing a main or backup storage site. In 2007, an additional 200 square meters were made available, which has made possible the expansion of services.

In 2007, revenues from the corporate customer communications and data business segment, which include revenues from equipment sales and rental, data transmission services and complementary services, amounted to Ch\$82,256 million (US\$165.5 million), representing 13.0% of total consolidated revenues. Revenues from this segment have increased 0.6% compared to 2006 and decreased 4.1% compared to 2005.

The following table sets forth information regarding some of the Company's data services as of the dates indicated.

	As of December 31,				
	2003	2004	2005	2006	2007
Dedicated IP connections	7,018	10,377	10,869	12,634	15,581
Datared (circuits)	10,820	9,770	5,821	5,353	4,808
Frame Relay (points)	5,016	3,892	2,621	1,930	1,865
ATM (points)	1,790	1,660	1,085	1,101	1,101

Other Businesses

t-gestiona

Telefónica Gestión de Servicios Compartidos Chile S.A. (*t-gestiona*), a subsidiary of Telefónica Chile, provides support services to all Company subsidiaries and other Telefónica Group companies.

t-gestiona's strategy is focused on positioning itself as a provider of shared services, mainly within the Telefónica Group. Its services include, without limitation, logistics, e-learning, accounting, insurance, collections, payroll, real estate management and general services.

Fundación Telefónica

Fundación Telefónica is a non-profit organization whose mission is to develop and channel the community and cultural activities of the Grupo Telefónica companies in Chile.

Market and Competition

The telecommunications industry in Chile, including the pay television business, achieved sales of US\$6.0 billion in 2007, an increase of 17% from 2006. This increase was largely driven by mobile growth and broadband development. Additionally, it is estimated that investment in the industry in 2007 was approximately US\$1.4 billion.

In 2007, the industry advanced with great momentum toward full market availability of integrated services. In the residential segment, there was significant growth in the area of bundled voice, broadband and television. A similar situation is developing in the small and medium enterprises (*SME*) segment, where voice and broadband plans are becoming available. The corporate communications segment is witnessing a consolidation of IP networks, making it possible to offer voice and data and facilitating integration toward IT-based business processes. Additionally, there has been massive, across-the-board growth in mobile communications in all of Chile's social and business strata.

At the country level, there has been a clear consolidation of a competitive model based on overlapping networks that primarily employ the following access technologies:

- Four operators with copper pair and ADSL broadband technology, with estimated potential coverage of 65% of the country's 4.5 million households and a majority of businesses.
- Coaxial network concentrated in one cable television company with potential coverage of almost 53% of all households.

- Fiber optic networks for corporations with an approximate length of 25,000 kilometers, operated primarily by four operators.
- Mobile coverage using the GSM standard in close to 95% of the country's inhabited territory; mobile service provided by three companies.

Nationwide, a competitive model based on network infrastructure that mainly uses copper pair (ADSL), coaxial, optic fiber and wireless technologies (3G , WiMax , PHS) remains in place. During 2007, the consolidation of bundled services generated a new competitive focus among diverse sectors' operators, which created their own services or alliances with third parties. As a result, almost all fixed operators in the residential segment offer bundled services of voice, broadband and pay television. A similar situation exists in the SME segment with offers of voice plans and broadband. In the corporate segment, operators offer bundled solutions that

allow corporations to consolidate their IP networks for transmitting voice and data, simplifying the integration of business processes based on IT. Similarly, mobile communications have grown in the country, becoming a mass service and penetrating all segments of the population.

In the context of solutions of wireless last mile, Telmex launched the WiMax service for voice and broadband, VTR stated its intention of expanding its current coverage under the same technology and Telsur continues to implement its wireless telephony services.

One of the more relevant events of 2007 was Telmex's entry into the residential segment through an offer of bundled services of telephony, broadband and satellite television. The telephony and broadband services are provided over wireless WiMax access, while its acquisition of ZAP TV allows it to bundle these services with satellite television.

In mobile business, 3G technology was included in the operators' sale offers, which runs through UMTS and HSDPA standard.

The following chart shows the business segments in which the main Chilean telecommunications companies operate:

Company	Fixed Telephony	Broadband ⁽¹⁾	Long Distance	Mobile Communications	Data Transmission	ISP Corporate	ISP Residential	Pay Television ⁽⁹⁾
Telefónica Chile ⁽²⁾	a	a	a		a	a	a	a
T. Móvil de Chile S.A. ⁽³⁾			a	a				
ENTEL ⁽⁴⁾	a	a	a	a	a	a	a	
VTR ⁽⁵⁾	a	a	a				a	a
Claro ⁽⁶⁾				a				
Telmex Chile ⁽⁷⁾	a		a		a	a	a	a
Telefónica del Sur	a	a	a		a	a	a	a
Terra Networks							a	
CMET	a	a	a				a	a
Direct TV								a
	a	a	a		a	a	a	

GTD -
Manquehue
(8)

-
- (1) Broadband with last mile access. Does not include resellers or ISPs and does not consider dedicated accesses to corporations.
 - (2) In July 2004, the extraordinary shareholders meeting of Telefónica Chile approved the offer made by TEM to acquire 100% of the Company's subsidiary, Telefónica Móvil de Chile S.A. See Item 4. Information on the Company History and Development of the Company Divestitures.
 - (3) Includes operations from Bellsouth Chile acquired by TEM in 2004. The Antitrust Commission approved the merger of both companies in January 2005.
 - (4) Telecom Italia sold its stake in Entel Chile (55%) to Chilean investors in 2005.
 - (5) Includes Metrópolis Intercom merged in July 2005.
 - (6) Until July 2006, it was named Smartcom. It was acquired by América Móvil in August 2005.
 - (7) Includes operations from AT&T Chile (at present known as Telmex Chile) and Chilesat Corp.
 - (8) Includes Manquehue Net, which was acquired by GTD in September 2005.
 - (9) Only those companies that own the infrastructure to provide the service.

Telefónica Chile faces intense competition in every aspect of its business activities. Unless otherwise indicated, all statements regarding the competitive position of Telefónica Chile are based on the Company's internal estimates.

Fixed Telecommunications

The fixed telephony market in Chile reached approximately 3.4 million lines as of December 2007, reflecting an increase of close to 2% with respect to year-end 2006. The rate of penetration of fixed lines, as of December 2007, was 20.2 lines per 100 inhabitants, slightly higher than the 19.8 rate for 2006.

Although Telefónica Chile operates approximately 65% of the local fixed lines in service in Chile, its market share has been declining for the past six years because of intense competition in key niches of the market due to the aggressive offers of competitors.

Currently, there are ten operators that provide fixed telephony service and, in the aggregate, operate the total number of fixed lines in service in Chile as of December 31, 2007. In certain areas of the Santiago Metropolitan Region, Complejo Manufacturero de Equipos Telefónicos S.A.C.I. (CMET), GTD S.A. (Grupo Teleductos), that includes operations from Manquehue Net and Telesat S.A., VTR Telefónica S.A. (VTR), which is an 80% subsidiary of Liberty Media, Entel Telefonía Local S.A. (Entelphone), which is a local telephony subsidiary of Empresa Nacional de Telecomunicaciones S.A. (Entel), and Compañía Nacional de Teléfonos (Telefónica del Sur or Telsur), hold licenses to provide local service. Furthermore, two companies, Telsur and its subsidiary Compañía Telefónica de Coyhaique S.A. (Telcoy), have licenses to provide local service in southern Chile Telsur in Regions X and XI and Telcoy in Regions XI and XII. Additionally, Telmex operates in the corporate segment of the main cities in the country after acquiring Chilesat's operations in 2003, and recently entered the residential segment with an offer of bundled services. Apart from Telefónica Chile, three other companies provide local telephone service in rural areas. Telefónica Chile also competes with providers of private communications systems, particularly in areas of significant business activity.

Broadband

Broadband connections (ADSL, cable modem and Wireless Local Loop (WLL)) in Chile currently represent 99% of all Internet connections (broadband, narrowband and dedicated). Broadband penetration of total homes in Chile (calculated as total accesses / total homes) has increased from 23% in 2006 to 29% at the end of 2007. Moreover, broadband connections grew to 1,300,000 by year-end 2007, a 26% increase, while dial-up access dropped by 54% to 30,000 connections. As of December 2007, ADSL broadband connections represented 59% of the country's total broadband use. Also during 2007, the deployment of Wi-Fi continued, enabling cable-free high-speed Internet connections. As of December 2007, there are an estimated 525 Hotspots installed throughout the country.

There are eight operators in the Chilean broadband market (broadband being defined as connections of 128 kbps or more) using the different technologies. One of the eight operators provides broadband service utilizing cable modems (VTR, which merged with Metrópolis Intercom). Four use only ADSL technology (Telefónica Chile, Telefónica del Sur, GTD and CMET). Additionally, Entel utilizes ADSL and WLL technology and Telmex utilizes ADSL and WiMax. The Company estimates that, as of December 31, 2007, its ADSL service (including direct sales and as a wholesale provider) accounted for approximately 50% of all broadband access offered in Chile.

Long Distance

The LD telephony market in Chile maintains its trend toward decreased traffic, observed since 1999. Thus, annual domestic LD traffic decreased by 10.8% in 2007, while international LD traffic fell by 9.9% . These results are primarily due to the growth in mobile telephony and Internet communications.

Although there are 39 operators authorized to offer LD services in the country, as of December 2007, only 30 offered the service and 17 of those companies accounted for approximately 99% of all LD traffic. Three of these companies, Telefónica Larga Distancia, Entel and Telmex, operate their own LD networks. These three operators accounted for 81% of DLD traffic and 91% of the outgoing ILD traffic in 2007, according to Company estimates. The following companies are the other main operators which offer LD services in Chile under the Multicarrier System: Telefónica del Sur Carrier S.A., a subsidiary of Telefónica del Sur; GTD Larga Distancia S.A.; VTR Global Carrier S.A.; Micarrier Telecomunicaciones S.A., a subsidiary of Entel; and Telmex 171 (formerly Carrier 171 Chilesat) and AT&T Chile S.A., both subsidiaries of Telmex. In 2007, Telefónica Larga Distancia's market share represented

approximately 41% of DLD voice traffic and 41% of outgoing ILD voice traffic, maintaining market leadership in DLD and in ILD, according to Telefónica Chile estimates.

Corporate Customer Communications and Data

Strong competition remains in the corporate communications and data transmission market in Chile because of the ongoing aggressiveness exhibited by operators. Operators are continuing to migrate their traditional services (ATM, Frame Relay and Dated) to IP networks and are expanding their services into outsourcing of IT services.

As of December 2007, there are eight operators in the country's major cities and only three have national infrastructure coverage. Telefónica Chile estimates that as of December 31, 2007, its share of the total revenues generated by the market for these services was approximately 42%. In this market, the Company competes mainly with Entel, Telmex Chile (formerly AT&T Chile and Chilesat), Teleductos and Telsur.

Security

With a market share of 19%, Teleemergencia is now the market's second-leading alarm monitoring company, behind ADT, which has 46% of the market, according to Company estimates.

Mission and Corporate and Business Strategy

Telefónica Chile's mission is to lead the growth and innovative development of the information society in Chile by building relationships of deep-seated trust and mutual benefit with customers, employees, shareholders, the government and the country at-large.

The Company harnesses its corporate values, technological innovations and communications solutions in the service of this objective, striving to improve the lives of its customers and contribute to the country's welfare.

In furtherance of its mission, in 2007, the Company invested more than US\$290 million toward the development of broadband technologies and digital services such as digital television, data services and information technologies.

Telefónica Chile's corporate and business strategy is focused on making the Company more competitive and the leader in the Chilean telecommunications industry. Current market dynamics and new customer needs, such as coverage assurance, greater Internet connection speed or greater direct interaction with users, require Telefónica Chile to offer increasingly fast, flexible and attractive services and make them available at the customer's request. Another important goal is to provide coverage for all socioeconomic sectors, making Internet access and simpler communications possible for the entire population.

The execution of this strategy is based on *Plan Ahora* (Plan Now), an internal action plan built on the Company's commitment to four strategic pillars: customers, employees, society and shareholders. The plan defines specific objectives for each and the initiatives undertaken to achieve these objectives.

Shareholders: The best combination of growth and profitability

Telefónica Chile maintains particular emphasis on constant innovation and on productivity gains, with the aim of growing profitably and in line with shareholders' demands. Thus, the Company invests in businesses with the greatest potential impact, ensuring efficient operations and process management.

Customers: The best customer experience

The objective is to lead the industry in customer satisfaction. To achieve this, the Company promotes an organizational culture based on excellence, innovation and customer focus in all areas, emphasizing service delivery and customer care quality with a view to consolidating its competitive and market leadership position.

Employees: The best company to work for in the telecommunications industry

With a view to attracting the best talent and assembling a team that is not only the best but also motivated and keen to accomplish its goals, the Company has implemented an internal workplace management model that focuses on five

areas of action: leadership, communications, compensation, development and recognition.

Society: Social commitment

The Company's objective is to be recognized as a socially responsible company in light of its efforts to shrink the digital-social gap by providing broadband access to the low-income population and by contributing to education through digital literacy and connectivity programs at schools and through social programs

In this context, the line of action by business area is as follows:

Residential

The objective is to grow and build customer loyalty through a leveraged bundled offering of services that include flexible minute plans, broadband, television and value-added services. A significant component of this strategy is to develop an extensive and innovative range of services on ADSL broadband, thus helping to make the digital home concept a reality and driving the market through interactive entertainment.

SME

The objective is to provide customers with flexible solutions and integrated services that meet specific needs in the area of information and communication technology, while offering competitively superior quality and service. The emphasis is on improving service by migrating to minute plans, increasing broadband speed and massively expanding solutions designed to integrate equipment, maintenance, and voice and data services.

Corporate

The objective is to maintain leadership by reinforcing long-term relationships with customers, developing deeper customer insight and offering comprehensive solutions through the IP-driven convergence of voice, data and video. Quality assurance will be the principal underpinning; consequently, efforts will be made to achieve a high degree of operations, service provision and resource management excellence.

Wholesale

The objective is to offer telecommunications solutions to industry operators and deliver a range of regulated and non-regulated services according to the needs of the sector, meeting legal requirements and industry quality standards.

Licenses and Tariffs

Licenses

Under Law No. 18,168 (as amended, and together with the regulations promulgated thereunder, the Telecommunications Law), companies must obtain licenses in order to provide the following telecommunications services:

- public telecommunications services (services provided to the public, such as local and mobile telephony, data transmission, paging and trunking);
- intermediate telecommunications services (services provided to companies that are holders of telecommunications licenses, as well as domestic and international LD services provided under the Multicarrier System); and
- broadcasting services, such as those provided by radio and television stations.

Only corporate entities may obtain licenses. Licenses specify the conditions that the license holder must fulfill in order to install, operate and develop the service and business that are the subject of the license. Licenses granted since 1994 for public and intermediate services generally have 30-year terms and may be renewed indefinitely for 30-year periods at the request of the operator (although certain licenses held by Telefónica Chile have longer terms).

