TELECOMMUNICATIONS CO OF CHILE
Form 20-F
April 13, 2007

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, 2006

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	New York Stock Exchange
Series A Common Stock	New York Stock Exchange*

* 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 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 our ordinary shares at December 31, 2006. 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, referen 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 of 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, 2006 and 2005 and the related consolidated statements of income, shareholders equity and cash flows for each of the three years in the period ended December 31, 2006 (collectively, the Audited Consolidated Financial Statements or Financial Statements), which were audited by Ernst & Young and, for the year 2004, by Deloitte & Touche Sociedad de Auditores y Consultores 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, 2006 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, 2007, the Central Bank reported that the Observed Exchange Rate with reference to December 29, 2006, the last business day in 2006 for which an exchange rate was reported, was Ch$532.39 = 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, 2002. 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.

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 expres 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 sale of the Company s mobile operations to Telefónica Móviles S.A., or TEM;
- 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 our 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, 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. We have 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.

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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, 2006 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 our 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 our corporate structure during the years presented. In particular, the data for 2004 reflects the divestiture and deconsolidation of our mobile subsidiary Telefónica Móvil as it was sold in July 2004, and also reflects the deconsolidation of the information system subsidiary, Sonda, since August 2002. On September 26, 2002, the Company entered an agreement to sell 25% of its 60% ownership of Sonda. The Company s remaining 35% ownership of Sonda was recognized under the equity method until August 2003, when the Company sold its remaining interest in Sonda.

	2002	2003	2004	2005	2006	2006
	(in millions of constant Chilean pesos as of December 31, 2006, except ratios)					(in millions of U.S. dollars)
Statement of Operations Data: ***Chilean GAAP***						
Operating Revenues	942,950	881,227	743,471	592,904	577,204	1,084.2
Operating Costs and Expenses	(657,245)	(570,266)	(470,120)	(380,888)	(373,025)	(700.7)
Administrative and Selling Costs	(142,809)	(185,890)	(168,491)	(123,091)	(121,555)	(228.3)
Operating Results	142,896	125,071	104,860	88,925	82,624	155.2
Interest Income	18,277	7,673	9,822	8,152	4,437	8.3
Interest Expense, Net of Capitalized						

Interest	(89,215)	(66,402)	(57,175)	(30,121)	(19,480)	(36.6)
Price Level Restatement and Exchange Differences[1]	(9,803)	689	9,501	2,962	666	1.3
Other non-operating income net[7]	(51,428)	(24,440)	328,918	(10,082)	(15,335)	28.8
Income before Income Taxes	10,727	42,592	395,925	59,836	52,911	99.4
Income Tax	(29,256)	(31,452)	(65,999)	(34,093)	(29,600)	(55.6)
Net Income (loss)	(19,365)	10,987	329,627	25,712	23,353	43.9
Dividends Paid[2]	1,486	18,123	670,459	118,172	25,340	47.6
Chilean GAAP earnings (loss) per Share[3]	(20.23)	11.48	344.38	26.86	24.40	0.05
Earnings per ADS[4]	(80.92)	45.92	1,377,52	107.44	97.59	0.18
Dividends per Share[5]	1.55	18.93	700.47	123.46	26.47	0.05
Dividends per ADS[4]	6.20	75.74	2,801.88	493.86	105.90	0.20
Weighted Average Number of Shares Outstanding	957,157,085	957,157,085	957,157,085	957,157,085	957,157,085	

	2002	2003	2004	2005	2006	2006
	(in millions of constant Chilean pesos as of December 31, 2006, except ratios)					**(in millions of U.S. dollars)**
Statement of Operations Data:						
U.S. GAAP						
Net Income (loss) in accordance with U.S. GAAP	31,743	30,517	21,218	46,594	40,695	76.4
Net income (loss) from continuing operations*	15,512	17,348	22,541	46,594	40,695	76.4
Net income (loss) from discontinuing operations*	16,230	13,169	(1,323)	-	-	-
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	33.16	31.88	22.17	48.68	42.52	-
Net Income (loss) from continuing operations per Share	16.21	18.12	23.55	48.68	42.52	-
Net Income (loss) from discontinuing operations per Share	16.96	24.74	(1.38)	-	-	-
Balance Sheet Data:						
Chilean GAAP						
Current Assets	488,808	456,103	446,719	324,992	296,291	556.5
Property, Plant and Equipment, net	2,123,334	1,983,943	1,462,746	1,327,808	1,229,591	2,309.6
Other Assets	331,738	265,010	94,581	94,254	90,894	170.7
Total Assets	2,943,880	2,705,056	2,004,046	1,747,054	1,616.776	3,036.8
Total Long-Term Debt (including Current Maturities)[8]	1,232,438	909,545	592,637	512,919	401,590	754.3
Total Shareholders Equity	1,408,979	1,398,876	1,041,753	945,012	900,761	1,691.9
U.S. GAAP						
Total Assets	2,963,298	2,730,730	2,008,450	1,746,768	1,624,487	3,051.3
Shareholders Equity	1,264,373	1,273,111	913,558	822,016	797,013	1,497.5
Paid in Capital	806,464	931,859	931,859	931,859	890,895	1,673.4
Other Data:						
Capital Expenditures[6]	154,592	149,659	86,037	77,985	109,003	204.7

* *The Company has revised its amounts previously presented under US 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, we are not required to restate or reclassify financial information presented in previous years to reflect significant divestures. For purposes of U.S. GAAP, we are required to eliminate the results of operations of certain divested operations from those of our continuing operations in presenting our U.S. GAAP results. See Note 37 to the Consolidated Financial Statements.

(1) 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 represent 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 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.

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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 2002 and for each of the past six months, as reported by the Central Bank. On April 11, 2007 the Observed Exchange Rate was Ch$534.93 = US$1.00.

	Observed Exchange Rates[1] (Ch$ per US$)			
	Low[2]	**High[2]**	**Average[3]**	**Period-End**
Year ended December 31, 2002	641.75	756.56	688.24	718.61
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
Month ended October 31, 2006	524.12	537.63	530.95	524.75
Month ended November 30, 2006	523.34	530.61	527.44	527.69
Month ended December 31, 2006	524.78	534.43	527.58	532.39
Month ended January 31, 2007	532.39	545.18	540.51	544.49
Month ended February 28, 2007	535.29	548.67	542.05	540.07

Month ended March 31, 2007	535.36	541.95	538.45	539.21
Month ended April 11, 2007	534.93	539.69	537.05	534.93

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 Our 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 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. In accordance with the telecommunications law, all the 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 2006, approximately 31% of Company revenues (including 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 2004-2009, 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 to 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.

As part of recent M&A activity underway, primarily in the cable operator business, two leading companies have merged, and now have approximately 90% market share of the paid television market, while also becoming a relevant player in broadband and fixed telephony. Meanwhile, in the mobile telephony business, Telefónica Móviles (TEM) acquired Bellsouth in Chile and the mobile subsidiary of Telefónica Chile. There was also an increase in competition with the entry of new operators in the market, primarily in the long-distance and data transmission businesses, such as the Mexican operator Telmex after acquiring a long-distance carrier and a data transmission operator and additionally, through América Móvil (a Telmex affiliate) entered the local mobile market by acquiring the operator Smartcom, and the change in ownership of Entel which also competes in both markets. 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 68% in 2006. In the long-distance services market, Telefónica Chile competes with fifteen 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. During 2006, rates for domestic long distance services increased by 3.0% and rates for international long distance services decreased by 9.3% compared to rates as of December 31, 2005. Telefónica Chile also faces increasing competition in broadband services. The development of new technologies, such as wireless accesses like Wi Max 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, at lower prices. The Telecommunications Law in Chile 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 about 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 with 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, 2006, approximately 61% of the Company s employees were union members. As of December 31, 2006, the Company had collective bargaining agreements in force with 22 unions.

In June 2002, the Company experienced a work stoppage of 28 days that involved 3,445 employees and temporarily caused certain disruptions in the Company s service to customers. Following the strike, the unions involved in the strike elected to invoke the provisions of Article 369 of the Chilean Labor Code, allowing them to freeze the conditions of the previous labor contract for a period of 18 months, without readjustment. In 2006, eight collective bargaining agreements were successfully negotiated with 21 unions representing 2,141 individuals. As part of the collective bargaining process, in 2006, the remaining employees subject to Article 369 after having applied it since 2002, terminated their claim and renewed their agreements with the Company.

The Company has taken steps to maintain stable labor relations, such as the contracts for periods from two to three years that were signed after a succesful 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. 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.

The passage of new outsourcing legislation may adversely affect our operating income.

New outsourcing legislation took effect in January 2007 which requires certain persons that the Company had treated as outsourced independent contractors to be treated as employees and, therefore, be entitled to certain benefits to which employees are entitled as a matter of Chilean law. The Company estimates that approximately 800 persons that were formally independent contractors will be hired as internal employees between January and April 2007. We estimate that the financial impact of this change will not be material.

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

Telefónica Internacional Chile S.A. (Telefónica Internacional Chile) 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. In accordance with the Company s Bylaws, at the General Annual Shareholders Meeting held on April 14, 2005, Telefónica elected five out 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.

We depend on suppliers for network infrastructure and equipment to satisfy our operating needs. They 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 our customers demands, the Company could be negatively affected. Similarly, interruptions in the supply of telecommunications equipment for networks could impede network development and expansion.

Our 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 Divestures. 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 our 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, our historical consolidated financial results for and as of the end of periods ending on or prior to these transactions may not be indicative of our future operating and financial performance.

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

The Company cannot assure 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 paid 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 technical platforms and other equipments such as television up links located in Perú, as part of shared platforms within the Telefónica Group. As a result, the Company cannot assure that volatility or unfavorable economic, political and social conditions will not materially affect its ability to provide services.

We may not be able to refinance our outstanding indebtedness.

The Company s total financial debt as of December 31, 2006 amounted to Ch$401,590 million (US$754.3 million), with an average maturity of 3.6 years. 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 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. During 2006, the Company continued with debt reductions and the renegotiation of loans, lowering interest rates and extending maturities. These efforts have resulted in a stable level of maturities for the next five years, which are expected to be funded through cash flow generated from operations and refinancing. The Company cannot assure 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 over 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, we will need to continue to provide our customers reliable service over our network. Some of the risks to our network and infrastructure include:

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

- software defects;
- disruptions beyond our control; and
- disruptions due to changes in obsolete equipment.

Our operations also rely on a stable supply of utilities. Given recent instability of those supplies, including the supply of gas from Argentina, we can not assure that future institutional instability will not impair our ability to procure required utility services in the future which could adversely impact our operations.

Prolonged service interruptions could affect our business. We rely heavily on our network equipment, telecommunications providers, data and software to support all of our functions. We rely on our networks and the networks of others for substantially all of our revenues. We are able to deliver services only to the extent that we can protect our 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. During 2006, Telefónica Chile s networks were impacted due to an increase in thefts of copper cables. These thefts had to be absorbed into the investment plan by devoting approximately Ch$6,000 to replacing the affected networks. While we endeavor to provide for failures in the network by providing backup systems and procedures, we cannot guarantee that these backup systems and procedures will operate satisfactorily in an emergency. Should we experience a prolonged failure, it could seriously jeopardize our ability to continue operations. In particular, should a significant service interruption occur, our ongoing customers may choose a different provider, and our reputation may be damaged, reducing our attractiveness to new customers.

We may not be successful in the legal proceedings currently pending.

The Company is a party to lawsuits and other legal proceedings in the ordinary course of its businesses. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs. See Item 8. Financial Information Consolidated Statements and Other Financial Information Legal Proceedings.

Risk 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 business by 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, as of December 31, 2006. 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, although inflation has decreased in recent years. 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 2002 , 2003, 2004, 2005 and 2006, was 2.8%, 1.1%, 2.4%, 3.7% and 2.6% 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.

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. The Chilean peso has been volatile in the past, including an approximate 9.8% nominal devaluation against the U.S. dollar during 2002, but 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% . The main drivers of the volatility in the exchange rate in recent years have been the substantial devaluations in other Latin American markets, mainly Brazil, as well as general uncertainty and trade imbalance in global markets. In 2003, 2004 and 2005 Chilean peso appreciation was driven by improvement in Chilean economic indicators together with weakness in the US 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, 2006, 66.7% 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 remaining 33.3% 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.

Risk Relating To Our ADSs

Controls on foreign investment and repatriation of investments in Chile may adversely impact a holder of our ADSs ability to obtain and dispose of the shares of our 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. Our 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 our ADSs and the depositary access to Chile s formal exchange market. See Item 3. Key Information Exchange Rates. Pursuant to current Chilean law, our ADR foreign investment contract may not be amended unilaterally by the Central Bank of Chile. However, we cannot make any assurances that additional Chilean restrictions applicable to holders of our ADSs, the disposition of underlying shares of our 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 we assess the duration or impact of the restrictions if imposed. If for any reason, including changes to our 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 our 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 affect the price of our ADSs and common stock adversely.

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 our 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 Sobre Sociedades Anónimas*, Law No. 18,046 and the *Reglamento de Sociedades Anónimas* (Chilean Corporations Law) and applicable regulations require that whenever we issue new common stock for cash, we grant preemptive rights to all of our 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 we are 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.

Our corporate affairs are governed by our *estatutos*, or bylaws, and the laws of Chile. Under such laws, our 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 our ADSs.

Chilean trading in the shares of the common stock underlying ADSs is conducted in pesos. Our depositary bank will receive cash distributions that we make 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 US 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:

Compañía de Telecomunicaciones de Chile S.A.	CT Corporation System

Avenida Providencia 111	111 Eight Avenue
Santiago, Chile	New York, New York 10011
Telephone: (562) 691 2020	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. After the purchase of an additional 1.3% in July 2004, as of December 31, 2005, Telefónica Internacional Chile s ownership stake in the Company was 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, the Company reorganized its subsidiaries in the following manner:

- In January 2006, the ownership of Tecnonaútica was transferred from TIE to Telefónica Chile. Following this transfer, the Telefónica Chile direct subsidiary changed its name to TELEFONICA MULTIMEDIA and expanded its line of business to television.

- Also in January 2006, the ownership of TIE was transferred from Telefónica Empresas to Telefónica Chile.

- In November 2006, Telefónica Internet Empresas S.A. sold its participation in Telepeajes de Chile S.A to Telefónica Gestión de Servicios Compartidos de Chile, S.A. (t-gestiona), a Telefónica Chile s subsidiary. Also 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.

- In March 2006, CTC Equipos was absorbed by Telefónica Chile.

Also in March 2006, Telefónica Chile 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.

Divestitures

On July 3, 2000, the Company sold: (i) its 40% ownership interest in cable TV 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 TV network; and (iii) the cable TV network. The sales price for the entire transaction amounted to the Chilean peso equivalent of US$270 million, of which Ch$165,290 million, the equivalent of US$250 million, was paid on October 2, 2000 and the remaining Ch$15,693 million (historic value), equivalent to 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. (Spain). The sale agreement was signed on April 26, 2004 for a sale price of US$14.8 million, equivalent to Ch$9,781 million. The transaction resulted in a positive impact of Ch$5,358 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 a 92.44%-controlled subsidiary of Telefónica S.A, Telefónica Móviles S.A.(TEM), 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 shareholders approval at an extraordinary shareholders meeting held on July 15, 2004. 69.1% of total shares outstanding approved the sale for US$1.058 million, equivalent to Ch$709,069 million, in addition to Ch$179,480 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$321,071 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$421 per share (US$2.5074 per ADR), charged against accumulated retained earnings, and a gross interim dividend of Ch$140 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 our 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 restricts 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 assetsequal to or above 5% of the Company s consolidated assets. The Company obtained waivers of this limit from 28 national and international banks.