Holders of local telephone service licenses are required to provide service to all parties located in the license area that have requested such service within two years of such request. In addition, license holders must provide service to all parties situated outside the license area who are willing to pay for the line extensions required to reach their location from the license holder's facilities.

The Telecommunications Law requires that holders of public telecommunications service licenses interconnect their networks to other networks providing the same type of service. This requirement is intended to ensure that subscribers and users of public services are able to communicate with each other, both inside the country and abroad. The same requirement applies to holders of intermediate service licenses for LD services, who are required

to interconnect their networks to the local telephone network. The Chilean telecommunications authority, the Subsecretaría de Telecomunicaciones (Subtel), sets the tariffs applicable to services provided through the interconnection of networks, in accordance with the procedures established in the Telecommunications Law. The structure, level and indexing of these interconnection rates are fixed by a tariff decree.

More than one service license may be granted for the same geographic area. Moreover, in instances where the number of licenses to be granted is limited by technical or other concerns, such licenses are awarded through a public bidding process.

The Telecommunications Law specifies certain causes for which an operator can be sanctioned through the termination of its public or intermediate service license. A license may be terminated, after notice of noncompliance with the applicable technical regulations, by executive decree, if the operator is in violation of the law or does not comply with the terms and conditions to which the license is subject. If the holder believes that its license has been terminated unlawfully, the holder may appeal the termination in Chilean courts. If a license is terminated, the holder is barred from applying for any license for a period of five years.

The following table provides the breakdown of those products and services offered by Telefónica Chile that are regulated under the 2004 to 2009 tariff regime (Tariff Decree No. 169) or are unregulated and that require or do not require licenses.

Services Subject to Tariff Regulation	Activities Not Subject to Tariff Regulation	
License Required⁽¹⁾	License Required	License Not Required
Local telephone service	Domestic long distance service	Sale of advertising in telephone directories
Access charges and interconnection	International long distance service	Direct marketing
Public telephones ⁽¹⁾	Mobile communications ⁽²⁾	Sales and leasing of telephone and facsimile equipment and private exchanges (PABX)
Line connections	Public data transmission	Supplementary services
Unbundled network services ⁽³⁾	Other unbundled network services ⁽³⁾	Broadband
	Pay television	

(1) All services subject to tariff regulation require licenses, except the public telephony. However, Telefónica Chile's public telephony services are regulated.

(2) The interconnection fee for calls to the mobile networks is regulated under the CPP structure. See Licenses and Tariffs Calling Party Pays Structure below. The mobile business was sold in July 2004.

(3) Only the unbundling of the local network, as defined by the Antitrust Commission, is regulated.

Licenses Held by Telefónica Chile

Telefónica Chile holds the following licenses for the provision of telecommunications services:

- *Local Telephony Public Service Licenses.* Telefónica Chile holds a license for local telephone service in all regions of Chile for a 50-year renewable period beginning as of December 1982, except Regions X and XI, which were incorporated to said license in 1995. In addition, the Company holds licenses for local telephone service in the Santiago Metropolitan Region and in certain cities in Regions V and VIII for an indefinite term. Telefónica Chile also holds a nationwide public service renewable license for data transmission for a 30-year period beginning as of July 1995.
- *Multicarrier Long Distance Licenses.* Under the Multicarrier System, Telefónica Chile's long distance subsidiary, Telefónica Larga Distancia S.A. (formerly Telefónica Mundo), held 30-year renewable licenses beginning as of April 1993 to install and operate a nationwide fiber-optic network, a network of base stations and other transmission equipment, and to provide domestic and international LD services, including voice, data and image transmission, throughout Chile. The Company's other LD subsidiary, Globus, also held licenses for an indefinite term to provide domestic and international LD services through central switches and cable and fiber-optic networks nationwide. Since the merger of Globus and Telefónica Mundo in 2006, all the aforementioned licenses are owned by Telefónica Larga Distancia.

- *Public Service Data Transmission.* In addition to the 30-year data transmission license previously mentioned, Telefónica Chile, through Telefónica Empresas, holds, as of March 1987, nationwide public service data transmission licenses for an indefinite term.
- *Limited Television License.* The Company's subsidiary Telefónica Multimedia, formerly known as Tecnonaútica S.A. (see Item 4. History and Development of the Company Divestitures), has a license to establish, operate, and use a part of the spectrum of the 2.6 GHz bandwidth in Santiago, Chile, for an indefinite period. The license was modified to be an intermediate telecommunications service concession, authorizing the frequencies used to communicate voice, data and images for a 30-year period. This period started on February 29, 2008. Since December 2005, Telefónica Chile, through Telefónica Multimedia, has held a nationwide 10-year renewable license to provide limited satellite television service. Additionally, in January of 2006, Telefónica Chile, through Telefónica Multimedia, was assigned a limited television service license to provide the service nationwide in the main municipalities, except Region III, through the Company's xDSL broadband network for an indefinite period. Moreover, in March 2007, a limited television service license was granted in order to provide this service through the xDSL broadband network in the Metropolitan Region for an indefinite period.

Development of Other Telecommunications Projects in Chile

- *Wireless Local Loop.* On May 17, 2001, five companies participated in the public bidding process for WLL licenses (3400 to 3600 MHz), which enable the transmission of voice, fax, Internet and data through switching centers to customers by antennas. Three nationwide licenses of 50 MHz each were awarded to Entel, Protel and Chilesat and three regional licenses of 50 MHz each were awarded to Entel (in all regions), Telefónica del Sur (in Regions VIII to XI) and to VTR (in the Metropolitan Region). Of these five companies, only Entel is developing its project. Telefónica del Sur is only developing WLL services in rural and suburban areas of Region X. Based on its evaluation of the project, Telefónica Chile decided not to participate in this process at the time.
- *Wireless Local Telephony.* On October 1, 2004, Subtel announced a public bidding process for wireless local telephony licenses (3400 to 3700 MHz), which enable the transmission of voice, data and images. This frequency may be used for Wi-Fi and Wi-Max developments, among others. On November 30, 2004, Telmex filed a protection measure with the Santiago Court of Appeals against Subtel for failing to recognize an alleged first option in the case of a tie in the bidding process. Additionally, on December 1, 2004, Entel filed an appeal with the *Tribunal de Defensa de la Libre Competencia* (Antitrust Authority) against Subtel, for excluding Entel from the bidding process since it already holds a license for 100 MHz in the 3400-3700 MHz frequency range. Under instruction from the Antitrust Authority, on December 14, 2004, Subtel temporarily suspended the public bidding process. On December 13, 2005, Subtel awarded the national license to Telmex Servicios Empresariales S.A. and ten regional licenses to VTR (Regions I to IX and in the Metropolitan Region). The licenses for Regions XI and XII were awarded to Telefónica Chile.

The Tariff System

Pursuant to the Telecommunications Law, prices for public telecommunications services and intermediary telecommunications services in Chile are not regulated unless the Antitrust Commission specifically rules that the conditions existing in the market are insufficient to ensure a free pricing system, in which case maximum tariffs for certain telecommunications services must be subject to tariff regulation. The Antitrust Commission may subject any telephony service to price regulation, except for mobile telephone services to the public which are expressly exempted under the Telecommunications Law. In addition, maximum prices for interconnection services (mainly inter-company access fees for network usage) are, as a matter of law, subject to tariff regulation and are set in accordance with

procedures established by the Telecommunications Law.

Also pursuant to the Telecommunications Law, once the Antitrust Commission has determined that tariff regulation is warranted, the structure, level and indexing of the maximum tariffs that may be charged for tariff-regulated services are fixed by a joint decree issued by the Ministry of Transport and Telecommunications and the Ministry of the Economy (together, the Ministries). The Ministries determine such maximum tariffs by applying to each regulated company an economic model based on the costs, efficiency and growth rates of a hypothetical company that provides only regulated services, and calculating a rate of return on such services in line with the hypothetical company's market cost of capital. Telefónica Chile's actual rate of return, however, may vary from the predictions of the model. Each maximum tariff takes into account the relevant cost components associated with providing the regulated service, and is adjusted monthly in accordance with the tariff index (the Tariff Index), as contemplated in the tariff structure and described below. A distinct Tariff Index exists for each individual regulated service that reflects the different theoretical cost components associated with each such service.

As part of the tariff-setting process, license holders prepare studies of each regulated service that they provide in each license area, calculating the incremental development costs and the long-term average cost with respect to each such service for a five-year period. The purpose of these studies is to assist the Ministries in determining the structure and level of future tariffs for each regulated service in each license area.

Regulatory Framework

The first five-year tariff period commenced in 1989, at which time the Antitrust Commission determined that the conditions prevailing in the local, DLD and ILD markets did not guarantee free competition and therefore would be subject to regulation. However, according to Resolution No. 515, in April 1998, the Antitrust Commission determined that only local services, public telephone services and line connections offered by dominant companies would be subject to tariff regulation. In addition, Resolution No. 515 included the unbundled network services among the services subject to tariff regulation. As of December 31, 2007, 13 contracts had been signed with eight companies for the provision of unbundled network services.

On January 18, 2001, the Company estimated that market conditions had changed and consequently asked the Antitrust Commission to deregulate local telephone rates charged to the public, stating, in its opinion, that the then-existing market conditions had not yet warranted deregulation throughout the country. However, on July 11, 2001, by Resolution No. 611, the Antitrust Commission rejected the Company's petition, although the Antitrust Commission asked the National Economic Attorney General's Office to monitor the evolution of the market in order to detect changes as they occur that could lead to the deregulation of certain services in certain geographic areas. The Antitrust Commission also decided that Telefónica Chile could request authorization to offer alternative tariff plans and request the authority to issue complementary resolutions to Tariff Decree No. 187, which would allow for differentiated rates within each tariff area. In accordance with this decision, in the second half of 2001, the Company submitted a proposal to Subtel for alternative tariff plans for different customer categories. In this regard, on May 24, 2002, Subtel approved the Company's proposal to offer prepaid service for fixed line customers. Moreover, on August 24, 2002, the Ministries issued Decree No. 455, which approved a high usage plan oriented toward residential customers and a very high usage plan oriented toward corporate customers, which were based on a flat monthly fee.

In January 2008, Subtel asked the Antitrust Commission to determine whether current market conditions guarantee healthy competition. The Antitrust Commission remains in the process of evaluating the market.

Tariff Structure for 1999 to 2004

In April of 1998, the Antitrust Commission determined that Telefónica Chile would be regulated as the dominant operator in all regions of Chile, except in Region X and Region XI and Easter Island. As determined by the Antitrust Commission, the dominant operator for Region X was Telefónica del Sur, for Region XI was Telcoy and for Easter

Island was Entelphone. Tariff Decree No. 187 was in effect from May 5, 1999 until May 5, 2004, setting maximum prices that the Company could charge for regulated services in those regions in which it was determined to be the dominant operator.

Based on the Company's estimates, the impact of the tariff structure defined by Tariff Decree No. 187 for the period 1999 to 2004 resulted in a 24.7% decrease in annual revenue derived from regulated services per telephone line for the Company in the first year, taking into account tariff reductions in the fixed monthly charge, the variable

charge per minute and local tranche and access charges, and assuming stable traffic per line. This decrease included an average reduction of 17.1% in revenues from subscribers (fixed charge and variable charge) and of 72.9% in revenues from access charges paid by interconnected companies, which were mainly LD carriers.

Tariff Setting Process for Telefónica Chile's Services for 2004 to 2009: Tariff Decree No. 169

On January 13, 2003, Telefónica Chile requested that the Antitrust Commission, on the basis that market conditions were sufficient to guarantee healthy competition, rule in favor of fully deregulating tariffs in specific geographical areas. The Company also requested that, in cases where conditions are not sufficient to guarantee competition, the Antitrust Commission define the services that will be subject to tariff regulation by the corresponding ministries, nonetheless affording the Company the flexibility to offer alternative tariff plans to the regulated rates without previous authorization.

On May 22, 2003, the Antitrust Commission issued Resolution No. 686. This Resolution ruled against deregulation of rates charged by Telefónica Chile for services to the public. The Antitrust Commission did not issue a specific pronouncement regarding the request for tariff flexibility. In view of this, on September 1, 2003, the Company submitted to the Antitrust Commission a request for an explanation and expansion of Resolution No. 686 regarding tariff flexibility.

Thus, on October 13, 2003, the Antitrust Commission issued Resolution No. 709, unanimously approving the Company's September 1, 2003 request for local telephony services tariff flexibility and making it possible to offer alternative plans within a framework of conditions to be subsequently specified by the regulator. The Company requested that, by way of general framework governing implementation of such tariff flexibility, the regulators confirm the terms previously set forth by the Ministries as part of the process.

On February 26, 2004, a rule of procedures regarding how the Company may offer alternative tariff plans was published in the Official Gazette. A relevant aspect is that no previous authorization is required to offer these plans. Plans are not subject to maximum tariffs or predetermined structures, and may include joint offers with other telecommunications and non-telecommunications services. As of December 31, 2007, the Company had approximately 570 alternative plans subject to tariff flexibility.

By Open Resolution No. 1,559, dated December 1, 2006, Subtel lowered the average monthly consumption of heavy use plans to 7,000 minutes per client for 2007, compared to 9,500 minutes for 2006.

Resolution No. 686 of May 2003, also defined the services subject to tariff regulation by the Ministries for the 200 to 2009 tariff decree, which were substantially similar to the services regulated in Tariff Decree No. 187.

In February 2005, Tariff Decree No. 169 was approved and published in the Official Gazette. Starting in May 2005, the Company began charging customers with the published rates retroactively from May 6, 2004, as required by the Telecommunications Law. The tariffs published on February 11, 2005 do not materially differ from those used to provision revenues from May 6, 2004 to December 31, 2004 in the Company's consolidated financial statements. In addition to the new tariffs, Tariff Decree No. 169 also provides for seven tariff areas compared to four in the previous decree, three time slots (normal from 8:00 to 19:59 hrs.; reduced from 20:00 to 24:00 hrs.; and night from 0:00 to 8:00 hrs. on weekdays) versus two in Tariff Decree No. 187, adjustments in the composition of the tariff indicator and a new prepaid tariff. The average variation in tariffs between Tariff Decree No. 169 and the existing Tariff Decree, based on 2003 traffic, is as follows:

**Average Tariff Variation
Between**

**Decree No. 169 and Decree
No. 187⁽¹⁾**

Fixed Charge	+7.7%
Variable Charge Measured Local Service (MLS)	-18.3%
Local Tranche (to mobile and rural operators)	+48.2%
Local Tranche (to Internet and 10X numbers)	+28.3%
Access Charge	+49.1%

(1) Traffic is weighted according to 2003 Company traffic in the different time slots. 2003 was used as the reference year, because 2004 traffic was influenced by the impact of two different tariffs (under Tariff Decrees

No. 187 and No. 169). Tariff Decree No. 169 also introduced a regulated prepaid tariff which amounted to Ch\$150.48 in Chilean pesos as of Dec. 2002 (excluding VAT).