(ii) Series F local bonds for a total of US$23 million that contained a prohibition on the sale of suchassets 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 carried out by the Company in 2004, 2005 and 2006 amounted, respectively, to Ch$93,296 million (US$151.2 million; historic value as of December 31, 2004); Ch$73,579 million (US$149.1 million; historic value as of December 31, 2005) and Ch$109,523 million (US$204.7 million as of December 31, 2006). In July 2004, the Company sold its mobile subsidiary Telefónica Móvil de Chile S.A. and thus no longer

consolidated mobile capital expenditures. Capital expenditures of the mobile subsidiary during the first half of 2004 totaled US$32 million (equivalent to Ch$17,837; historic value as of December 31, 2004), approximately 21% of the Company s total capital expenditures for the year. Due to the sale of the mobile subsidiary, capital expenditure requirements have been significantly reduced.

The Company has been steadily adjusting its capital expenditures in local telephony and using its available installed capacity to expand service, rather than creating new lines. During 2006, the Company focused its investment primarily on consolidating broadband growth and launching a new product, digital television. Together these investments consumed 45% of the year s capital expenditure requirements. The investment plan for the year also included the continued initiative to upgrade the Company s operational support systems by improving the tools that support its business, technical, and administrative management. With regard to the Company s traditional business, investment was focused on maximizing installed capacity, marketing telephone lines, and initiating a network improvement and plant modernization plan aimed at increasing quality of service.

It is important to note that, during 2006, Telefónica Chile s networks were seriously impacted due to an increase in thefts of copper cables. These thefts had to be absorbed into the investment plan by devoting approximately Ch$6,000 million to replacing the affected networks.

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

According to Company estimates, as of December 31, 2006, Telefónica Chile owned approximately 67.7% of all fixed telephone lines in the country. As of that date, 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 (pay TV) 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, our 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 held licenses to provide mobile telephony services in Chile through its subsidiary Telefónica Móvil de Chile S.A. until its sale in July, 2004. See Licenses and Tariffs Licenses below.

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 our fixed monthly charge, variable charge, connections and other installations, access charges for rural companies, the number for information services (level 103) through an operator, access charges and interconnections and public telephones. In 2006, approximately 31% 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 TV, value-added services, directory advertising and sales and leasing of terminal equipment.

Products and Services

Fixed Telecommunications

The fixed telecommunications business segment includes all services provided using the fixed line network infrastructure, such as basic telephony that consists of traditional telephone services including fixed charge, variable charge, minute plans (flexible plans), line connections, value-added services, broadband services through ADSL technology, access charges, interconnections and other fixed telecommunications businesses (which include directory advertising, ISP for companies and small and medium businesses, security services such as alarm monitoring through fixed lines, public telephones, pay TV, interior installations and equipment sales and rentals). Fixed telecommunications revenues reached Ch$439,548 million (US$825.6 million), accounting for 76.2% of the Company s operating revenues in 2006, compared to 76.0% in 2005 and to 60.1% in 2004.

The Fixed Telecommunications business area uses marketing channels owned by the Company, such as commercial offices and retail stores that sell Telefónica Chile s products, as well as external marketing channels, such as direct telemarketing sales by third parties, complemented by an external sales force and specialized distributors.

Basic Telephony

The Company provides basic telephony to its customers over the public telephone network within the tariff areas defined in the Tariff Decree. Revenues from basic telephony includes: (i) telephone line service fees (fixed monthly charge), (ii) variable charges that includes local traffic defined as measured local service (MLS), traffic from local lines to Internet and mobile telephones (local tranche) and prepaid traffic through prepaid cards, (iii) flexible plans (plans of minutes), (iv) connections and other installations and (v) certain value-added services that enhance the communications experience of its customers, such as voice mail, call-waiting, call-forwarding, caller-ID, and access to information and entertainment services (600 and 700 numbers), among others.

During 2006, 384,003 new fixed lines were connected, a 7.2% and 11.9% increase in new line connections as compared to 2005 and 2004, respectively, and 609,201 lines were disconnected, a 76.8% increase compared with 2005 and a 83.1% increase compared with 2004. As a result, lines in service under Fixed Telephony as of December 31, 2006 totaled 2,215,629 representing a decrease of 9.2% as compared to December 31, 2005 and a decrease of 8.7% as compared to December 31, 2004. Of the 2,215,629 lines in service as of December 31, 2006, 11.1% were corporations, 18.0% were small business and professional clients, 70.1% were residential and 0.8% 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,				
	2002	2003	2004	2005	2006
Lines installed	3,023,541	3,037,267	3,043,379	3,007,432	3,021,487
Fixed lines in service	2,686,695	2,416,779	2,427,364	2,440,827	2,215,629
Average fixed lines in service	2,732,208	2,558,291	2,406,266	2,451,356	2,332,634
Lines per 100 inhabitants(1)	17.4	16.1	15.0	15.1	13.4
Number of new lines connected	340,419	308,266	343,318	358,088	384,003
Number of lines disconnected	377,034	578,182	332,733	344,625	609,201
Defects per line (annual average)(2)	0.35	0.35	0.40	0.44	0.54
Local traffic (in millions of minutes)(3)	15,900	15,178	13,759	12,012	9,643

(1) Telefónica Chile fixed lines per 100 inhabitants. Figures according to projections from Census 2002 which were released in August 2005 (16.5 million inhabitants as of December, 2006).

(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.

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. The Company markets new services aimed at facilitating customer communications options and increasing the number of successfully completed calls, such as:

Flexible tariff plans

In February 2004, Telefónica Chile was authorized to offer alternative tariff plans to the regulated plan consisting of a fixed charge plus variable charge. This new regulatory rule allowed the Company to offer alternatives to the regulated plan without previous authorization by the Regulator and compete by adapting to customers needs. These plans are not subject to maximum tariffs or predetermined structures and may include joint offers with other services. According to this, starting in 2004, the Company began to market plans such as: (i) Plans of Minutes, consisting of telephone service with a certain number of minutes for a monthly charge, (ii) Economy Line, consisting of a monthly amount from which customer calls are deducted, allowing for additional calls to be placed by means of prepaid cards (iii) 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 or broadband plus minute plans and pay TV.

As of December 31, 2006, 1,324,597 lines, which is more than a 100% increase compared with 2005, have been signed up for flexible tariff plans in agreement with Decree No. 742, representing 59.8% 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 15.7% of consolidated revenues compared with 7.9% in 2005.

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

Prepaid Services

The Company has also sought to increase the use of its fixed lines by offering prepaid card services. These services have provided strong support to the development and growth of the fixed line business and have played a role in the development of alternatives to the traditional regulated plan. They have also allowed for the introduction of the prepaid model into new business areas such as wireless broadband (Wi-Fi technologies) and switched Internet. Among the prepaid services, the *Tarjeta Línea Propia,* or TLP card, allows users to make calls from any fixed line telephone (including those blocked for long-distance, cellular or 700 number calls), public telephones and Telefónica Móvil de Chile S.A. or other enabled mobile company phones. This product allows customers to have

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their own versatile, portable virtual line, while controlling and managing their telecommunications expenses. As of December 31, 2006, 16.0 million TLPs were activated in the amount of Ch$1,000 each, representing an increase of 6.7% over 2005 and an increase of 23.7% over 2004. The total number of prepaid lines reached 360,970 in 2006, which represents a decrease of 32.4% and 11.7% from 2005 and 2004, respectively.

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 the fixed telephony installation. Currently, the public telephony market in Chile is made up of seven operators and numerous private parties of which Telefónica Chile has a market share of approximately 30% 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, 2006, the Company had installed a total of 10,000 smart public telephones, representing a decrease of 0.6% from 2005 and 2.9% from 2004, which allow the use of coins or prepaid cards to make calls. As of December 31, 2006, the Company also installed 10,523 licensee telephones and community lines, representing a decrease of 20.1% from 2005 and 41.5% from 2004, located inside buildings and communities which allow calls to 800 numbers, prepaid card calls and use of the automatic collect call service.

Revenues from public telephony in 2006 were Ch$9,963 million (US$18.7 million), which represents 1.7% of total consolidated revenues and a decrease of 0.6% and 13.1% in respect to 2005 and 2004 public telephony revenues, respectively.

Alarm Monitoring and Security Services

Telefónica Chile, through its subsidiary Telemergencia, offers home security and home assistance services through monitoring and alarm systems connected to a security platform over its existing fixed telephone lines. Telemergencia offers a wide variety of plans adapted to customers needs and budgets, ranging from an alarm monitoring service through telephone lines to the more complex Viginet plan, a digital video-surveillance system that can be operated online from a broadband Internet connection. In 2006, this business reached 55,037 customers, which amounts to a 9.8% decrease from 2005 and 8.0% from 2004. Revenues from Telemergencia in 2006 were Ch$8,825 million (US$16.6 million), which represents 1.5% of total consolidated revenues and an increase of 7.0% and 24.9% in revenues from Telemergencia in 2005 and 2004, respectively.

Other Fixed Telecommunications Services

Telefónica Chile sells value-added services to its customers, such as caller ID, voice mail, call waiting, call forwarding, call waiting ID, outbound traffic control to mobile phones, and information and entertainment services (600 and 700 numbers). In addition, Telefónica Chile sells advanced telecommunications equipment to residential, businesses and corporate customers.

Telefónica Chile also provides its residential customers with access to the Internet over analog lines. The Telefónica Internet Empresas (TIE) subsidiary provides switched Internet browsing services to small and midsized companies through dedicated links and via ADSL.

Under an 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 August 2006 for a five-year period that can be extended by two additional years. Publiguías also prints and distributes telephone directories from the customer database provided by Telefónica Chile. Revenues from other fixed telecommunications services in 2006 were Ch$62,650 million (US$117.7 million), which represents 10.9% of total consolidated revenues and an increase of 1.8% compared to 2005. These revenues represent a decrease of 11.3% in 2005 compared to 2004.

Digital Television

On June 14, 2006, Telefónica Chile launched its pay 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 TV Digital offering, and it offers an entry-level plan for Ch$9,900, including a selection of the channels in greatest demand including, among others, the basic version of the Canal del Fútbol (soccer channel), Disney Channel, Discovery Channel, TNT, Sony, Warner, ESPN 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.

The pay TV 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.

The launch of this service has stimulated the pay television market in Chile, increasing the customer base while facilitating access to this new service for new customers. Growth is achieved by providing flexibility to customers, who can purchase a convenient service tailored to their interests and budgets.

As of December 31, 2006, after only six months of operation, the Company had 94,209 pay TV customers, representing an 8.7% market share (and making it the number two pay television operator in the country).

ADSL Broadband Services

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 PC, 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, parental controls for Internet, and PC technical support, both remote and in-home.

In 2006, broadband showed strong growth as a result of the Company s bundling, flexibility and segmentation strategy. The progress achieved in the broadband business has laid the foundation for 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, among others, the implementation of an innovative broadband self-install kit for customers, the addition of a customer PC care service called Doctor Speedy , and the ability for customers to have access to all of Telefónica Chile s Hot Spots throughout the country, free of charge. These initiatives are in addition to the success of the Dúo campaigns, consisting of broadband plus minute plans, the Trío campaigns, incorporating Digital Television, for residential customers, as well as the broadband campaigns for SMEs. Value-added services such as the Security Suite , which includes antivirus, firewall and parental control for the Internet, among others, were also launched during the year.

As of December 31, 2006, ADSL connections totaled 495,479, representing an increase of 57.7% and 146.8% with respect to 2005 and 2004, respectively, of which 77.7% were residential, 16.9% were small business and professional clients, 3.6% were wholesale and 1.8% were corporations, with the most significant growth coming from the residential sectors. These ADSL connections account for 48.6% of connections for the national broadband market (connections at speeds of 128 kbps or higher).

The following table sets forth the number of ADSL connections in service as of the dates indicated.

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	As of December 31,				
	2002	2003	2004	2005	2006
ADSL connections in service	54,163	125,262	200,794	314,177	495,479
ADSL/Lines in service	2.0%	5.2%	8.3%	12.9%	22.4%

In 2006, revenues from broadband were Ch$61,297 million (US$115.1 million), which represent 10.6% of total consolidated revenues and 13.9% of fixed telecommunications revenues. Revenues from broadband have grown by 39.9% and 130.3% compared to 2005 and 2004, respectively.

Long-Distance

The Long-Distance (LD) services and products provided by the Company are not subject to tariff regulation. The Company provides a broad offering of domestic and international LD services, including public and private voice, data and video services, through its subsidiary Telefónica Larga Distancia. 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 long-distance 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 2006, the Company recorded a decline of 9.9% in Domestic LD (DLD) traffic compared to 2005 and 18.3% compared to 2004 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 3.9% compared to 2005 and increased 1.7% compared to 2004, 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.

	2002	2003	2004	2005	2006
DLD traffic (in millions of minutes)	717	647	664	602	542
Outgoing ILD traffic (in millions of minutes)	66	64	67	66	68

The challenges currently facing the long distance business include, among others: (i) its replacement by mobile telephony, e-mail and the Internet, (ii) the increase in domestic lines blocked for long distance calling, and (iii) significant price-competition in international long distance. Nevertheless, Telefónica Chile continues to benefit from the existing infrastructure (since new investment is not required), and the ability to generate cash flows from long distance services. In order to streamline Telefónica Larga Distancia operations, in June 2006, billing and sales functions were outsourced to an independent firm. As a result, the subsidiary has been able to leverage synergies, and its operations have become more flexible. In addition to offering traditional long distance traffic services under the multi-carrier system, the Company s strategy includes numerous plans to generate traffic, enhance customer loyalty, and maximize usage of the existing network and infrastructure. These plans consist of domestic or international long distance calls at a fixed monthly price, with preferred rates or discounts for the use of frequent routes, on specific schedules, or all day, depending on the plan selected. Highlights for 2006 include the launch of 188 en movimiento (Mobile 188) and unlimited plans, which are minute plans aimed at Residential customers. As of December 31, 2006, 288,400 customers had plans under contract. This has enabled Telefónica Larga Distancia to overcome the industry s downward trend.

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 Internet service providers (ISPs).

In 2006, revenues from LD were Ch$58,922 million (US$110.7 million), which represent 10.2% of total consolidated revenues. Revenues from LD have decreased by 0.5% and 9.6% compared to 2005 and 2004, respectively.

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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 in Chile. Clients of Telefónica Empresas include 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 growing convergence and integration of different technologies. By integrating technologies, this company delivers solutions that add value to each client s business through new applications that better serve their needs.

One of the primary services provided by Telefónica Empresas is data transmission, mainly through IP technology-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 also offers advanced telecommunications solutions in the form of consulting projects, professional services and outsourcing.

These services are complemented with international services tailored to client needs. These services take advantage of the Telefónica Group s network and international presence, delivering value for global clients.

In 2006, major projects were agreed upon with public sector clients (including, among others, the police department s logistics department, the special investigation police force, the National Forestry Department and the Department of Justice) as well as important private sector clients. It is important to note that Telefónica Empresas contains a Datacenter which provides a main or backup storage site for hosting equipment. This Datacenter helps to support and ensure business continuity for our clients.

The Datacenter was certified in 2005 under standard BS 7799-2:2002. This certification means that the Datacenter has a secure information management system for the help desk, operations, reporting, infrastructure, engineering, and implementation, and also guarantees control over the level of security of the information included in the processes. Our Datacenter is expected to obtain ISO-27001 certification during 2007, which will contribute to the ongoing improvements in our Datacenter services.

In 2006, revenues from the corporate customers communications and data business segment amounted to Ch$76,113 million (US$143.0 million), which represent 13.2% of total consolidated revenues. Revenues from the corporate customers communications and data business segment have decreased by 4.7% and 13.2% compared to 2005 and 2004, respectively.