A Tariff Index has also been defined to adjust monthly maximum regulated tariffs, which is different for the fixed monthly charge and the variable charges (including the variable charge per minute, the local interconnection charge and access charges) taking into account: (i) the monthly variation of the wholesaler price index (WPI) for domestic goods, (ii) the monthly variation of the WPI for imported goods, (iii) consumer price index, (iv) wholesaler price index, (v) access charge index (for variable charge only) and (vi) the prevailing corporate income tax rate. The use of the Tariff Index permits the Company to significantly minimize the impact of inflation on its revenues from tariff-regulated services.

The following is the tariff index for Tariff Decree No. 169:

Index	WDGPI⁽¹⁾	WIGPI⁽²⁾	Index of wages and salaries	CPI⁽³⁾	WPI⁽⁴⁾	Access charge index⁽⁵⁾
Fixed Charge	36%	21.3%	-	12.4%	30.3%	-
Variable Charge (MLS)	9.5%	34.0%	-	19.4%	26.3%	10.8%

(1) WDGPI: Wholesaler domestic goods price index

(2) WIGPI: Wholesaler imported goods price index (U.S. dollar component)

(3) CPI: Consumer price index

(4) WPI: Wholesaler price index

(5) Access charge index: A composite of access charges for non-Telefónica Chile operators

Tariff Setting Process for Telefónica Chile's Services for 2009-2014

In April 2008, Telefónica Chile presented its technical and economic basis for a new Tariff Setting Process for the Company's regulated services for the period from 2009-2014. Subtel will present its basis in May, and if there are significant differences, either party may request a review by a panel of experts. In November 2008, the Company will have to present a tariff proposal and in March 2009 Subtel will issue an objections and counterproposals report. Finally, a new Tariff Decree for the period 2009-2014 will commence on May 5, 2009 and continue for a five-year period.

Multicarrier System

On March 10, 1994, Law No. 19,302 amended the Telecommunications Law to introduce the Multicarrier System for LD services. Among other things, the Multicarrier System permits local telephone service providers to obtain licenses to supply domestic and international LD services through a subsidiary or affiliate using their own equipment. Under this system, users are able to select LD carriers on a dialed or pre-subscribed basis.

Calling Party Pays Structure

Calling Party Pays (CPP) was implemented on February 23, 1999. Under this tariff structure, local telephone companies pay mobile telephone companies an interconnection charge for calls placed from fixed networks to mobile networks.

On April 12, 2004, the Chilean General Comptroller approved the tariff decrees for mobile interconnection tariffs and interconnection facilities of the mobile telephony networks, applicable to the operators in this market for the 2004 to 2009 period, which were published in the Official Gazette on April 14, 2004. These decrees were applied retroactively to January 23, 2004 for mobile operators, except for Telefónica M3vil de Chile S.A. for which it is applied retroactively to February 12, 2004. The tariff decrees stipulate three time slots defined as peak, reduced and night and new per-minute tariffs for the period. The tariffs implied a decline of 26.5% in the first year compared to the average tariff in Chilean pesos as of December 2002 with a subsequent 0.5% decrease per year thereafter. The new tariffs imply an average decrease of 27.4% for the period of 2004 to 2009 in comparison with the average tariff in Chilean pesos as of December 2002.

In July 2004, the Company sold its mobile subsidiary and therefore is no longer regulated in this business. See History and Development of the Company Divestitures above.

The tariff-setting process for the mobile companies, corresponding to the period 2009-2014, started when the definite technical-economic basis was notified by Subtel to the mobile companies.

Lawsuit Against the State of Chile

On October 31, 2001, Telefónica Chile filed an administrative motion for reconsideration with the Ministries, to correct the following errors in the issuance of Tariff Decree No. 187: a mathematical error in determining the fixed monthly charge for telephone line service; unlawful application of the depreciation method; failure to consider the costs of telephone directories; incorrectly assuming lower investments related to the location of switching centers; erroneous application of the same local telephone service non-payment rate to the CPP service; and failure to scale access charges and local tranche charges. On January 29, 2002, the Ministries issued a joint response rejecting the administrative motion filed by Telefónica Chile.

Upon exhausting the administrative recourses available to correct what the Company believes are illegal actions taken in the tariff-setting process discussed above, in March 2002, Telefónica Chile filed a lawsuit for damages against the State of Chile. This legal action seeks damages in the amount of Ch\$181,038 million (US\$274 million, historical value as of the date of the lawsuit), plus adjustments and interests, covering past and prospective losses through May 2004 arising from errors incurred in Tariff Decree No. 187. Experts' reports have been presented on various aspects of the case supporting the position held by Telefónica Chile's position. On March 29, 2005, the judge called the period of discussion and proof provision from the interested parties to a close, in order to issue a sentence in first instance. In March 2008, the trial court rejected the Company's claims. The Company is appealing this decision.

For further information, see Item 8. Financial Information Legal Proceedings.

Voissnet Lawsuit

On March 14, 2005, Telefónica Chile responded to the complaint filed by Voissnet before the Antitrust Commission alleging Telefónica Chile attempted to hinder free competition and the development and growth of broadband, particularly broadband IP telephony, by contractually prohibiting the provision of telephone services through the Internet broadband service provided by Telefónica Chile. Voissnet requested the Antitrust Commission to obligate Telefónica Chile to allow third parties to provide IP telephony through the Internet using its ADSL.

On October 26, 2006, the Company was notified of the Antitrust Commission's ruling. The ruling accepted, in part, the complaint filed by Voissnet and the requirement of the National Economic Attorney General's Office, and fined Telefónica Chile 1,500 Annual Tax Units (approximately Ch\$616 million or US\$1.2 million) (hereafter, UTA). On November 8, 2006, Telefónica Chile filed an appeal before the Supreme Court asking that the sentence be revoked and the Company be exonerated from any sanction.

On July 4, 2007, the Supreme Court partially overturned the ruling of the Antitrust Commission, and reduced the fine from 1,500 to 556 UTA (approximately Ch\$228 million or US\$0.5 million). Its decision also overturned part of the Antitrust Commission's ruling, which allowed Voissnet to act without a concession, and left in force the clauses that declared that broadband in a non-regulated service does not require a concession.

Key Proposed Changes to the Regulatory Framework

Commission of Telecommunications Experts

On May 17, 2006, the Minister of Transportation and Telecommunications convened a commission of experts for the purpose of preventing regulations from becoming obsolete. This commission performed its duties in two stages. During the initial stage, over a 90-day period, terms of reference for a telecommunications industry review were crafted. The second stage called, over the course of one year, for proposing regulations consistent with industry demands, generating greater competition, eliminating barriers to entry, and identifying consumer guarantees and rights.

On October 11, 2006, the commission of experts issued a report entitled Strategic Review of Telecommunications Regulations Terms of Reference, containing terms of reference for a future review of the telecommunications industry and identifying basic policy considerations which include the promotion of competition, tariff and access fee regulation, radio-electric spectrum management, equitable access to basic telecommunications services, quality of service and the regulatory institutional framework.

Public Inquiries on Regulations for Network Unbundling and IP Telephony Services

In July and August 2004, Subtel initiated a process of public inquiries addressed to the main participants in the telecommunications industry in connection with their proposals regarding network unbundling and IP telephony.

The network unbundling proposal (which was presented at a new public inquiry in December 2004) defines the service and its operating conditions, and includes new services which depart from those provided under Tariff Decree No. 169. Additionally, it creates new obligations for companies subject to network unbundling (obligation to invest, new client rights, differences in requirements based on technology type, among others). Furthermore, the new proposal creates a resale obligation for mobile operators and regulates resale conditions for wholesalers of alternative plans, which Telefónica Chile offers.

As a participant in the aforementioned public inquiries, the Company studied the proposal and submitted its opinion and legal objections. These included the fact that most of the provisions contained in the proposal were a matter of law and not of resolution, while other aspects of the proposal impaired rights which are guaranteed by the Constitution.

The proposal for IP telephony defined a special type of telephony over broadband, which is provided over existing infrastructure and with lower regulatory requirements than traditional telephony. This discriminates against traditional local operators, which are subject to different conditions for the same service. The Company, along with other operators, presented its comments on, and legal objections to, the proposal, calling it, among other things, discriminatory and likely to inhibit investment in new infrastructure and broadband.

On December 20, 2006, Subtel made a public inquiry on the proposed rules governing public voice over IP. As was required, Telefónica Chile provided its comments and proposals on January 26, 2007.

From the new regulation presented by Subtel, the most relevant proposals were:

- The concessionaires of public telephone services and LD intermediate telecommunication services will be able to obtain concessions for the new service, without restrictions or limitations of any sort. This means that the regulation does not exclude or limit the participation of Telefónica Chile and Telefónica Larga Distancia.
- To provide public services of voice over IP, a concession obtained by supreme decree will be required.
- The concessionaires of the new services must establish and accept the interconnection with telephony public services networks. Costs of interconnections must be charged to the new operators.
- The coverage of the concession will be nationwide.
- The concessionaires of the new services must provide access to emergency services and will not be obligated to distribute phone directories.

- The concessionaires will be able to use the telephone service numbering.
- The regulation will come into effect 6 months from the date of the publication in the Official Gazette.

Thirty companies provided comments. In general, the telephone companies approved of the regulation and favored the application of regulations similar to those of public telephone service to voice over IP. Companies from the computer sector, however, supported having less regulation over this service.

As of December 2007, Subtel had submitted the regulation, but was awaiting legal compliance confirmation by the Office of the General Comptroller of the Republic.

Public Inquiry on Bill Amending Law No. 18,168 (the General Telecommunications Act) to Create a Panel of Experts to Resolve Disputes Arising in the Telecommunications Industry

On September 6, 2006, Subtel announced a public inquiry on a bill to create a panel of experts, made up of seven professionals, to resolve disputes in the telecommunications industry. The document proposes, among other things, a list of matters to be resolved by the panel, the panel's powers and duties, its composition (five engineers and two attorneys named by the Antitrust Commission), and the areas where it lacks jurisdiction. The costs of the panel would be borne by the concessionaires on a prorated basis, which may take into account the value of their assets and/or the estimated number of disputes affecting them as well as the nature and complexity of these disputes.

Telefónica Chile duly submitted its proposal and comments, along with Movistar, Telmex, Telefónica del Sur and Telcoy, GTD, VTR, Entel, SOFOFA, Colegio de Ingenieros, and Instituto Libertad y Desarrollo.

The Ministry of Transportation and Telecommunications, acting through Subtel, is preparing an amended draft of the General Telecommunications Act.

Public Inquiry on Removing Obstacles for Telecommunications Development in the Short Term

On May 18, 2006, Subtel made a public inquiry to identify barriers and obstacles in the technical and regulatory standards that were impairing efficient market development in terms of competition, investment incentives and protection of users and customers of telecommunications services. In order to create a more equitable and competitive sector, the public consultation was ultimately aimed at identifying changes that could be made in the short term, such as repealing, amending, formally interpreting or making additions to any obsolete, ambiguous or missing legal provisions.

On October 13, 2006, Subtel published a response to the 350 contributions received, addressing, among others, proposals by Telefónica Chile, Movistar, Telmex, Terra, Entel, VTR, Telefónica del Sur, Colegio de Ingenieros and Grupo GTD. Part of the response included a list of the commitments and actions that Subtel will take to address the problems. In accordance with its commitments made in the response document, Subtel is devoting efforts to help modify the technical norms. At present, 11 exempt resolutions that approve modifications of technical norms and regulations have been published.

Public Inquiry on Creation of an Office of Superintendent of Telecommunications

This bill aims at creating a jurisdictional separation between the setting of telecommunications policy and the monitoring and punitive preventive control of market operations. As of January 31, 2008, this draft bill is under analysis at Subtel.

Public Inquiry on Amendment of License Rules

This bill aims to give network operators and service providers a set of rules to eliminate bureaucratic procedures when initiating services. In view of technological advances leading to a convergence of networks and services, the proposed system is designed, among other issues, to replace the license and permit granting procedures currently required prior to initiating service. The new registration-based system would make it necessary to register before telecommunications service can be provided, but would eliminate the need for prior approval from regulatory authorities unless the service involves exclusive use of the radio spectrum.

In addition, this bill:

- establishes differences between network operators and service operators;
- eliminates local and domestic long distance separation and DLD multicarrier, keeping it only for ILD;
- amends the freedom to determine service areas by providing that service areas originally listed upon registration may not be reduced;

- defines broadband as a telecommunications service ;
- provides for higher penalties by increasing fines; and
- shortens the period for addressing service supply requests from two years to six months.

Subtel has indicated that it will conduct a second public consultation on this issue.

Network Neutrality Bill

Aimed at ISPs and telecommunications access providers, the Network Neutrality Bill, among other provisions, maintains the prohibition against blocking, interfering with, discriminating against or hindering the ability of users to access, utilize, send, receive or offer any legitimate content, application or service through the Internet; requires access providers and ISPs to take action designed to ensure user privacy, virus protection and network security; and sets a 90-day period for Subtel to issue regulatory provisions for operating issues and identify practices restricting the free use of content or services. This bill is now at its second constitutional stage. Telefónica Chile has submitted a report, including comments and proposals, to the Senate Public Works, Transportation and Telecommunications Committee, including comments and proposals.

Digital connectivity

In 2007, Telefónica Chile jointly executed a Digital Connectivity Agreement with Subtel, Fundación País Digital, fixed and mobile telephony licensees, LD carriers, the Mobile Telephony Association and the Association of Internet Providers. By setting goals aimed at improving telecommunications service coverage, the agreement seeks to enhance collaborative efforts toward significantly reducing the digital gap. Goals include facilitating communications for the general public, attaining two million broadband access points, connecting 100% of rural schools, providing access to telecommunications services to 95% of the country's rural population, and driving the country's productive development through information and communication technologies.

Telefónica Chile will participate in various work areas described in the Digital Connectivity Agreement. These include: digital connectivity regulations, competition and new technology, the Telecommunications Development Fund and corporate social responsibility, and indicators and tracking.

Bill to Amend the Free Competition Act

On June 6, 2006, the Chilean government announced a legal initiative seeking to amend the law on free competition to eliminate the implicit risks in market concentration. This initiative is aimed at taking preventive action and increasing the maximum penalty that the Antitrust Commission may impose from 20,000 to 30,000 Annual Tax Units (from US\$17 to US\$25 million). This bill is still under review in the Congress.

Permit for Limited Cable Television Service

By Open Resolution No. 1,605 dated December 23, 2005, Subtel granted Telefónica Multimedia Chile, a subsidiary of Telefónica Chile, a permit to operate limited satellite television service throughout Chile.

In addition, pursuant to Subtel Resolution No. 81, dated February 21, 2006, Telefónica Multimedia Chile also holds a permit to provide limited television service over the Telefónica Chile broadband network for an unlimited term throughout the main communities of Chile, with the exception of Region III and the Metropolitan Region. The license to provide this service using that technology for some communities in the Metropolitan Region was granted

through Subtel Resolution No. 260 in 2007.

Subtel also issued a technical standard to the effect that cable television service may be provided by means of any technology over physical networks, thereby covering the use of the ADSL broadband network to provide television service.

Public Hearings on Digital Terrestrial Television

On November 17, 2006, Telefónica Chile S.A. participated in a series of public hearings on the introduction of digital terrestrial television (DTT) in Chile in order to help define the technical standard for DTT in Chile. The Minister of Transportation and Telecommunications opened the first public hearing and was joined by the Chairman of the National Television Council, representatives of the FUCATEL media observatory and representatives of the cable television company VTR Banda Ancha S.A.

Subtel reported that the technical standard on DTT will be released when it is clear that the best option has been identified.

Law Project that Modifies the Telecommunications Development Fund

Currently, companies with public and intermediate telecommunications service concessions that offer LD services and companies with limited television service permits are required to participate in a Telecommunications Development Fund. In order to participate in this fund, these companies are required to create separate corporations, which are subject to the laws and standards governing publicly traded companies and to the regulation of the Superintendency of Securities and Insurance. On July 12, 2007, Law No. 20,196 was passed, modifying Article 28F of the *Ley General de Telecomunicaciones*, eliminating the obligation for concessionaires and permit holders of telecommunications services to create separate corporations when participating in public bidding processes of the Telecommunications Development Fund.

C. Organizational Structure

Telefónica Internacional Chile owns 44.9% of all shares of Telefónica Chile and is a 99.9% -owned subsidiary of Telefónica Chile Holding B.V., which is an indirectly wholly-owned subsidiary of Telefónica S.A., which is a Spanish telecommunications company and is a public corporation listed on various European, American and Asian stock exchanges. Telefónica S.A. also has direct or indirect ownership interests in the following companies that operate in the Chilean market: Atento Chile S.A., Terra Networks Chile S.A., Telefónica International Wholesale Services Chile S.A., Telefónica Móviles Soluciones y Aplicaciones S.A. and Telefónica Móviles Chile S.A.

Subsidiaries and Certain Affiliates of Telefónica Chile

The following chart sets forth the organization of Telefónica Chile's subsidiaries and affiliates, all of which are Chilean corporations, except for TBS Celular Participações S.A., which is a Brazilian corporation. Percentage ownership information is as of December 31, 2007.

Telefónica Chile's business activities are managed through the following operating subsidiaries:

During 2006, the Company underwent organizational restructuring to reduce costs and simplify the Company's management. In January 2006, the indirect subsidiaries (Telefónica Internet Empresas S.A. and Tecnonáutica S.A.) became subsidiaries of Telefónica Chile. Additionally, on February 28, 2006, Telefónica Chile acquired the

remainder of Compañía de Telecomunicaciones de Chile Equipos y Servicios S.A. and dissolved this subsidiary. As a result, the assets and liabilities of Compañía de Telecomunicaciones de Chile Equipos y Servicios S.A. were transferred to the Company, which is the continuing legal entity.

Subsidiaries and Related Companies

Telefónica Larga Distancia

Telefónica Larga Distancia S.A. (*Telefónica Larga Distancia*), formerly Telefónica Mundo S.A., a subsidiary formed in 1989, is the Company's domestic and international long distance subsidiary carrier. See [Business Overview Licenses and Tariffs The Tariff System Multicarrier System](#) and [Business Overview Licenses and Tariffs Licenses](#).

The Government granted Telefónica Larga Distancia licenses to provide domestic and international long distance services with its own equipment effective August 27, 1994.

On October 14, 1998, Telefónica Chile completed its acquisition of 99.9% of the equity securities of VTR Larga Distancia, a telecommunications company offering data transmission and domestic and international long distance services throughout Chile. The LD business of VTR Larga Distancia was transferred to a newly created subsidiary, Globus, and the data transmission business of VTR Larga Distancia was later absorbed by Telefónica Empresas, the subsidiary which largely forms the Company's corporate customers communications and data business area. In 2006, Telefónica Larga Distancia was formed out of the merger of Globus and Telefónica Mundo.

Telefónica Larga Distancia currently operates the most extensive fiber-optic network in the country, stretching from Region I (the Peruvian border) to Region XII (Punta Arenas), including connections to Peru and Argentina. In 2006, a new tranche of the network was inaugurated from Region X (Osorno) to Region XII, passing through Argentina between Aduana Pajaritos (Region X) and Cerro Redondo (Region XII). In 2007, this connection was complemented with a new fiber optic link between Aduana Pajaritos and Puerto Natales (XII Region). Telefónica Larga Distancia also operates digital satellite and microwave links. In addition, Telefónica Larga Distancia participates actively in the development and use of submarine fiber-optic networks such as Unisur, Americas I, Americas II, Atlantis II, Columbus II, Panamericano, Maya I, TPC-5, Pencan 5, Taino Caribe, Sea Me We-3 and SAM-1 (TIWS), and in the Hispasat, Intelsat and Telesat (formerly Loral Skynet) satellite systems.

Telefónica Empresas

In 1992, Telefónica Empresas Chile S.A. (*Telefónica Empresas*) began operating Telefónica Chile's private telecommunications services (including data transmission, and the sale and rental of networks and equipment) and managing the Company's large business and institutional customer accounts.

Telefónica Multimedia

In February 2006, the Tecnonáutica subsidiary changed its name to Telefónica Multimedia, extending its corporate purpose to television services. This subsidiary is responsible for developing, installing, maintaining, marketing, and operating cable, satellite and regular or broadband television services using any physical or technical media, including basic, special or paid individual or multi-channel services, video on demand, and interactive or multimedia television services.

t-gestiona

On August 1, 2001, Telefónica Gestión de Servicios Compartidos Chile S.A. (t-gestiona) began operations. This subsidiary is responsible for the provision of support services to other business areas of the Company, including logistics delivery, e-learning, fund management, insurance, collection, personnel, tax, real estate administration and general services.

Instituto Telefónica

In November 2006, a former Telefónica Chile subsidiary, Telepeajes, changed its name to Instituto Telefónica Chile and also changed its corporate purpose to training under the terms set forth in Law 19,518, including training in private security matters.

Atento Chile

Atento Chile S.A. (Atento Chile) was created on May 5, 1999. Currently Telefónica Chile holds 28.84% (27.41% directly and 1.43% indirectly) of this affiliate, which operates an integrated global call-center business platform among its members. Atento Chile offers Telefónica Chile directory assistance, technical assistance and customer complaint management, as well as general commercial and sales information.

Telemergencia

Telefónica Asistencia y Seguridad S.A. (Telemergencia) was created in 2001 to offer security services through alarm monitoring systems connected to the phone line, as well as home assistance services. Currently, Telefónica Chile holds 99.9% of this subsidiary.

Fundación Telefónica

Fundación Telefónica Chile (Fundación Telefónica) has existed since 1999 when it was created to contribute to the improvement of living conditions for the most vulnerable social groups, encouraging the development of education and equal opportunity by applying new information technologies to the learning process. The equity interest of Telefónica Chile in this subsidiary amounts to 50.0% .

TBS Celular

The primary purpose and activity of TBS Celular Participações S.A. (TBS Celular) is to hold the shares of Compañía Riograndense de Telecomunicaciones (CRT) acquired through an international bidding process conducted pursuant to Edital COD 04/96 or any other shares that may be offered in the future. In addition, TBS Celular performs any and all activities pertaining to the management of CRT, as well as to acquire an interest as a partner or shareholder in other companies in connection with its primary activities. The ownership interest of Telefónica Chile in TBS Celular is 2.61% .

In February 2006, CRT merged with Vivo Participações S.A. (formerly Telesp Celular Participações S.A.); therefore, Telefónica Chile now indirectly holds 0.124% of Vivo Participações S.A. through TBS Celular.

D. Property, Plant and Equipment

The principal plant and equipment of the Company consists of outside plant and switching equipment and operating units that are located throughout the country. Furthermore, there is an extensive network consisting of 707 central switches linked by 58,332 kilometers of copper cabling and 7,096 kilometers of local fiber optic cabling. This represents 3.0 million lines, of which 2.2 million are in service. Within the xDSL broadband network, the Company has deployed 1,600 broadband nodes (DSLAM) with capacity to serve roughly 800,000 clients. In addition, in June 2006, Telefónica Chile launched a new satellite digital television service which by the end of 2007 had 219,916 clients with an average of 2.2 set-top boxes per home. Additionally, Telefónica Chile's LD subsidiary currently owns the longest LD fiber-optic network in the country (4,450 kilometers), which includes connections to Peru and Argentina.

The Company's land and buildings principally consist of its telephone exchanges and other technical, administrative and commercial properties. As of December 31, 2007, the Company's telephone plants and equipment represented 71.3% of its gross fixed assets (including depreciation), construction in progress represented 2.1%, land and buildings represented 20.5%, and furniture, office equipment and other assets represented 6.2% .

Substantially all of Telefónica Chile's telephone exchanges are situated within buildings owned by the Company. Telefónica Chile also owns its corporate headquarters located at Avenida Providencia 111 in Santiago. This building, which houses the Company's principal offices, was completed in October 1996 and currently

provides office space for the majority of the administrative and technical staff of Telefónica Chile and its subsidiaries. The assets of Telefónica Chile and its subsidiaries are insured, subject to standard deductibles and other terms and conditions, for all events of physical damage and loss of revenue resulting from service outages. As of December 31, 2007, the value of the assets and operating revenue insured totaled approximately Ch\$1,285,454 million (US\$2,587 million), which consisted of Ch\$866,079 million (US\$1,743 million) in insured assets and Ch\$419,375 million (US\$844 million) in insured revenues.

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The information in this Item 5 should be read in conjunction with the Company's Audited Consolidated Financial Statements and the notes thereto included elsewhere in this Annual Report. The Audited Consolidated Financial Statements have been prepared in accordance with Chilean GAAP, which differs in some significant respects from U.S. GAAP. See Note 37 of the Company's Audited Consolidated Financial Statements for a description of the main differences between Chilean GAAP and U.S. GAAP and a reconciliation to U.S. GAAP of net income and total shareholders' equity.

Overview

Telefónica Chile is the largest local telephony operator in Chile, with a market share, as of December 31, 2007, of 65% (according to Company estimates). The Company provides a broad range of telecommunications services throughout Chile, including local telephone service, domestic and international long distance service, data transmission, broadband access and services, dedicated lines, terminal equipment sales and leasing, public telephone service, interconnection services, certain value-added services and, since June 2006, pay television service.

To strengthen the Company's leadership and broadband growth, in June 2006, Telefónica Chile launched a new pay television service to its different client segments. This product has enabled the Company to strengthen client loyalty and earn new customers using the current infrastructure, increasing the revenue per client. The pay television service is provided by the Telefónica Multimedia Chile S.A. subsidiary, and it is marketed in bundles: *Dúo*, combining television and fixed telephone service, and *Trío*, combining television, fixed telephony and broadband service.

Several factors that influence the Company's financial results are described in *Trend Information* below.

Critical Accounting Policies

This Operating and Financial Review and Prospects is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in Chile. The preparation of financial statements in accordance with GAAP requires the Company's management to make estimates. Ultimate results could differ from those estimated if the Company's estimates or assumptions used do not actually occur.

The Company believes the following represents its critical accounting policies. The Company's accounting policies are more fully described in Note 2 to the Audited Consolidated Financial Statements. The most critical accounting policies adopted in preparing the Audited Consolidated Financial Statements according to Chilean GAAP relate to:

Property, Plant and Equipment. The Company believes that the accounting estimates related to the establishment of the depreciable lives of assets is a critical accounting estimate because it requires management to make assumptions about technology evolution and competitive uses of assets. Management's assumptions about technology and its future development require significant judgment because the timing and impacts of technological advances are difficult to predict. For a description of the Company's principal assets and what their depreciable lives are, see Note 2 of the Audited Consolidated Financial Statements included herein. Depreciation represented 39.8%, 41.9% and 38.1% of total operating costs and expenses for the years 2005, 2006 and 2007, respectively.

Impairment of Long-Lived Assets. The Company evaluates finite-lived assets it holds and uses for impairment when there are changes in circumstances which indicate that the carrying amount of the assets may not be recoverable. Recoverability of assets to be held and used is measured under Chilean GAAP by comparison of the carrying amount of an asset to its recoverable amount, calculated as discounted future net cash flows expected to result from the use of the asset and eventual disposition. Should a comparison of undiscounted cash flows versus book value indicate inability to recover the asset's book value, the measurement of the impairment would be performed as described above. The most significant estimates made in determining discounted future net cash flows include the selection of the appropriate discount rates and the number of years on which to base the cash flow projection, as well as historical results adjusted for anticipated operating conditions.

The number of years included in the discounted cash flows is, in the Company's opinion, subject to various factors which may differ from experience due to the rapid changes in technology in the industry. The factors which the company takes into consideration when establishing these lives are:

- foreseeable technology and business strategy changes; and
- tariff regulatory actions which may affect determination of the useful lives.

Assumptions about the revenue stream included in such cash flows are estimable in those lines of the Company's business which are regulated by tariffs. For those which are not, the Company takes into consideration its operational strategy for increasing volume of customers or revenues versus the additional costs which would be incurred related to these increases in order to arrive at projected cash flows.

Should this strategy or the basis for these assumptions change, the results of any recoverability test which the Company may be required to perform would differ.

Impairment of Goodwill. Goodwill includes the cost of acquired subsidiaries in excess of the book value of the net assets recorded in connection with acquisitions. Accounting for goodwill requires management's estimate regarding the amortization period and the recoverability of the carrying value of goodwill. As prescribed under Chilean GAAP, there is a maximum amortization period of 20 years. Factors that are considered in estimating the useful life of goodwill include:

- the foreseeable life of the business;
- expected actions by competitors and potential competitors; and
- legal, regulatory or contractual provisions affecting the useful life.

Under Chilean GAAP, the Company would test goodwill for impairment using the same methodology described above for long-lived assets in estimating the future net cash flows made by management. These include the determination of the projected sales growth and projected amounts for capital expenditures. In making these assumptions, the Company considers historical results adjusted to reflect current and anticipated operating conditions. Because a change in these assumptions can result in a significant change in the recorded amount of goodwill, the Company believes the accounting for goodwill is one of its critical accounting policies.

The Company has evaluated the recoverability of its recorded goodwill in accordance with Technical Bulletin No. 56 and No. 72, based on the fair values of the assets and liabilities acquired. Any excess of the purchase of assets and the liabilities assumed will be allocated to goodwill. As of December 31, 2006 and 2007, there were no indicators of an impairment of goodwill.

Allowance for Doubtful Accounts. The Company estimates its doubtful account provision primarily based on analysis of history and future expectations of its retail and corporate customers in each of its operating companies. The Company's assumptions are reviewed at least quarterly and adjustments are made to the bad debt allowance as appropriate. For both its retail and corporate customers, the Company uses a statistical model based on its aging of accounts receivable balances. The Company's risk categories, risk percentages and reserve balance assumptions built into the model are reviewed monthly and the bad debt allowance is adjusted accordingly.

The allowance for doubtful accounts was Ch\$71,793 million and Ch\$79,596 million (US\$160.0 million) as of December 31, 2006 and 2007, respectively.

Severance Indemnity. The Company sponsors a severance indemnity plan for employees which is treated, for accounting purposes, as a defined benefit plan. The defined benefit pension plan pays benefits to employees at retirement using formulas based on participants' years of service and compensation. These obligations are recorded at the present value of the liability determined using an annual discount rate of 6% considering the projected service periods of the employee determined on the basis of actuarial assumptions at each year-end based on the current salary. The Company funds these plans as claims are incurred.