The following table sets forth the number for some of the Company s data services as of the dates indicated.

As of December 31,

	2002	2003	2004	2005	2006
Datared (circuits)	13,496	10,820	9,770	5,821	5,353
Frame Relay (points)	5,215	5,016	3,892	2,621	1,930
ATM (points)	1,719	1,790	1,660	1,085	1,101
Dedicated IP connections	3,788	7,018	10,377	10,869	12,634

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. The provided services include logistics, e-learning, accounting, fund management, collections, insurance, payroll, real estate management and general services. The t-gestiona strategy is focused on positioning itself as a provider of shared services, primarily within the Telefónica Group, as t-gestiona has established an alliance with Telefónica Empresas to market its services. To a lesser extent, t-gestiona provides services to third parties that are not related to the Telefónica Group. This subsidiary s strategy is based on its unwavering objective of seeking efficient use of resources and continued improvement of its processes.

Fundación Telefónica

Fundación Telefónica, a nonprofit organization created to develop and channel community and cultural activities of the Telefónica Group companies in Chile, continues to support digital literacy in Chile by providing Internet training to teachers, community leaders and the disabled.

Telefónica Internet Empresas

Telefónica Internet Empresas (TIE), a direct subsidiary of Telefónica Chile since the Company s organizational restructuring in 2006, provides Internet access services to corporate clients and small and medium-sized businesses over dedicated and switched lines and through ADSL.

Mobile Communications

In July 2004, Telefónica Chile sold its mobile communications business to Telefónica Móviles S.A. (TEM). See Item 4. Information on the Company--Divestitures. As a result, since July 1, 2004, the Company no longer includes Telefónica Móvil de Chile S.A. in its financial statements.

The mobile communications business segment (mobile communications) offered mobile telecommunications products and services through the Company s former subsidiary, Telefónica Móvil de Chile S.A., and generated revenues from outgoing cellular traffic, interconnection fees from incoming calls from other networks and mobile equipment sales.

Market and Competition

The telecommunications industry in Chile, including the pay TV business, achieved sales of US$4.7 billion in 2006 an increase of 10.5% from 2005, this increase was largely driven by mobile growth and broadband development. Additionally, it is estimated that investment in the industry in 2006 was approximately US$900 million.

In 2006, 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 4.4 million households and a majority of businesses.

- Coaxial network concentrated in one cable TV company with potential coverage of almost 50% 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.

In addition, operators have begun to expand the development of wireless solutions, as evidenced by the deployment of Wi-Fi (Wireless Fidelity) by Telefónica Chile, the launching of a PHS (Personal Handy System) by Telsur, and the recent entry of Transam into local telephony through the GSM standard.

The most relevant events in 2006 were the launching of satellite digital TV by Telefónica Chile during the second quarter and the mass migration to the GSM standard by Movistar and América Móvil. In late July 2006, the latter changed its local brand from Smartcom to Claro .

The rise in thefts of cables from the fixed network is also noteworthy, as it has negatively impacted the quality of service offered by fixed operators, particularly in the low-income sectors of the population.

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 TV** (10)
Telefónica Chile(2)	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
Claro(6)				a				
Telmex Chile(7)	(8)		a		a	a	a	
Telefónica del Sur	a	a	a		a	a	a	
Terra Networks							a	
CMET	a	(8)	a				a	a
Direct TV								a
GTD - Manquehue (9)	a	a	a		a	a	a	

(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 America Movil in August 2005.

(7) Includes operations from AT&T Chile (at present known as Telmex Chile) and Chilesat Corp.

(8) Recently entered into the market and/or without significant operations.

(9) Includes Manquehue Net acquired by GTD in September 2005.

(10) 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 3.3 million lines as of December 2006, reflecting a decrease of close to 4.7% with respect to year-end 2005. The rate of penetration of fixed lines, as of December 2006, was 19.8 lines per 100 inhabitants, slightly lower than the 21.1 rate for 2005.

Although Telefónica Chile operates approximately 67.8% of the local fixed lines in service in Chile, our market share has been declining for the past six years. Factors that have contributed to our declining market share include the intense competition in key niches of the market due to the aggressive offers of competitors.

Currently, there are seven operators that provide fixed telephone service and, in the aggregate, operate the total number of fixed lines in service in Chile as of December 31, 2006. 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 operations in 2003. The initial licenses have been modified over the years, extending the license areas of the local telephone service providers, mainly VTR (in all Regions except Region X, XI and XII) and Telefónica del Sur (in Regions VIII and IX). 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 93% of all Internet connections (broadband, narrowband and dedicated). Broadband penetration of total homes in Chile has increased from 17% in 2005 to 23% at the end of 2006. Moreover, broadband connections grew to 1,020,000 connections by year-end 2006, posting a 38% increase, while dial-up access dropped by 61% to 65,000 connections. As of December 2006, ADSL broadband connections represented 58% of the country s total broadband use. Also during 2006, the deployment of Wi-Fi (Wireless Fidelity) continued, enabling cable-free high-speed Internet connections. As of December 2006, there are an estimated 585 HotSpots installed throughout the country, making Chile the leading Latin American country in the deployment of this technology.

There are seven operators in the Chilean broadband market (broadband being defined as connections of 128 kbps or more) using the different technologies. One of the seven operators provides broadband service utilizing cable modems (VTR, which merged with Metrópolis Intercom), five utilizing only ADSL technology (Telefónica Chile, Telefónica del Sur, GTD, CMET and Telmex) and one utilizing ADSL and WLL technology (Entel). The Company estimates that, as of December 31, 2006, its ADSL service (including direct sales and as a wholesale provider) accounted for approximately 49% of all broadband access over 128 kbps 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 11.5% in 2006, while international LD traffic fell by 15.3% . 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 2006, only 30 offered the service and 18 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 79% of DLD traffic and 87% of the outgoing ILD traffic in 2006, 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 2006, Telefónica Larga Distancia s market share represented approximately 36.3% of DLD voice traffic and 34.1% of outgoing ILD voice traffic, maintaining market leadership in DLD while holding the number-two position in ILD, according to Telefónica Chile estimates.

Corporate Customer Communications and Data

An increase in competition was observed in the corporate communications and data transmission market in Chile because of the increased aggressiveness exhibited by operators. To remain competitive, operators are continuing to migrate their traditional services (ATM, Frame Relay and Datared) to IP networks and expand their services into Outsourcing of Information Technology Services. As of December 2006, 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, 2006 its share of the total revenues generated by the market for these services was approximately 44%.

In 2006, Telefónica Empresas showed significant growth in the Hosting and Solutions and IP Services product lines. It also positioned itself as a major player in Electronic Billing services (approximately 19% of market share), as well as providing outsourcing solutions, data networking, and multicompany voice solutions for the financial sector. Moreover, the Company estimates that it had approximately 33% of the corporate market share for dedicated Internet access. In this market, the Company competes mainly with Entel, Telmex Chile (formerly AT&T Chile and Chilesat), Teleductos, Telsur, as well as other competitors.

Security

With a market share of 28%, Telemergencia is now the market s second leading alarm monitoring company, behind ADT which has 44% of the market, according to Company s estimates.

Mission and Corporate and Business Strategy

Telefónica Chile s mission is to lead in 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. Telefónica Chile thus underscores its sense of responsibility and unwavering commitment to the development of Chile. For these reasons, in 2006, Telefónica Chile invested more than US$100 million in the development of broadband technologies, television and IP solutions, representing more than 50% of the Company s total capital expenditures. Telefónica Chile s corporate and business strategy is focused on being the most competitive, leading telecommunications company in Chile. Telefónica Chile s primary focus is on the customer, who constitutes the basis for growth and drives the Company s goal of creating value for all of its stakeholders. In this context, the Company s strategic priority is to position itself as the market s preferred brand through:

- A diversified offering of comprehensive and innovative solutions, competitive in terms of both quality and price, and tailored to each business segment.
- Improvements to our quality of service as the foundation for our customers satisfaction.
- The development of a corporate reputation that is consistent with our business strategy.