Recorded severance indemnities reflect the Company's best estimate of the future cost of honoring its obligations under these benefit plans. The Company believes the accounting estimate relating to costs for pensions is a critical accounting estimate because changes in actuarial assumptions can materially affect the projected benefit obligations and net periodic pension costs. Should these assumptions change, the Company's pension benefit obligation would require increase or decrease in the balance sheet and the recording of the offsetting effect in the income statement.

In 2005, changes to the underlying assumptions were implemented in the determination of the projected benefit obligation based on actuarial valuation. In 2006, the underlying discount rate was changed from 7% to 6%. The effects of these changes are described in Note 3 to the Audited Consolidated Financial Statements.

Access Charges and Interconnection. Access costs are costs incurred for transmission of voice and data over other carriers' networks. These costs consist of both fixed payments and variable amounts based on actual usage and negotiated or regulated contract rates. The Company expenses access costs as incurred. Accordingly, at each balance sheet date, it records its best estimate of the access costs incurred but not yet billed based on internal usage reports. Once it receives an invoice from a carrier, a process of reconciling that carrier's invoice to the Company's internal usage reports begins. In certain cases, this reconciliation process can take several months to complete. Once the reconciliation is complete, the Company agrees with the carrier on the final amount due. In most cases, this process does not result in significant adjustments to the Company's estimates. Accordingly, at each balance sheet date, the Company accrues access costs for estimated expenses that have not yet been billed by other carriers and for amounts for which the reconciliation of the carriers' invoices to the Company's internal usage reports has not been completed. Because of the significance of access costs, the complexity of the systems that capture usage information and the number of different negotiated and regulated rates, the Company believes that the estimation of access cost accruals is a critical accounting policy.

Derivatives. The Company's financial derivative instruments are primarily foreign currency forward exchange contracts to purchase U.S. dollars and cross-country interest rate swaps. The Company records these financial derivative contracts at fair value. Estimates of fair values of financial instruments for which no quoted prices or secondary market exists have been made using valuation techniques such as forward pricing models, present value of estimated future cash flows and other modeling techniques. These estimates of fair value include assumptions made by the Company about market variables that may change in the future. Changes in assumptions could have a significant impact on the estimate of fair values disclosed. The net asset (liability) recorded under Chilean GAAP related to financial derivative instruments was Ch\$(29,710) million and Ch\$(68,136) million (US\$(137.1) million) as of December 31, 2006 and 2007, respectively.

Income and Deferred Taxes. In accordance with Chilean law, the Company and each of its subsidiaries compute and pay taxes on a separate basis. The Company estimates its actual current tax exposure while assessing temporary differences resulting from differing treatment of items, such as depreciation, for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the Company's consolidated balance sheet. As a transitional provision under Chilean GAAP, the Company recorded a contra asset or liability offsetting the

effects of the deferred tax assets and liabilities not recorded prior to January 1, 2000. Such contra asset or liability amounts must be amortized to income over the estimated average reversal periods corresponding to the underlying temporary differences to which the deferred tax asset or liability relates, calculated using the tax rates in effect at the time of reversal. The Company then assesses the likelihood that its deferred tax assets will be recovered from future taxable income and, to the extent it believes that recovery is unlikely, it establishes a valuation allowance. In order for us to estimate the realizable value of deferred tax assets and the average reversal periods of contra assets or liabilities, the Company must make assumptions about future events that are highly uncertain at the

time of estimation. For example, the Company makes estimates of future earnings, including estimates of future interest rates, exchange rates and cost trends. Revisions to the estimated realizable value of deferred tax assets or estimated average reversal periods of contra assets or liabilities could cause its provision for income taxes to vary significantly from period to period.

The net deferred tax liability was Ch\$37,652 million, and Ch\$29,729 million (US\$59.8 million) as of December 31, 2006 and 2007, respectively.

Provisions. Provisions are recorded when, at the end of the periods, the Company has a present obligation as a result of past events, whose settlement requires an outflow of resources that is considered probable and can be measured reliably. This obligation may be legal or constructive, arising from, but not limited to, regulation, contracts, common practice or public commitments, which have created a valid expectation for third parties that the Company will assume certain responsibilities. The amount recorded is the best estimation performed by the management in respect of the expenditure that will be required to settle the obligation, considering all the information available at the closing date, including the opinion of external experts, such as legal advisers or consultants.

If the Company is unable to reliably measure the obligation, no provision is recorded and information is then presented in the notes to the Audited Consolidated Financial Statements.

Because of the inherent uncertainties in this estimation, actual expenditures may be different from the originally estimated amount recognized.

Convergence of Chilean Accounting Standards with International Financial Reporting Standards. In 2004, as recommended by the World Bank, the SVS began working to promote the convergence of Chilean accounting standards with International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board. At the end of 2005, the SVS established a timeline such that publicly listed companies will be required to apply the new set of rules beginning on January 1, 2009. Several different regulatory organizations have been collaborating on this initiative, in particular the Chilean Association of Accountants, which is in charge of the convergence process in Chile. The financial statements for the years ended December 31, 2010 and thereafter must be presented in accordance with IFRS, and they must include comparative information for the previous period.

For a description of significant differences between Chilean GAAP and U.S. GAAP, see Note 37 to the Audited Consolidated Financial Statements.

A. Operating Results

Figures from previous years in the following discussion are adjusted for general price-level changes and expressed in millions of constant Chilean pesos as of December 31, 2007.

Net Income and Operating Revenues for 2005, 2006 and 2007

The following table presents historical information regarding the contribution, by amount and as a percentage of total operating revenues, of each of the Company's business segments to the Company's total operating revenues during the periods indicated below, calculated in accordance with Chilean GAAP.

Change in Consolidated Revenues Presentation: The Company changed its presentation of consolidated revenues to respond to the Company's diversification with new bundled services. The Company now presents Broadband and Television revenues separately, with the remaining revenues from the previous Fixed Telecommunications category grouped in Voice, Fixed Network and Complementary Services, which consists of voice revenues (traditional

telephony, including fixed charge and minute plans), access charges and interconnection revenues (fixed network), and complementary services (including other revenues associated with fixed telephony, such as public telephones, interior installations, equipment marketing, connections and other installations, and value added services). The presentation of previous years results was changed in order to reflect the current organization.

Operating Revenues

Years ended December 31,

	2005		2006		2007	
		% of Total Operating Revenues		% of Total Operating Revenues		% of Total Operating Revenues
(in millions of constant Ch\$ as of December 31, 2007, except percentage amounts)						
VOICE, FIXED NETWORK AND COMPLEMENTARY SERVICES ⁽¹⁾	437,060	68.64%	402,165	64.87%	361,284	57.11%
⁽²⁾ Telephony (Voice)	291,875	45.84%	258,808	41.75%	231,831	36.65%
Fixed charge	135,468	21.27%	86,648	13.98%	52,403	8.28%
Variable charge	106,265	16.69%	75,039	12.10%	49,899	7.89%
Minute plans (tariff flexibility) ⁽³⁾	50,142	7.87%	97,121	15.67%	129,529	20.48%
Access Charges and Interconnection (Fixed Network)	48,254	7.58%	55,011	8.87%	52,838	8.35%
Domestic long distance	11,343	1.78%	9,123	1.47%	7,473	1.18%
International long distance	2,600	0.41%	1,715	0.28%	1,740	0.28%
Other interconnection services	34,311	5.39%	44,174	7.13%	43,625	6.90%
Complementary Services	96,932	15.22%	88,349	14.25%	76,615	12.11%
Directory advertising	5,888	0.92%	4,663	0.75%	3,245	0.51%
ISP- switched and dedicated	2,774	0.44%	2,391	0.39%	1,532	0.24%
Security services (Teleemergencia)	8,862	1.39%	9,478	1.53%	8,125	1.28%
Public telephones	10,767	1.69%	10,700	1.73%	8,439	1.33%
Interior installations	33,649	5.28%	32,922	5.31%	29,076	4.60%
Equipment marketing	4,168	0.65%	3,059	0.49%	4,342	0.69%
Connections and other installations	3,597	0.56%	1,592	0.26%	2,610	0.41%
Value added services	21,355	3.35%	17,788	2.87%	14,865	2.35%
Other	5,872	0.92%	5,757	0.93%	4,381	0.69%
BROADBAND ^{(2) (4)}	47,043	7.39%	65,833	10.62%	101,632	16.07%
TELEVISION ^{(2) (5)}	-	0.00%	4,073	0.66%	26,556	4.20%
LONG DISTANCE ⁽⁶⁾	63,570	9.98%	63,282	10.21%	58,435	9.24%
CORPORATE CUSTOMER COMMUNICATIONS	85,762	13.47%	81,745	13.19%	82,256	13.00%
OTHER BUSINESSES ⁽⁷⁾	3,344	0.53%	2,815	0.45%	2,409	0.38%
TOTAL OPERATING REVENUES	636,779	100.00%	619,917	100.00%	632,572	100.00%

-
- (1) In 2007, the Company changed its revenues presentation, separating Broadband and Television revenues from the Fixed Telecommunications group. The remaining revenues are grouped into Voice, Fixed Network and Complementary Services, which includes traditional telephony (fixed charge and minute plans), access charges and interconnection (fixed network), and complementary services, which groups the other revenues associated with fixed telephony, such as public telephones, interior installations, equipment marketing, connections and other installations, and value-added services. The presentation of previous years results was changed in order to reflect the current structure.
 - (2) Revenues from bundled services are distributed proportionately between the relevant business segments. To the extent discounts are offered, they are primarily ascribed to telephony (voice).
 - (3) Beginning in February 2004, the Company was allowed to offer different plans for fixed telephony as alternatives to the regulated plan. See Item 4. Information on the Company Business Overview Licenses and Tariffs.
 - (4) Beginning in 2007, the Company changed the way it commercialized broadband by providing a single point of contact. The Company now provides the customer with both the broadband infrastructure and, through outsourcing, Internet access. This strengthens the Company's relationship with the final customer. Thus, all revenues from broadband and Internet access collected from clients are now recorded in the income statement and outsourcing service costs are recorded in general expenses.
 - (5) The pay television business was launched on June 14, 2006.

- (6) Revenues from LD service include revenues from LD traffic and the rental of the LD network to other telecommunications operators.
- (7) Revenues from other businesses include revenues from Tecnonáutica until 2006 and t-gestiona, Instituto Telefónica and Fundación Telefónica, among others.

Results of Operations for the Year Ended December 31, 2007 Compared to the Year Ended December 31, 2006

Operating Revenues

Operating revenues increased by 2.0% to Ch\$632,572 million (US\$1,273.1 million) in 2007 from Ch\$619,918 million in 2006. This growth mainly resulted from increased revenues from broadband, pay television, corporate communications and minute plans, which offset decreased revenues from fixed and variable charges as well as the LD business.

Voice, Fixed Network and Complementary Services Revenues

Voice, fixed network and complementary services revenues, which accounted for 57.1% of the Company's operating revenues in 2007, decreased by 10.2% to Ch\$361,284 million (US\$727.1 million) compared to Ch\$402,165 million in 2006. Voice, fixed network and complementary services includes revenues from (i) telephony (voice) that consists of traditional telephone service (fixed and variable charge) and minute plans, (ii) access charges and interconnection and (iii) complementary services, which includes other revenues associated with fixed telephony, such as: interior installations, equipment marketing, connections and other installations, directory advertising and Telemergencia, which provides security services such as alarm monitoring through fixed lines subsidiary, and public telephones, among others.

Telephony (Voice). Revenues from basic telephony represented 64.3% of all revenues from voice, network and complementary services in 2007, which includes telephone line service fees (fixed monthly charges), variable charges and minute plans associated with tariff flexibility. Telephony (voice) revenues decreased by 10.4% in 2007 to Ch\$231,831 million (US\$466.6 million) from Ch\$258,808 million in 2006, mainly due to: (i) a 39.5% decrease in the fixed monthly charge to Ch\$52,403 million (US\$105.5 million) in 2007 from Ch\$86,648 million in 2006 and (ii) a 33.5% decrease in revenues from variable charges to Ch\$49,899 million (US\$100.4 million) in 2007 from Ch\$75,039 million in 2006, primarily because of a decrease in the number of lines that are charged fixed monthly and variable charges, as customers with traditional lines (subject to tariff regulation) have migrated to flexible plans such as minute plans and prepaid plans, which do not charge a monthly telephone line service fee. Additionally, the average traffic per line decreased by 4.0% in 2007 compared to 2006, and the average number of lines in service decreased by 6.3%. These decreases are mostly due to increased competition from mobile telephony. These effects were partially offset by an increase of 33.4% in revenues from minute plans, which generated Ch\$129,529 million (US\$260.7 million) in 2007 as compared with Ch\$97,121 million in 2006. As of December 31, 2007, these plans represented 68% of the total lines in service.

Revenue diversification through the increased mix of plans associated with tariff flexibility has helped mitigate the decline in revenues due to lower traffic and lines in service, in line with the Company's strategy. The revenues associated with flexible plans represent 20.5% of the consolidated revenues, surpassing the revenues of traditional telephony (fixed monthly charge and variable charge).

Access Charges and Interconnection. Access charges and interconnection include revenues from interconnection charges generated by LD carriers, as well as those paid by other telecommunications operators that use Telefónica Chile's network and data-processing services such as metering, rating, billing and collections offered to LD operators.

Access charges and interconnection revenues decreased by 3.9% to Ch\$52,838 million (US\$106.3 million) in 2007 from Ch\$55,011 million in 2006. This drop was mainly due to decreases of 18.1% in access charge revenues from DLD, which was partially offset by an increase of 1.5% in access charge revenues from ILD. Long distance access charge traffic decreased 16.0% in 2007 as compared with 2006.

Complementary Services. Complementary services include interior installations, equipment marketing, connections and other installations, directory advertising, Telemergencia (security services including alarm monitoring), public telephones, operator services, rural telephony and dedicated lines for the Internet, among others. These revenues decreased 13.3% in 2007 to Ch\$76,615 million (US\$154.2 million) from Ch\$88,347 million in

2006, impacted by (i) a 14.3% decrease in revenues from Telemergencia home security services mainly due to a 9.8% decrease in clients and greater market competition (ii) an 11.7% decrease in interior installations due to lower number of lines subject to maintenance charges, (iii) a 16.4% decrease in value-added services, (iv) a 21.1% decrease in public telephones due to lower traffic and lines as a result of mobile substitution and (v) a 13.3% decrease in directory advertising due to greater market competition. The above were partly offset by a 64.0% increase in connections and other installations, as well as higher equipment marketing revenues, which amounted to Ch\$4,342 million (US\$8.7 million) in 2007 as compared to Ch\$3,059 million in 2006. These increases are mainly explained by the sale of data and telecommunications equipment to corporate clients and the sale of computers and telecommunications equipment related to the *Puesto de Trabajo Informático* plan for small and medium enterprises, which was launched in July 2007. The plan offers voice and broadband services to small and medium enterprises, including the necessary equipment to provide the service.

Broadband Services Revenues

Broadband revenues represented 16.0% of all operating revenues in 2007 and include revenues from broadband Internet access provided by the Company through ADSL to residential customers, small and medium-sized companies, and corporate customers. Broadband revenues grew by 54.4% to Ch\$101,632 million (US\$204.5 million) in 2007 as compared to Ch\$65,833 million in 2006, based on a 30.1% increase in ADSL connections in the year, driven by a commercial focus on bundled plans of broadband plus minutes of voice and digital television (for residential customers), as well as a new plan for small and medium enterprises, called *Puesto de Trabajo Informático*, launched in July 2007. As of December 31, 2007, the number of broadband connections totaled 644,522.

At the beginning of 2007, the Company changed the way it commercialized Internet access. Previously, the Company used to allow customers to select their own ISPs; now the Company contracts with an ISP to provide Internet access. By providing a single point of contact, through which the Company provides the customer with broadband infrastructure and, through outsourcing, Internet access, the Company strengthened its relationship with the final customer. As such, all revenues from broadband and Internet access collected from clients are recorded in revenues from broadband and outsourcing service costs are recorded in general expenses. The Company recognized Ch\$16,120 million (US\$32.4 million) in additional broadband revenues in 2007 as a result of this change, but its impact on net income was neutral.

Television Revenues

Revenues from the pay television business, launched in June 2006, accounting for 4.2% of total revenues, reached Ch\$26,556 million (US\$53.4 million) in 2007, as compared with Ch\$4,090 million in 2006.

As of December 31, 2007, the Company had 219,916 pay television clients, attaining a 17.0% market share. During 2007, the Company enhanced its offer by incorporating five additional channels and complementing its existing television offering as of June 2007 with interactive services through IPTV (television over broadband). The interactive services include Video on Demand, which features a virtual library with over 200 hours of content. Additionally, as of September 2007, the Company is offering a personal video recorder service, which allows the client to digitally record, pause, rewind or fast-forward any television program.

Long Distance Revenues

Revenues from the long distance business segment, which accounted for 9.2% of total revenues in 2007, decreased by 7.7% to Ch\$58,435 million (US\$117.6 million) compared to Ch\$63,282 million in 2006. LD revenues include revenues from domestic and international long distance traffic carried by the Company, as well as revenues from the rental of the Company's LD network to other telecom operators. The decrease in LD revenues was mainly attributable

to a 10.4% decrease in DLD revenues and an 28.8% decrease in rental capacity. However, this was compensated by an 8.4% increase of revenues from ILD.

Corporate Customers Communications Revenues

Revenues from the corporate customers communications business segment, which accounted for 13.0% of the Company's revenues in 2007, increased by 0.6% to Ch\$82,256 million (US\$165.5 million) compared to Ch\$81,745 million in 2006. Corporate customers communications includes revenues from (i) the sale and rental of

telecommunications equipment to large corporate customers; (ii) complementary telephone services, such as 800-numbers and digital communication services; (iii) data services, including ATM, Frame Relay, data equipment and services related to the IP network; and (iv) dedicated links and other services, including videoconference, Dateded, E1 Links and VSAT, housing and hosting, and consulting services to large corporate customers. In 2007, Dateded links decreased by 10.2%, whereas data links through the IP network (dedicated IP) grew by 23.3%, and ATM links remained stable in comparison with 2006.

The increase in revenues was mainly due to a 1.9% increase in data services revenues to Ch\$29,291 million (US\$58.9 million) from Ch\$28,737 million in 2006 together with a 2.5% increase in revenues from circuits and others and a 0.3% rise in terminal equipment marketing due to increased revenues from advanced solutions for clients. Revenues from complementary services partially offset these increases with a 4.9% decrease during 2007.

Other Businesses Revenues

Revenues from other businesses, which accounted for 0.5% of the Company's revenues in 2007, decreased by 13.9% to Ch\$2,409 million (US\$4.8 million) as compared to Ch\$2,798 million in 2006. Revenues from other businesses include revenues from Tecnonáutica (until 2006), t-gestiona, Instituto Telefónica and Fundación Telefónica, among others.

Operating Costs and Administrative and Selling Expenses

Operating costs and administrative and selling expenses increased by 6.2% to Ch\$564,238 million (US\$1135.5 million) in 2007, as compared to Ch\$531,179 million in 2006, mainly explained by higher commercial activity in 2007 due to the full-year operation of the television business as compared with only six operating months in 2006.

Operating Costs and Expenses.

Operating costs and expenses, which accounted for 75.0% of total operating costs and administrative and selling expenses, increased by 5.7% to Ch\$423,274 million (US\$851.8 million) in 2007, as compared to Ch\$400,629 million in 2006, mainly because other operating costs, which represented 40.3% of total operating costs and expenses in 2007, increased by 20.1% to Ch\$170,772 million (US\$343.7 million) from Ch\$142,173 million in 2006. The increase was due to several factors, including higher general expenses related to the provision of television content to a larger subscriber base, increased operating salaries and related costs, and increased uncollectable accounts cost. Operating salaries and related costs, which represented 11.5% of total operating costs and expenses during 2007, increased by 2.3% to Ch\$48,587 million (US\$97.8 million) from Ch\$47,505 million in 2006. Provisions for doubtful accounts as a percentage of revenues were 3.3% as of December 31, 2007, compared to 3.2% in the previous year. The above was partially offset by a 3.3% decrease in depreciation, which accounted for 48.2% of total operating costs and expenses, to Ch\$203,915 million (US\$410.4 million) in 2007 from Ch\$214,750 million in 2006.

Administrative and Selling Expenses.

Administrative and selling expenses, which accounted for 25.0% of total operating costs and administrative and selling expenses in 2007, increased by 8.0% to Ch\$140,964 million (US\$283.7 million) from Ch\$130,550 million in 2006, mainly due to an increase in salaries as result of the hiring of personnel during 2007 who were previously considered external contractors in compliance with the Outsourcing Law passed at the beginning of 2007. Operating salaries and related costs increased by 22.8% to Ch\$32,199 million (US\$64.8 million) from Ch\$26,223 million in 2006. In addition other expenses increased due to higher costs and sales commissions related to broadband, television and corporate communications.

Operating Income

Operating income decreased by 23.0% to Ch\$68,334 million (US\$137.5 million) during 2007 from Ch\$88,738 million in 2006, mainly due to higher expenses resulting from more commercial activities.

Other Income (Expenses) or Non-Operating Results

Interest Income. Interest income increased by 50.5% to Ch\$7,173 million (US\$14.4 million) in 2007 from Ch\$4,765 million in 2006, mainly due to higher cash flows from operations that were available for financial investments during 2007.

Interest Expense. Interest expense decreased by 9.6% to Ch\$18,910 million (US\$38.1 million) in 2007 from Ch\$20,922 million in 2006, mainly due to lower financial debt and an improvement in international risk classification, which was Baa1 as of December 31, 2007 compared to Baa2 in September 2006.

Price Level Restatement and Exchange Differences. Price level restatement and exchange differences recorded a net gain in the amount of Ch\$1,393 million in 2007, as compared to a gain of Ch\$715 million in 2006.

Price level restatement registered a gain of Ch\$1,754 million (US\$3.5 million) in 2007 as compared to a gain of Ch\$538 million in 2006. The price level restatement reflects the net impact on the Company's accounts of purchasing power gain and loss on indexing. The Company will recognize a purchasing power gain or a loss on indexing on its statement of operations whenever the Company's average monetary liabilities for a given period during which inflation occurs (determined monthly) exceed or fall below its average monetary assets. The Company's average UF and Chilean peso-denominated liabilities and revenues fell below its average UF and Chilean peso-denominated assets and expenses, resulting in a purchasing power gain for the period, as shown in Note 27 to the Audited Consolidated Financial Statements. The principal inflation index-linked unit used in Chile is the UF, a rate that is set monthly for each day of the coming month to reflect the prior month's change in the Chilean CPI. As of December 31, 2007, one UF was equal to Ch\$19,622.66 (US\$39.4).

Exchange rate differences registered a loss of Ch\$360 million (US\$0.7 million) from exchange rate differences in 2007, as compared to a gain of Ch\$177 million from exchange rate differences in 2006, as shown in Note 28 to the Audited Consolidated Financial Statements. To the extent that, during any given period, the Company has net liabilities denominated in a foreign currency (such as the U.S. dollar or euros) and the Chilean peso may depreciate or appreciate in nominal terms against that currency, the Company may recognize for that period a foreign exchange loss or gain. Nevertheless the conservative hedging policy of the Company for foreign-currency denominated interest-bearing debt allows the Company to minimize the exchange rate variation risk in results. During 2007, the peso experienced a nominal appreciation of 12.2% against the U.S. dollar.

Other Non-Operating Results. Other non-operating results recorded a loss of Ch\$14,030 million (US\$28.1 million) in 2007, compared to a loss of Ch\$16,708 million in 2006, resulting in a 16.0% decrease in loss. In 2007, the Company recognized: (i) a charge of Ch\$3,522 million (US\$7.1 million) as compared to Ch\$10,234 million in 2006 for severance payments; (ii) a charge of Ch\$6,244 million (US\$12.6 million) as compared to Ch\$2,209 million in 2006 for lawsuit indemnities and other provisions; (iii) a write-off of out-of-service property, plant and equipment, for Ch\$5,915 million (US\$11.9 million) as compared to Ch\$4,439 million in 2006; and (iv) extraordinary payments to contractors and others for Ch\$3,675 million (US\$7.4 million) as compared to Ch\$1,322 million in 2006.

Income Taxes. The Company recorded an income tax charge in the amount of Ch\$33,214 million (US\$66.8 million) in 2007 corresponding to an effective consolidated tax rate for the Company of 75.6% compared to an income tax charge of Ch\$31,552 million in 2006 corresponding to an effective consolidated tax rate for the Company of 55.8%. Income taxes include current income tax expenses, tax provisions for the period, as well as deferred taxes from the period and from previous periods (complementary accounts), as shown in Note 7(c) to the Audited Consolidated Financial Statements. The Company's effective income tax rate in 2007 was principally affected by a charge of Ch\$14,135 million (US\$28.4 million) which represented the effect of amortization of deferred assets and liabilities of complementary accounts associated with deferred taxes incurred during previous periods, and by

price-level restatement not accepted for tax purposes and other non-deductible items.

Net Income (Loss)

As a result of the above, Telefónica Chile's net results amounted to a net income of Ch\$10,856 million (US\$21.8 million) in 2007, as compared to a net income of Ch\$25,081 million recorded in 2006. For 2007, the contribution to consolidated net income by business segment was as follows: (i) a net loss of Ch\$9,614 million in

fixed telephony; (ii) net income of Ch\$20,326 million in long distance; (iii) net income of Ch\$3,913 million in corporate customers communications and data; and (iv) a net loss of Ch\$3,769 million in other businesses.

Results of Operations for the Year Ended December 31, 2006 Compared to the Year Ended December 31, 2005

Operating Revenues

Operating revenues decreased by 2.6% to Ch\$619,917 million (US\$1,247.6 million) in 2006 from Ch\$636,778 million in 2005. The decrease is mainly due to a 12% drop of revenues from basic telephony and a 4.7% decrease of corporate communications revenues, due to lower traffic and revenues from services. This, however, was partially compensated by a 93.7% increase of revenues from flexible plans and a 39.9% increase from broadband revenues.

Voice, Fixed Network and Complementary Services Revenues

Voice, fixed network and complementary services revenues, which accounted for 64.9% of the Company's operating revenues in 2006, decreased by 8.0% to Ch\$402,165 million (US\$673.8 million) compared to Ch\$437,060 in 2005. Voice, fixed network and complementary services includes revenues from (i) telephony (voice) that consists of traditional telephone service (fixed and variable charge) and minute plans, (ii) access charges and interconnection and (iii) complementary services, which includes other revenues associated with fixed telephony, such as: interior installations, equipment marketing, connections and other installations, directory advertising and Telemergencia, which provides security services such as alarm monitoring through fixed lines subsidiary, and public telephones, among others.

Telephony (Voice). Revenues from basic telephony represented 64.4% of all revenues from voice, network and complementary services in 2006, which includes telephone line service fees (fixed monthly charges), variable charges and minute plans associated with tariff flexibility. Telephony (voice) revenues decreased 11.3% in 2006 to Ch\$258,808 million (US\$520.9 million) from Ch\$291,875 million in 2005, mainly due to: (i) a 36.0% decrease in revenues from fixed monthly charges to Ch\$86,648 million (US\$174.4 million) in 2006 from Ch\$135,468 million in 2005, primarily because of a decrease in the number of lines that are subject to fixed monthly and variable charges, as part of those with traditional lines (subject to tariff regulation) have migrated to flexible plans such as minute plans and prepaid plans, which do not charge a monthly telephone line service fee (fixed charge). Telephony (voice) revenues also decreased because of a 29.4% decrease in revenues from variable charges to Ch\$75,039 million (US\$151.0 million) in 2006 from Ch\$106,265 million in 2005 as a result of a 21.3% decrease in local traffic and the migration of traditional clients to flexible plans. However, the implementation of minute plans allowed by new tariff flexibility generated revenues in the amount of Ch\$97,121 million (US\$195.5 million) increasing 93.7% in comparison to the previous year. See Item 4. Information on the Company Business Overview Licenses and Tariffs The Tariff System. As customers with traditional lines (subject to tariff regulation) have migrated to flexible plans, revenues from fixed monthly charge, variable charge and flexible plans decreased a combined 11.3% mainly because of lower average traffic per line. As of December 31, 2006, average lines in service decreased 4.8% as compared to year 2005.

Access Charges and Interconnection. Access charges and interconnection include revenues from interconnection charges generated by LD carriers, as well as those paid by other telecommunications operators that use Telefónica Chile's network and data-processing services such as metering, rating, billing and collections offered to long distance operators. Access charges and interconnection revenues increased by 14.0% to Ch\$55,001 million (US\$110.7 million) in 2006 from Ch\$48,254 million in 2005. This was mainly due to a 28.7% increase of other interconnection services. There was a decrease of 19.6% and 34.0% in DLD and ILD access charges revenues, respectively, mainly due to an 18% decrease in access charges traffic.

Complementary Services. Revenues from complementary services decreased 8.9% in 2006 to Ch\$88,349 (US\$177.8) from Ch\$96,932 million, mainly impacted by a 55.8% decrease in revenues from installations and connections, to Ch\$1,591 million (US\$3.2 million) in 2006 from Ch\$3,596 million in 2005. They were also affected by a 16.7% decrease in value-added services to Ch\$17,788 (US\$35.8 million) in 2006 from Ch\$21,355 million in 2005, a 26.6% decrease in terminal equipment marketing, a 2.2% decrease in revenues from interior installation, a 20.8% decrease in phonebook advertising revenues and a 13.8% decrease in revenues from switched and dedicated

ISP services. This was partially offset by a 7.0% increase in revenues from Telemergencia to Ch\$9,478 (US\$19.1 million) in 2006 from Ch\$8,862 million in 2005.