Management s strategy to achieve these objectives is based on:

- Having the best human capital available, and ensuring that our team is constantly motivated and empowered to achieve the Company s objectives.

- Promoting a customer-oriented culture of excellence and innovation in all areas of the Company, particularly by focusing on the improvement of quality standards, systems and network excellence, and reformulation of processes.

- An infrastructure that provides a competitive advantage and that is oriented toward investment in the businesses with greatest potential.

- Consolidating our financial structure in terms of debt ratios and interest coverage.

- Obtaining a return on operations in line with market demands and focusing on continuous innovation and enhanced productivity.

- Service segmented by customer type allowing us to better serve customer needs and expectations.

- Satisfying clients and strengthening client loyalty to help ensure the Company s profitability and ongoing presence in the Chilean market.

The strategic focuses by business area are:

Residential Segment

- Fostering customer loyalty through a bundled offering of services that leverages flexible minute plans, broadband, television and value-added services as a response to customer needs in a convergent business.

- Developing an extensive service offering ADSL broadband, helping to make the digital home concept a reality. One of the primary services currently in development is a television service (IPTV) that will introduce the concept of interactive entertainment.

- Developing low-cost, mass solutions allowing digital inclusion in the lower income segments of the population.

Small and Medium Enterprises Segment

- Providing flexible solutions and comprehensive services in the areas of information and communication technology (ICT), satisfying the specific needs of the SME by distinguishing ourselves on the basis of quality and service.

- Expanding broadband services, advanced communications solutions, and industry applications that increase this segment s productivity.

Corporate Communications Segment

- Strengthening the Company s long-term relations with its business and large corporate customers by offering comprehensive telecommunications solutions through the IP-driven convergence of voice, data, and video. Special emphasis will be placed on helping customers to improve their efficiency through telecommunications support, from infrastructure to engineering and consulting.

- Technological differentiation through continuous improvement of the IP network, Telefónica Data Internet Center services and IT outsourcing.

Wholesale Segment

- Offering solutions to telecom industry operators that need to expand their national coverage, for their own use as well as for third parties.

- Delivering a range of regulated and non-regulated services, according to the needs of the sector and in line with current legal requirements and industry quality standards.

Quality of Service

Improving the quality of service provided by the Company to its customers is one of the biggest challenges facing Telefónica Chile, in its efforts to consolidate its competitive and leadership positions. During 2006, the Company faced an extensive and persistent problem with copper cable theft, damaging its network and placing further demands on the already depleted installment and repair capacity. This situation has had a significant impact on the Company s quality indicators, and as a result the Company has made a commitment to improve its levels of quality through a process of profound change. This process will take time, and it will operate on a number of levels.

In 2006, Telefónica Chile implemented a new quality organization in line with the Telefónica Group s regional structure. The primary objective of the quality organization is to help operating areas reach the proposed levels of quality.

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 long-distance 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 from 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 long-distance 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 2004-2009 tariff regime (Tariff Decree No. 169) or unregulated, require or do not require licenses.

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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 interconnections	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 TV	

(1) All services subject to tariff regulation require licenses, except the public telephony. However, Telefónica Chile s public telephone 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. 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, the former Telefónica Chile s long- term subsidiary, Telefónica Mundo, held 30-year renewable licenses, for a period 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 long-distance services, including voice, data and image transmission, throughout Chile. The other Company s long-distance subsidiary, Globus, also held licenses for an indefinite term to provide domestic and international long-distance services through central switches and cable and fiber-optic networks nationwide. After the merger of these subsidiaries in 2006, all the aforementioned licenses remain under the ownership of the same company, which is now known as 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.

- *Public Service Mobile Telephony Licenses*. Telefónica Móvil de Chile S.A. holds licenses with indefinite terms, beginning as of November 1989, to provide public service mobile telephony services throughout Chile in the 800 megahertz frequency range. In July 2002, Telefónica Móvil de Chile S.A. was assigned two 30-year 10 MHz licenses with nationwide coverage in the 1900 MHz frequency range. The sale of the Company s mobile subsidiary, Telefónica Móvil de Chile S.A. in July, 2004, also included the licenses held for such service. See Item 4. History and Development of the Company Divestitures.

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- *Limited Television License*. The Company s subsidiary Tecnonaútica S.A., today Telefónica Multimedia (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. This license is authorized by Resolution No. 47 enacted on November 28, 1990 by the National Council of Television and amended by Resolution No. 1536 of 1994, and Resolution 1453 of 2002, both Subtel resolutions. Since December 2005, Telefónica Chile, through Telefónica Multimedia, holds 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.

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 3700 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 the Undersecretary of Telecommunications, 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 Antitrust Authority (Tribunal de Defensa de la Libre Competencia) against the Undersecretary of Telecommunications, 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 Area). The licenses for regions XI and XII were awarded to Telefónica Chile. These companies have one year from the date of publication of the respective decree in the Official Gazette to begin their projects.

  In accordance with the procedures established by the Telecommunication Law, Telefónica Chile formally rejected the licenses awarded to Telmex and VTR. These claims were, in turn, rejected by the Ministries. Subsequently, the Company appealed before the Court of Appeals. Additionally, the Company filed a claim to annul VTR s preferential rights. The Company s position is that illegalities occurred when the Undersecretary of Telecommunications recognized VTR s preferential rights to accede a license. This recognition resulted in the assignment of the licenses to VTR, which prevented Telefónica Chile from participating in the organized bidding process that took place when a technical tie occurred.

  On November 3, 2006, the Court of Appeals upheld the resolutions of the Ministry of Transportation and Telecommunications that rejected Telefónica Chile s claims against the resolution granting Telmex and VTR the wireless local public telephone service concessions.

On January 3, 2007, a decree was published in the Official Gazette which grants Telmex the public wireless local telephone service concession, with nationwide coverage.

In regards to the concessions granted to VTR, the General Comptroller asked Subtel for a report on the legality of the claim presented by Telefónica on February 1, 2006. In January 2007, Telefónica Chile withdrew its claim, which leaves only the publication of the respective VTR concession decree.

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 on 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 Economy, together the Ministries. These 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, domestic long-distance and international long-distance 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, 2006, 17 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.

Tariff Structure for 1999-2004

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. In this regard, Tariff Decree No. 187 was in effect since 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 of 1999 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 long-distance carriers.

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

On January 13, 2003, Telefónica Chile requested that the Antitrust Commission, on the basis that market conditions are 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 different from 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. Some relevant aspects are 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, 2006, the Company had launched more than 530 alternative plans under the new flexible tariff in local telephony services.

By Open Resolution No. 1,559, dated December 1, 2006, the Office of the Undersecretary of Telecommunications 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 2004 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 our 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

Multicarrier System

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

Calling Party Pays Structure (CPP)

Calling Party Pays 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 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 Móvil 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. 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 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.

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 Calling Party Pays 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. A variety of expert reports have been presented on various aspects of the case supporting the position held by Telefónica Chile. The next phase in the process is the lower court s decision, which had not been issued as of December 31, 2006. No assurance can be given as to the outcome or the timing of a final ruling.

For further information regarding the lawsuit filed by the Company against the State of Chile, see Item 8. Financial Information Legal Proceedings.

RedVoiss Lawsuit

On January 20, 2005, Telefónica Chile rejected every aspect of the complaint filed by the IP telephony company RedVoiss before the National Attorney for Economic Matters, alleging attempts 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.

Subsequently, RedVoiss filed a complaint before the Antitrust Commission based on the same allegations, and Telefónica Chile answered, again along the same lines, on March 14, 2005. In addition, the Company filed a counterclaim action against RedVoiss for hindering free competition by providing telephone service without the license required by law.

On August 16, 2005, Telefónica Chile was notified of a complaint entered by the National Attorney for Economic Matters against the Company based on the same actions alleged by RedVoiss. In the complaint, the National Attorney for Economic Matters primarily asked the Antitrust Commission to find that Telefónica Chile infringed on free competition by creating artificial barriers to entry for new competitors. In addition, the National Attorney for Economic Matters asked the Court to void the clause prohibiting voice over IP and further requested a yearly fine of 350 Annual Tax Units (Chilean inflation-adjusted monetary unit, equivalent to Ch$386,472 or (US$726) at December 31, 2006) or any other amount deemed appropriate by the Commission. Lastly, the President of Chile was asked to examine the possibility of amending the current regulatory framework as needed. On September 2, 2005, Telefónica Chile formally rejected all charges contained in the complaint filed by the National Attorney for Economic Matters. On October 4, 2005, the Antitrust Commission accepted the Company s request to advance to the evidence stage of the proceedings, and the Commission subsequently commenced the process of receiving and examining evidence.

On October 26, 2006, the Company was notified of the Antitrust Commission s ruling. The ruling accepted, in part, the complaint filed by Voissnet S.A. and the requirement of the National Economic Attorney General s Office, and fined Telefónica Chile 1,500 Annual Tax Units (approximately Ch$580 million or US$1.1 million).

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. The Supreme Court has accepted the appeal for processing but has yet to set a date to hear arguments from the parties.

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 will perform its duties in two stages. During the initial stage, over a 90-day period, terms of reference for a telecommunications industry review were to be crafted. The second stage calls, 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 Telecommunicatio*ns* 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 include the fact that most of the provisions contained in the proposal are a matter of law and not of resolution, while other aspects of the proposal impair rights which are guaranteed by the Constitution.

The proposal for IP Telephony defines 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 that govern the public voice over Internet service. 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 concessionaries of public telephone services and long distance 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 project does not exclude or limit the participation of Telefónica Chile and Telefónica Larga Distancia.
- To provide public services of voice over Internet, a concession obtained by supreme decree will be required.
- The concessionaries 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 concessionaries of the new services must provide access to emergency services and will not be obligated to distribute Phone Directories.
- The concessionaries 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.

Telefónica Chile remitted its observations on January 26, 2007.

Thirty companies provided comments. In general, the telephone companies approve of the Regulation and favor the application of regulations similar to those of the public telephone service to voice over Internet. Companies from the computer sector, however, support having less regulations over this service.

Public inquiry on Bill amending law No. 18,168 (the General Telecommunications Act) so as 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 will be borne by the concession holders 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 are 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, this public consultation is ultimately aimed at identifying changes that can 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 includes 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.

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 (US$ 22 million).

Permit for limited cable television service

By Open Resolution No. 1,605 dated December 23, 2005, Subtel granted Telefónica Multimedia Chile S.A. (formerly Tecnonáutica S.A.), 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 S.A. 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 the 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 of year 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.

The claim filed against Telefónica Chile by two television channels, Televisión Nacional and Canal 13, for including their broadcast signals in the pay television services distributed by the Company, was declared inadmissible by the Santiago Court of Appeals. This decision was subsequently upheld by the Supreme Court.

Public hearings on digital terrestrial television

On November 17, 2006, Telefónica Chile S.A. participated in a program 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 TV company VTR Banda Ancha S.A.

In November and December, additional public hearings were held.

Subtel reported that the technical standard on Digital Terrestrial Television will be released in early 2007 upon completion of the study it is conducting and the public hearings.

Law Project that modifies the Telecommunications Development Fund

Currently, companies with public and intermediate telecommunications service concessions that offer long distance 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. However, Congress is evaluating a bill that would eliminate the obligation to create separate corporations to enable the concessionaries and permit holders to participate directly in the 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 in turn is an indirectly wholly owned subsidiary of Telefónica S.A. which is a Spanish telecommunications company, and is a public corporation listed on the Madrid, London, Paris, Frankfurt, Tokyo, New York, Lima, São Paulo and Buenos Aires stock exchanges. Telefónica S.A. also has ownership interests in the following companies that operate in the Chilean market: Atento Chile S.A., Terra

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Networks Chile S.A., Telefónica International Wholesale Services Chile S.A., Telefónica Móviles Soluciones y Aplicaciones S.A., Telefónica Móviles de Chile S.A. y 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 Participaçoes S.A., which is a Brazilian corporation. Percentage ownership information is as of December 31, 2006.

Telefónica Chile operates the Company s local telephone service activities, the Company s core business area. Telefónica Chile s other business activities are managed through the following operating subsidiaries:

(*) Telefónica Chile holds 28.84% of Atento Chile S.A. through the additional equity interest of 1.4% from its subsidiaries Telefónica Larga Distancia and Telefónica Empresas.

Note: During 2006, the Company underwent a process of restructuring its organizational structure, with the goal of reducing costs and simplifying the Company s management. In January 2006, the indirect subsidiaries, Telefónica Internet Empresas S.A. and Tecnonaútica S.A., became subsidiaries of Telefónica CTC Chile. Additionally, on February 28, 2006, Compañía de Telecomunicaciones de Chile S.A. acquired the remainder of Compañía de Telecomunicaciones de Chile Equipos y Servicios S.A. and dissolved this subsidiary. As a result, assets and liabilities of the subsidiary Compañía de Telecomunicaciones de Chile Equipos y Servicios S.A. were transferred to the parent company, which will be the continuing legal entity.

Additionally, at Telefonica Mundo s and Globus extraordinary shareholders meetings held on April 19, 2006, the merger of both companies was approved, effective as of May 1, 2006. The name of the company changed to Telefonica Larga Distancia S.A.

In September, 2006, the subsidiary Instituto Telefónica Chile S.A. was created, to continue to offer training and education services, in accordance to the Chilean Law N°19,518.

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 long-distance business of VTR Larga Distancia was transferred to a newly created Company long-distance 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 with 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 (Puerto Montt) to Region XII, passing through Argentina between Aduana Pajaritos (Region X) and Cerro Redondo (Region XII 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 and SAM-1 (Emergia), and in the Hispasat, Intelsat, Nahuelsat and Panamsat satellite systems.

Telefónica Empresas

In 1992, Telefónica Empresas CTC 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.

CTC-Equipos

As of February 28, 2006, Compañía de Telecomunicaciones de Chile Equipos y Servicios S.A. (CTC-Equipos) was dissolved by transferring its assets and liabilities to Compañía de Telecomunicaciones de Chile S.A. that will be its continuing legal entity. CTC-Equipos operated Telefónica Chile s public and rural telephone operations and provided home telephone installations, mainly for residential customers.

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 the equities securities 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 this company 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 a 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, an extensive network consisting of 687 central switches linked by 57,552 kilometers of copper cabling and 5,746 kilometers of local fiber opticare installed. These represent 3.0 million lines, of which 2.2 million are in service. Within the xDSL broadband network, the Company has deployed 1200 broadband nodes (DSLAM) with capacity to serve roughly 600,000 clients. In addition, in June 2006, Telefónica Chile launched a new satellite digital television service closing 2006 with 94,209 clients with an average of 2.5 STB (Set-Top Box) per home. Additionally, Telefónica Chile s long distance subsidiary currently owns the longest LD fiber-optic network in the country (4,200 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, 2006, the Company s telephone plants and equipment represented 70.8% of its gross fixed assets (including depreciation); construction in progress represented 2.4%, land and buildings represented 20.8%, and furniture, office equipment and other assets represented 6.0% .

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

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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, 2006, the value of the assets and operating revenue insured totaled approximately Ch$1,298,377 million (US$2.439 million), which consisted of Ch$869,370 million (US$1.633 million) in insured assets and Ch$429,007 million (US$806 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, 2006, of 68% (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, Internet access for corporate customers and, since June 2006, now provides pay television service. Until June 30, 2004, Telefónica Chile provided mobile communications services. These services ended as a result of the sale of the mobile subsidiary in July 2004. The key performance indicators for each of these services are described in detail in Item 4. Information on the Company Business Overview Products and Services.