Broadband Services Revenues

Broadband revenues represented 10.6% of all operating revenues in 2006, and include revenues from broadband Internet access provided by the Company through ADSL to residential, small and medium-sized companies and corporate customers. Broadband revenues grew 39.9% to Ch\$65,833 million (US\$132.5 million) in 2006 as compared to Ch\$47,043 million in 2005, due to a 57.7% increase in ADSL connections in the year. As of December 31, 2006, the number of broadband connections totaled 495,479.

Pay Television Revenues

Revenues from digital television services reached Ch\$4,073 million (US\$8.2 million) in 2006. On June 14, 2006, Telefónica Chile launched its pay television service, and at December 31, 2006, after only six months of operations, the Company had 94,209 pay television customers, representing an 8.7% market share.

Long Distance Revenues

Revenues from the long distance business segment, which accounted for 10.2% of total revenues in 2006, decreased by 0.5% to Ch\$63,282 million (US\$127.4 million) compared to Ch\$63,570 million in 2005. Long distance revenues include revenues from domestic and international long distance traffic carried by the Company, as well as revenues from the rental of the Company's long distance network to other telecom operators. The decrease in long distance revenues was mainly attributable to a 7.1% decrease in DLD revenues and an 8.1% decrease in rental capacity. However, this was compensated for by a 13.5% increase in revenues from ILD.

The increase in ILD revenues is mainly due to the absence in 2006 of an extraordinary charge associated with incoming ILD traffic revenues of Ch\$2,805 million (US\$5.6 million) in 2005.

Corporate Customers Communications Revenues

Revenues from the corporate customers communications business segment, which accounted for 13.2% of the Company's revenues in 2006, decreased by 4.7% to Ch\$81,745 million (US\$164.5 million) compared to Ch\$85,762 million in 2005. Corporate customers communications includes revenues from (i) the sale and rental of telecommunications equipment to large corporate customers, (ii) complementary telephone services, such as 800-numbers and digital communication services, (iii) data services, including ATM, Frame Relay, data equipment and services related to the IP network, and (iv) dedicated links and other services, including videoconferencing, Dated, E1 Links and VSAT, housing and hosting and consulting services to large corporate customers.

The decrease in revenues was mainly due to (i) a 6.8% decrease in data services revenues to Ch\$28,737 million (US\$57.8 million) from Ch\$30,833 million in 2005 together with a 17.1% decrease in revenues from terminal equipment marketing and an 8.3% fall in revenues from complementary services. Revenues from circuits and others partially compensated for this with an 8.0% increase during 2006. Data links through the IP network continued to grow (dedicated IP), reaching a 16.2% increase during this year.

Other Businesses Revenues

Revenues from other businesses, which accounted for 0.5% of the Company's revenues in 2006, decreased by 16.3% to Ch\$2,815 million (US\$5.7 million) as compared to Ch\$3,343 million in 2005. Revenues from other

businesses include revenues from subsidiaries, including Tecnonáutica and t-gestiona, among others.

Operating Costs and Administrative and Selling Expenses

Operating costs and administrative and selling expenses decreased by 1.9% to Ch\$531,178 million (US\$1069.0 million) in 2006, as compared to Ch\$541,273 million in 2005. This was a result of a Ch\$12,945 million (US\$26.1 million) decrease in salaries, due to the restructuring carried out in early 2006, and a 1.7% decrease in other operational costs, which was partially offset by an increase in depreciation costs.

Operating Costs and Expenses.

Operating costs and expenses decreased by 2.1% to Ch\$400,629 million (US\$806.3 million) in 2006, as compared to Ch\$409,074 million in 2005, mainly because of other operating costs, which represented 35.7% of total operating costs and expenses in 2006, and decreased by 7.0% to Ch\$143,462 million (US\$288.7 million) from Ch\$154,289 million in 2005, due to lower general expenses and a reduction in uncollectible accounts costs. During 2006, the Company continued implementing strict policies to control uncollectibles such as automatic disconnections of lines with more than 120-day past due invoices and strict policies for admitting new customers. Provisions for doubtful accounts as a percentage of revenues was 3.2% as of December 31, 2006, compared to 3.6% in the previous year.

The above was partly offset by the increase in operating salaries and related costs, which represented 8.9% of total operating costs and expenses during 2006. Operating salaries and related costs increased by 1.3% to Ch\$47,505 million (US\$95.6 million) from Ch\$46,839 million in 2005. In addition, depreciation, which accounted for 52.5% of total operating costs and expenses, increased 1.4% to Ch\$210,611 million (US\$423.9 million) in 2006 from Ch\$208,005 million in 2005, mainly due to the review of the useful lives of assets.

Administrative and Selling Expenses.

Administrative and selling expenses, which accounted for 24.6% of total operating costs and administrative and selling expenses in 2006, decreased by 1.2% to Ch\$130,550 million (US\$262.7 million) from Ch\$132,200 million in 2005, mainly due to salary savings due to personnel reductions at the beginning of 2006. Operating salaries and related costs, which represented 13.9% of total operating costs and expenses during 2007, decreased by 15.0% to Ch\$73,728 million (US\$148.4 million) from Ch\$86,713 million in 2006. The above was partly offset by higher costs and sales commissions related to broadband, television and corporate communications.

Operating Income

Operating income decreased by 7.1% to Ch\$88,738 million (US\$178.6 million) during 2006 from Ch\$95,505 million in 2005, due to a 2.6% decrease in operating revenues and a 1.9% decrease in operating expenses.

Other Income (Expenses) or Non-Operating Results

Interest Income. Interest income decreased by 45.6% to Ch\$4,765 million (US\$9.6 million) in 2006 from Ch\$8,756 million in 2005, mainly due to higher fund volumes transitorily destined to financial investments during 2005.

Interest Expense. Interest expense decreased by 35.3% to Ch\$20,922 million (US\$42.1 million) in 2006 from Ch\$32,350 million in 2005, mainly due to a low financial debt and a better international risk classification, varying from BAA2 to BAA1.

Price Level Restatement and Exchange Differences. Price level restatement and exchange differences, recorded a net gain in the amount of Ch\$715 million in 2006, as compared to a gain of Ch\$3,181 million in 2005.

Price level restatement registered a gain of Ch\$538 million (US\$1.1 million) in 2006 as compared to a gain of Ch\$2,133 million in 2005. The price level restatement reflects the net impact on the Company's accounts of purchasing power gain and loss on indexing. The Company will recognize a purchasing power gain or a loss on indexing on its statement of operations whenever the Company's average monetary liabilities for a given period during which inflation occurs (determined monthly) exceed or fall below its average monetary assets. The Company's average UF and Chilean peso denominated liabilities and revenues fell below its average UF and Chilean peso denominated assets and expenses, resulting in a purchasing-power gain for the period, as shown in Note 27 to the Audited Consolidated

Financial Statements. The principal inflation index-linked unit used in Chile is the UF, a rate that is set monthly for each day of the coming month to reflect the prior month's change in the Chilean CPI. As of December 31, 2006, one UF was equal to Ch\$18,336.38 (US\$36.9) .

Exchange rate differences registered a gain of Ch\$177 million (US\$0.4 million) from exchange rate differences in 2006, as compared to a gain of Ch\$1048 million from exchange rate differences in 2005, as shown in Note 28 to the Audited Consolidated Financial Statements. To the extent that, during any given period, the Company has net

liabilities denominated in a foreign currency (such as the U.S. dollar or euros) and the Chilean peso may depreciate or appreciate in nominal terms against that currency, the Company may recognize for that period a foreign exchange loss or gain. Nevertheless the conservative hedging policy of the Company for foreign-currency denominated interest-bearing debt allows the Company to minimize the exchange rate variation risk in results. During 2006, appreciation of the inflation-adjusted Chilean peso against the U.S. dollar was 1.72% .

Other Non-Operating Results. Other non-operating results recorded a loss of Ch\$31,912 million (US\$64.2 million) in 2006, compared to a loss of Ch\$31,242 million in 2005, resulting in a 2.1% increase in loss.

The Company recognized: (i) a charge of Ch\$10,234 million (US\$20.6 million) in 2006 as compared to Ch\$2,224 million in 2005 for severance payments; (ii) a charge of Ch\$2,722 million (US\$5.5 million) in 2006 as compared to Ch\$3,100 million in 2005 for provision for obsolete assets; (iii) a write-off of out-of-service property, plant and equipment, for Ch\$1,628 million (US\$3.3 million) in 2006 as compared to Ch\$4,802 million in 2005; and (iv) lawsuit indemnities and other provisions for Ch\$1,788 million (US\$3.6 million) in 2006 as compared to Ch\$1,277 million in 2005.

Income Taxes. The Company recorded an income tax charge in the amount of Ch\$31,791 million (US\$64.0 million) in 2006 corresponding to an effective consolidated tax rate for the Company of 55.9% compared to an income tax charge of Ch\$36,616 million in 2005 corresponding to an effective consolidated tax rate for the Company of 57.0% . Income taxes include current income tax expenses, taxes provision for the period, as well as deferred taxes from the period and from previous periods (complementary accounts), as shown in Note 8(c) to the Audited Consolidated Financial Statements. The Company's effective income tax rate in 2006 was principally affected by a charge of Ch\$14,837 million (US\$30.0 million) which represented the effect of amortization of deferred assets and liabilities of complementary accounts associated with deferred taxes incurred during previous periods, by price-level restatement not accepted for tax purposes of Ch\$2,815 million (US\$5.7 million) and by other non-deductible items of Ch\$3,886 million (US\$7.8 million).

The income tax charge includes a charge of Ch\$18,185 million (US\$37.0 million) related to the reversal of temporary differences associated with deferred tax liabilities related mainly to accelerated depreciation due to the fact that investments have decreased in the last six years generating lower temporary liabilities than temporary assets and Ch\$19 million for tax benefits from loss carry forwards.

Net Income (Loss)

As a result of the above, Telefónica Chile's net results amounted to a net income of Ch\$25,081 million (US\$50.5 million) in 2006, as compared to a net income of Ch\$27,615 million recorded in 2005. For 2006, the contribution to the consolidated net income by business segment was as follows: (i) a net loss of Ch\$6,217 million in fixed telephony; (ii) net income of Ch\$16,241 million in long distance; (iii) net income of Ch\$14,281 million in corporate customers communications and data; and (iv) a net income of Ch\$777 million in other businesses.

B. Liquidity and Capital Resources

Sources of Liquidity

The Company's main historical sources of liquidity have been its cash flows from operations, proceeds from borrowings and the issuance of equity. Although in the past Telefónica Chile has relied substantially on public debt issues and bank loans to meet its financing requirements, since 2001 its main sources of liquidity have been cash flow generated from operations and free cash resulting from savings associated with the refinancing of certain loans. The current working capital level is sufficient to meet present requirements. If any additional working capital is needed in

the future, the Company will evaluate additional financing.

During 2007, Telefónica Chile continued to pursue its strategy of improving its financial structure by focusing capital expenditures on Company businesses with the highest expected returns and reducing capital expenses.

During 2007, the Company generated net cash from operating activities totaling Ch\$244,285 million (US\$491.6 million), compared to Ch\$250,578 million in 2006, as a result of a net income of Ch\$10,856 million (US\$21.8 million) in 2007 as compared to net income of Ch\$25,081 million in 2006, adjusted for activities that affect net income but do not affect cash, principally depreciation and amortization charges of Ch\$210,354 million (US\$423.3

million) as compared to Ch\$220,669 million in 2006. The Company used cash to increase operating assets by Ch\$43,709 million (US\$88.0 million) in 2007, compared to an increase in operating assets of Ch\$21,860 million in 2006, and generated cash due to an increase in operating liabilities of Ch\$32,943 million (US\$66.3 million), compared to a decrease of Ch\$2,254 million in 2006. The increase in 2007 was due to increase in other assets, offsetting the decrease in trade accounts receivables.

Net cash used in financing activities reached Ch\$72,243 million (US\$145.4 million) in 2007 as compared with Ch\$193,689 million in 2006. Cash in 2007 was mainly used for dividend payments of Ch\$19,433 million (US\$39.1 million), a capital reduction of Ch\$51,445 million (US\$103.5 million) and repayments of public debentures of Ch\$1,365 million (US\$2.7 million).

Net cash used in investing activities reached Ch\$133,799 million (US\$269.3 million) in 2007, compared to Ch\$116,014 million in 2006. The cash used in investing activities in 2007 was principally associated with the acquisition of property, plant and equipment.

The Company's shareholders' equity as of December 31, 2007 and 2006 was Ch\$906,534 million (US\$1,824.4 million) and Ch\$967,417 million, respectively. The decrease in shareholders' equity as of December 31, 2007 was primarily attributable to the payment, during 2007, of dividends totaling Ch\$19,434 million (US\$39.1 million), as well as a capital reduction of Ch\$51,455 million (US\$103.6 million), in order to distribute additional cash to shareholders.

Outstanding Indebtedness

Following its privatization in 1988, the Company pursued an aggressive development plan to expand its fixed line network and develop other telecommunications services, such as LD service, mobile telephony and data transmission services. To fund the capital expenditures associated with this expansion, the Company has raised capital by issuing debt through domestic and international offerings, including the issuance of Yankee and Euro Bonds, and has borrowed funds from commercial banks in the form of syndicated and bilateral loans. The Company has also accessed the local Chilean capital markets through the issuance of medium and long-term bonds, primarily sold to pension funds, insurance companies and other institutional investors, commercial paper, and through borrowing from commercial banks.

At December 31, 2007, the Company's financial debt totaled Ch\$391,549 million (US\$78.8 million), which decreased as compared with 2006, due to amortization of Series F bonds in April and October 2007. The repayment of Series F bonds amounted to US\$3 million.

During 2007, the sources of financing were mainly operating funds, which allowed the Company to make Ch\$144,654 million (US\$291.1 million) in investments. In addition, a total of Ch\$19,434 million (US\$39.1 million) was distributed to shareholders as dividends and Ch\$51,445 million (US\$103.5 million) was distributed to shareholders through a capital decrease.

The following table sets forth the Company's outstanding debt as of December 31, 2007:

As of December 31, 2007

Total Debt Outstanding	Short-Term Portion	Long-Term Portion	Date Incurred	Original Principal Amounts Borrowed⁽¹⁾	Maturity
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	Type of Debt	Interest Rate
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(in millions of constant Chilean Pesos as of December 31, 2007, except as indicated)

Long-Term Obligations including current maturities: Long-Term Obligations with Banks:

				Syndicated				
Citibank	75,094	75,094	-	loan	2005	US\$150 million	Libor + 0.31	2008
Banco BBVA, Bancomer and Others	75,140	606	74,534	Syndicated loan	2005	US\$150 million	Libor + 0.334	2011
CALYON, New York and Others	99,523	145	99,378	Syndicated loan	2004	US\$200 million	Libor + 0.35 TAB360 +	2009
Banco Santander	70,238	480	69,758	Bilateral loan	2005	UF 3.555.000	0.325	2010
<i>Total Long-Term Obligations with Banks</i>	319,995	76,325	243,670					

As of December 31, 2007

	Total Debt Outstanding	Short- Term Portion	Long-Term Portion	Type of Debt	Date Incurred	Original Principal Amounts Borrowed⁽¹⁾	Interest Rate	Maturity
(in millions of constant Chilean Pesos as of December 31, 2007, except as indicated)								
<i>Bonds and Debentures:</i>								
Series F	12,314	1,802	10,512	Local bond	1991	UF 1.500.000	6.00%	2016
Series L	59,017	149	58,868	Local bond	2006	UF 3.000.000	3.75%	2012
<i>Total Bonds and Debentures</i>	71,331	1,951	69,380					
<i>Capital Lease Obligations:</i>								
Leasing Obligations	223	18	205	Leasing	-	-	8.10%	2016
Total Long-Term Debt (including current maturities)	391,549							
Total Debt Outstanding	391,549							

(1) In original currency of debt as incurred.

In addition to available cash as of December 31, 2007, the Company has the ability to draw up to approximately Ch\$1,200 million (US\$2.4 million) from unused lines of credit granted by Chilean banks.

The Company has the equivalent of US\$350 million of debt that will mature in 2008 and 2009 combined. The Company intends to refinance this debt.

Some of the Company's indebtedness is governed by instruments and agreements that contain restrictive covenants with which the Company is obligated to comply. During the last four years, the Company has been renegotiating its outstanding debt in order to improve its rates and maturities, but also to establish less restrictive covenants. Under terms of the Company's syndicated loan agreements, the Company must maintain a leverage ratio (as defined in each respective agreement) equal to or lower than 1.6. Additionally, the covenants for the local bonds require that the Company must maintain a leverage ratio (as defined in the local bond agreement) less than or equal to 1.6. In addition, the Investment and Financing Policy for 2007 approved by Telefónica Chile's shareholders at the General Annual

Shareholders Meeting held in April 2007 specifies that the maximum consolidated debt-to-equity ratio may not exceed 1.6. Non-compliance with these clauses would make all the obligations assumed in these financing contracts due and payable. As of December 31, 2007, the Company was in compliance with all financial covenants set forth under the agreements governing its debt obligations and with all other covenants in these agreements. As of December 31, 2007, the Company had a leverage ratio of 0.86 and an interest coverage ratio of 24.23.

During 2007, the ratings agency Moody's reaffirmed the Company's rating of Baa1 with a stable outlook, and Fitch Ratings also reaffirmed its rating of BBB+ with a stable outlook.

Capital Expenditures and Other Liquidity Requirements

Debt Prepayment and Repayment

In 2007, the Company continued its strategy of strengthening its financial structure and reducing financial expenses. During the last five years, the Company achieved a significant decrease in its total financial debt through greater cash flow, which enabled the Company to reduce its debt through several debt repayments.

During 2007, the Company's source of financing was operating resources. These resources allowed investments of Ch\$144,654 million (US\$291 million) for capital expenditures, debt repayments equivalent to US\$3 million and the payment of dividends and return of capital equivalent to US\$136 million.

Debt Renegotiation

On February 2, 2007, the Company renegotiated a bilateral loan in the amount of UF 3,555,000 (US\$140 million) with Banco Santander Chile in order to bring the spread down to market levels, from 0.45% to 0.325%. All other loan terms and conditions remained unchanged.

Capital Expenditures

Capital expenditures have been designated primarily for those business areas presenting the greatest potential.

In 2007, Telefónica Chile's capital expenditures totaled Ch\$144,654 million (US\$291 million). These investments were focused on consolidating business growth, mostly in broadband and digital television. In the fixed telecommunications business, investment funds were used for line commercialization efforts and to maximize the use of installed capacity, focusing on network deployment in areas of real estate development. The investment plan emphasized initiatives designed to update network infrastructure by replacing old equipment and introducing new generation technologies with a view to attaining high service quality standards with more stable and flexible platforms.

Additional emphasis was placed on simplifying the processes and systems that support Company operations, thus improving the support tools for the Company's business, technical and administrative management.

The main focus of these investments was consolidating broadband growth and digital television. Thus 26.1% of capital expenditures was invested in broadband, 24.7% in television services, 14.4% in data transmission, 25.1% in local telephony and the remaining 9.7% was invested in other areas, including the Company's systems and long distance.

The Company's management expects to maintain a similar level of capital expenditures in future years in addition to the capital expenditures required for the provision of pay television services to its different client segments. The management reviews the capital expenditures program periodically and adjustments are made as appropriate, due to changes in markets conditions, general economic conditions in the country, business competition and other factors.

Foreign Exchange and Interest Rate Risk Management

The Company obtains financing abroad mainly in U.S. dollars and, in certain cases, with floating interest rates. As a result, Telefónica Chile is exposed to financial risks related to foreign exchange and/or interest rate fluctuations. For this reason, Telefónica Chile periodically reviews its exposure to foreign exchange and interest rate risk to determine the levels of coverage required for each period. See Item 3. Key Information Risk Factors. Currency devaluations and foreign exchange fluctuations may adversely affect Telefónica Chile.

In 2007, the Company continued its policy of hedging 100% of its financial debt against foreign exchange fluctuations. Of the Company's total long-term debt (including current maturities) of Ch\$391,549 million (US\$788.0 million) as of December 31, 2007, 36.2% was denominated in Chilean pesos and 63.8% was denominated in foreign currencies, mainly the U.S. dollar.

As of December 31, 2007, 34.8% of the Company's long-term interest-bearing debt, including current portion and foreign currency and Chilean peso-denominated debt, was exposed to interest rate fluctuations. The remaining 65.2% of the Company's interest-bearing debt was insulated from interest rate fluctuations: 46.9% was hedged and 18.3% was fixed-rate debt. As of December 31, 2007, the Company had outstanding cross-currency swaps of Ch\$183,850 million (US\$370 million), which serve to hedge against dollar-peso exchange rate fluctuations and, at the same time, effectively change its floating rate to a fixed rate. See Item 11. Quantitative and Qualitative Disclosures About Market Risk.

Impact of Inflation

The Company is required under Chilean GAAP to restate its non-monetary assets, UF and foreign-currency denominated monetary assets and liabilities, shareholders' equity, and income and expense accounts to reflect the effect of variations in the purchasing power of the Chilean peso. However, Chilean peso-denominated monetary assets and liabilities are typically not restated. See Note 27 of the Audited Consolidated Financial Statements.

Non-monetary assets, UF-denominated monetary assets and liabilities, shareholders' equity, and income and expense accounts are generally restated using the Chilean CPI, based on the prior month rule, in which inflation adjustments are based on the Chilean CPI at the end of the month preceding the period-end. Inflation, as measured by the Chilean CPI, was 3.6%, 2.1% and 7.4% for the twelve-month periods ended November 30, 2005, 2006 and

2007, respectively. Monetary assets and liabilities in foreign currencies are restated at period-end exchange rates. In the Company's case, the amount of monetary correction for any period will depend primarily on the amount of foreign-currency denominated monetary assets and liabilities and the effect of adjustments for inflation on monetary assets and liabilities.

The following table sets forth the accounting treatment of the effect of inflation on Telefónica Chile's statement of operations for the periods indicated:

	Year ended December 31,			
	2005	2006	2007	2007
	(in millions of constant Ch\$ as of December 31, 2006)			(US\$ millions)
Price level restatement	2,134	538	1,753	3.5
Purchasing-power gain	21,326	11,759	31,239	62.9
(Loss) on indexation	(19,192)	(11,221)	(29,486)	(59.3)
Exchange differences				
(gain (loss) on foreign currency transactions)	1,048	177	(360)	(0.7)
Price level restatement and exchange differences, net	3,182	715	1,393	2.8

Recent Accounting Pronouncements Under U.S. GAAP

(i) In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements. This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities and November 15, 2008 for others. The Company is currently evaluating the impact that will result from the adoption of SFAS 157.

(ii) In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 permits measurement of recognized financial assets and liabilities at fair value with some exceptions. Changes in the fair value of items for which the fair value option is elected should be recognized in income or loss. The election to measure eligible items at fair value is irrevocable and can only be made at defined election dates or events, generally on an instrument by instrument basis. Items for which the fair value option is elected should be separately presented or be parenthetically disclosed in the statement of financial position. SFAS No. 159 also requires significant new disclosures that apply for interim and annual financial statements. SFAS No. 159 will be effective for fiscal years beginning after November 15, 2007 with earlier adoption permitted, if certain conditions are met. The Company does not expect the result of adopting SFAS No. 159 to be material to the consolidated financial statements.

(iii) In December 2007, the FASB issued SFAS No. 141 (revised 2007) Business Combinations. SFAS 141 (R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree and the goodwill acquired. SFAS 141 (R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS 141 (R) is effective for fiscal years beginning after December 15, 2008. Earlier adoption is prohibited. SFAS 141 (R) will be applied to future business combinations, if any, consummated by

the Company.

(iv) In December 2007, the FASB issued SFAS No. 160 Noncontrolling interests in Consolidated Financial Statements an amendment of ARB No. 51. SFAS No. 160 establishes accounting and reporting standards that require that the ownership interests in subsidiaries held by parties other than the parent be clearly identified, labeled, and presented in the consolidated statement of financial position within equity, but separate from the parent's equity; the amount of consolidated net income attributable to the parent and to the noncontrolling interest be clearly identified and presented on the face of the consolidated statement of income; and changes in a parent's ownership interest while the parent retains its controlling financial interest in its subsidiary be accounted for consistently. SFAS

No. 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. The Company is in the process of evaluating the financial impact of adopting SFAS 160.

(v) In March 2008, the FASB issued SFAS No. 161 Disclosures about Derivative Instruments and Hedging Activities. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity's financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company is in the process of evaluating the financial impact of adopting SFAS 161.

(vi) On August 28, 2007, the SVS issued an official announcement with respect to the adoption of International Financial Reporting Standards (IFRS) in Chile. According to this announcement, the Company will have to adopt IFRS as of January 1, 2009 or 2010. The Company is in the process of defining a convergence plan, and is currently evaluating the impact that the application of IFRS will have on the financial statements.

C. Research and Development, Patents and Licenses, Etc.

The Company does not incur any material research and development expenses. The Company has a technological development unit responsible for developing solutions to satisfy technical needs of different business units of the Company. No separate investment budget is allocated to that unit's activities, which are based on specific project tasks.

The Company holds no material patents and does not grant to others material licenses on its intellectual property. In connection with its provision of telecommunications services, the Company plans infrastructure development based upon present and projected future demand for such services. The Company mainly acquires the necessary technology, including equipment, from third parties.

D. Trend Information

Regulatory Environment

The Chilean Government has historically regulated local telephony services in Chile. The Chilean government, through the Chilean Antitrust Authority, which is the agency responsible for making certain determinations relating to competitive conditions in the telecommunications industry, has determined that Telefónica Chile is a dominant operator of local telephony in many areas of Chile. As a result, the Company is subject to tariff decrees that regulate certain rates and fees the Company can charge for such local telephony services in most of the country. Tariff regulation, which is set every five years, may have a significant impact on Company revenues and its ability to compete in the marketplace, as the Company is required to charge the same tariff to all clients in a designated tariff area.

Recent trends seen outside of Chile have shown an increased use of IP technology as a substitute for traditional voice services at lower prices. The Telecommunications Law in Chile requires a regulation to be defined for these services to be offered to the public. Currently IP telephony may only be offered to corporate customers for internal use. See Item 4. Information on the Company Business Overview Licenses and Tariffs.

The Chilean Economy

The Company's operations are located almost entirely in Chile; therefore, the Company's operating and financial performance is sensitive to, and dependent upon, the level of economic activity in Chile. For the last seven years the Chilean economy has experienced positive growth, with an expansion of GDP at rates of 3.9% in 2003, 6.2% in 2004,

6.3% in 2005, 4.2% in 2006 and 5.2% in 2007. The Central Bank's concern for price stability has translated into the application of an inflation-targeting monetary approach. Inflation reached 1.1% in 2003, 2.4% in 2004, 3.7% in 2005, 2.6% in 2006, while in 2007 it climbed to 7.8% due to price increases in crude oil and food. The current account had a surplus of 1.5% of GDP in 2004, 0.6% in 2005, 2.7% in 2006 and 3.6% in 2007. Annual average unemployment declined from 9.0% in 2002 to 7.0% in 2007; therefore, household spending has helped drive the current expansion. During 2007, fiscal revenue reached record levels, driven by the high prices of commodities, particularly copper, resulting in a fiscal surplus equal to an estimated 8.4% of GDP. Meanwhile,

domestic demand increased by approximately 7.3%, domestic consumption grew by approximately 6.5% and investment grew by approximately 10.0% . In spite of the favorable economic climate, there can be no assurance that the consumption of the Company's products and services will grow in the same proportion.

Increased Competition, New Entrants and M&A Activity

Telefónica Chile faces intense competition in every aspect of its business. Telefónica Chile competes with both mobile telephony and other fixed and cable telephony operators, none of which are subject to the same tariff regulations as the Company and therefore compete under different conditions. The Company's market share in fixed lines has declined from 82% in 2000 to 65% in 2007. In 2004 and 2005, the competitive environment has led to major merger and acquisition activity, primarily in the cable operator business, where the top two companies consolidated and, combined, had nearly 90% of the pay television market, while also becoming a relevant player in broadband and fixed telephony. Additionally, in the mobile telephony business, in 2004, Telefónica Móviles (TEM) acquired Bellsouth in Chile and the mobile subsidiary of Telefónica Chile in order to merge these two companies. During 2005, the Mexican operator America Móvil (a subsidiary of Telmex) acquired the local mobile operator Smartcom, Telecom Italia sold its controlling stake in Entel to the local group Almendral, and the fixed network operator Manquehue Net was acquired by the local data transmission operator, GTD Group. In 2006, Telefónica Chile entered the pay television market, where the dominant operator (the cable company VTR) controlled approximately 90% of the market in May 2006. Launched in June 2006, the Company's market share reached 17.1% as of December 31, 2007.

There is also an increase in competition with the entry of new operators in the market, primarily in the LD and data transmission businesses. Telefónica Chile competes with fifteen other LD operators and with mobile telephone operators in the DLD market. As a result, the Company has faced intense pricing pressure, and a decreasing trend in traffic, which may result in further price decreases and market share losses in the future.

The mobile telephony market has continued to grow, reaching a penetration in the market of about 88 lines per 100 inhabitants as of December 31, 2007, as compared with only 20 lines per 100 inhabitants in the local service. The Company has experienced substitution since the introduction of mobile communications service, which has contributed to the declines in number of fixed lines, volume of local traffic and DLD traffic.

See also Item 4. Information on the Company Business Overview.

E. Off-Balance Sheet Arrangements

There are no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on the Company's financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

F. Tabular Disclosure of Contractual Obligations

The following table summarizes the Company's contractual cash obligations and commercial commitments as of December 31, 2007 and the liquidity requirements for such obligations in the future periods specified.

Payments due by period
(in millions of constant Ch\$ as of December 31, 2007)

Contractual Obligations:	Total	Payments due by period			
		Less than 1 year	1-3 years	3-5 years	More than 5 years

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Long-term debt, including current maturities ⁽¹⁾	391,210	78,253	171,634	77,031	64,292
Capital (finance) lease obligations ⁽¹⁾	339	41	82	82	134
Operating lease obligations	-	-	-	-	-