Several of the factors described below have been particularly significant in the recent years and are expected to continue to influence our financial results in the future. See also D. Trend Information. The most significant factors that influence our financial results are as follows:

Regulation

The Company s results from operations are significantly affected by the regulatory regime to which it is subject. In particular, the maximum rates and fees that the Company can charge for certain local telephony services, which together accounted for 42% of the Company s operating revenues in 2006 are set by tariff, and this tariff does not equally apply to other local telephony operators, mobile phone service providers and cable telephony operators with which the Company competes.

On May 4, 2004, a new Tariff Decree No. 169 for the period between May 6, 2004 and May 6, 2009 was issued by Subtel. This Tariff Decree was ratified and published in the Official Gazette on February 11, 2005. The maximum rates applicable under the new tariffs principally affect revenues from local telephone services, public telephone service payphones, fixed-line connections and other services associated with local telephone service. The application of the local telephone tariffs, defined by Tariff Decree No. 169 for the period 2004 2009, resulted in a minor impact in the 2004 and 2005 financial statements of Telefónica Chile. See Item 4. Information on the Company Business Overview Licenses and Tariffs The Tariff System.

In February 2004, Telefónica Chile was authorized to offer alternative tariff plans to the regulated plan consisting of a fixed charge plus variable charge. This new regulatory rule allowed the Company to offer alternatives to the regulated plan without previous authorization by the Regulator and compete by adapting to customers needs. These plans are not subject to maximum tariffs or predetermined structures and may include joint offers with other services. As of December 31, 2006, 1,324,597 lines have been signed up for flexible tariff plans, representing 59.8% of the Company s total lines in service. Although the effective rates charged for flexible tariff plans are less than those charged in traditional plans, these types of products still allow the Company to use the available capacity of the network to be more competitive, helping to counteract the fall in fixed lines, as they are marketed as part of bundles with broadband and television. See Item 4. Information on the Company Business Overview Products and Services.

Sale of the mobile telephone business

Results of operations for the year ended December 31, 2004 reflect the effects of the sale of our subsidiary Telefónica Móvil de Chile S.A. in July 2004, which produced a gain of approximately Ch$321,071 million. As of July 2004, the Company no longer consolidated the mobile operations.

Telefónica Móvil de Chile S.A. accounted for 29.2% of our operating revenues in 2003 and 32.1% of our operating revenues during the first six months of 2004.

The sale agreement restricts the Company from participating in the mobile telephony business for a period of two years from the date of the sale.

New TV business

To strengthen the Company s leadership and broadband growth, in June 2006, Telefonica Chile launched a new pay TV 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 TV 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.

Critical Accounting Policies

This operating financial review and prospects is based upon our 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 our management to make estimates. Ultimate results could differ from those estimated if our estimates or assumptions used do not actually occur.

We believe the following represents our critical accounting policies. Our accounting policies are more fully described in Note 2 to our Consolidated Annual Financial Statements. The most critical accounting policies adopted in preparing the Consolidated Annual 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 our principal assets and what their depreciable lives are, see Note 2 of our Audited Consolidated Financial Statements included herein. Depreciation represented 37.8%, 39.8% and 41.9% of total operating costs and expenses for the years 2004, 2005 and 2006, respectively.

Impairment of Long-lived Assets. We evaluate finite-lived assets we hold and use 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 our opinion, subject to various factors which may differ from experience due to the rapid changes in technology in our industry. The factors which we take 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 our business which are regulated by tariffs. For those which are not, we take into consideration our 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 our projected cash flows.

Should our strategy or our basis for these assumptions change, the results of any recoverability test which we 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, we 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, we consider 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, we believe the accounting for goodwill is one of our 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, 2005 and 2006, 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 our retail and our corporate customers in each of our operating companies. Our assumptions are reviewed at least quarterly and adjustments are made to our bad debt allowance as appropriate. For both our retail and corporate customers, we use a statistical model based on our aging of accounts receivable balances. Our 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$64,607 million and Ch$66,846 million as of December 31, 2005 and 2006, respectively.

Severance Indemnity. We sponsor 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. We fund these plans as claims are incurred.

Recorded severance indemnities reflect our best estimate of the future cost of honoring our obligations under these benefit plans. We believe 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, our pension benefit obligation would require increase or decrease in the balance sheet and the recording of the offsetting effect in the income statement.

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

Access Costs. 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. We expense access costs as incurred. Accordingly, at each balance sheet date, we record our best estimate of the access costs incurred but not yet billed based on internal usage reports. Once we receive an invoice from a carrier, a process of reconciling that carrier s invoice to our internal usage reports begins. In certain cases, this reconciliation process can take several months to complete. Once the reconciliation is complete, we agree with the carrier on the final amount due. In most cases, this process does not result in significant adjustments to our estimates. Accordingly, at each balance sheet date, we accrue 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 our 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, we believe 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 US 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$(28,939) million and Ch$(27,663) million as of December 31, 2005 and 2006, 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. We estimate our 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 our consolidated balance sheet. As a transitional provision under Chilean GAAP, we 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. We then assess the likelihood that our deferred tax assets will be recovered from future taxable income and to the extent we believe that recovery is unlikely, we establish 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, we must make assumptions about future events that are highly uncertain at the time of estimation. For example, we make 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 our provision for income taxes to vary significantly from period to period.

The net deferred tax liability was Ch$44,177 million, Ch$47,658 million, and Ch$41,132 million as of December 31, 2004, 2005 and 2006, 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 advisors or consultants.

If we are unable to reliably measure the obligation, no provision is recorded and information is then presented in the notes to the 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 (IFRS). In 2004, the SVS began working to promote the convergence of Chilean accounting standards with International

Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB), as recommended by the World Bank. 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, 2009 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 US GAAP, please see Item 18. Financial Statements Note 37 Differences Between Chilean And United States Generally Accepted Accounting Principles.

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, 2006.

Net Income and Operating Revenues for 2004, 2005 and 2006.

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.

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Operating Revenues

	Years ended December 31,					
	2004		2005		2006	
	Revenues	% of Total Operating Revenues	Revenues	% of Total Operating Revenues	Revenues	% of Total Operating Revenues
	(in millions of constant Ch$ as of December 31, 2006, except percentage amounts)					
Fixed Telecommunications	446,609	60.1%	450,748	76.0%	439,548	76.2%
Basic Telephony	317,169	42.7%	300,464	50.7%	264,380	45.8%
Telephone line service fee	155,283	20.9%	126,134	21.3%	80,678	14.0%
Variable charge	125,020	16.8%	98,943	16.7%	69,869	12.1%
Connections and other installations	4,121	0.6%	3,349	0.6%	1,482	0.3%
Plans of minutes (tariff flexibility)(1)	9,194	1.2%	46,687	7.9%	90,429	15.7%
Value-added services	18,074	2.4%	19,884	3.4%	16,562	2.9%
Other basic telephony revenues	5,477	0.7%	5,467	0.9%	5,360	0.9%
Broadband	26,615	3.6%	43,802	7.4%	61,297	10.6%
Access charges and Interconnections	33,411	4.5%	44,928	7.6%	51,221	8.9%
Domestic long-distance	10,705	1.4%	10,561	1.8%	8,494	1.5%
International long-distance	2,969	0.4%	2,421	0.4%	1,597	0.3%
Other interconnection services	19,737	2.7%	31,947	5.4%	41,130	7.1%
Other Fixed Telecommunications businesses	69,412	9.3%	61,553	10.4%	62,650	10.9%
Directory Advertising	6,221	0.8%	5,482	0.9%	4,342	0.8%
ISP-switched and dedicated	3,298	0.4%	2,583	0.4%	2,226	0.4%
Security services (Telemergencia)	7,066	1.0%	8,251	1.4%	8,825	1.5%
Public telephones	11,464	1.5%	10,025	1.7%	9,963	1.7%
Interior installations	33,081	4.4%	31,331	5.3%	30,654	5.3%
Equipment marketing	8,281	1.1%	3,881	0.7%	2,848	0.5%
Pay Television(5)	-	0.0%	-	0.0%	3,792	0.7%
Long-Distance(2)	65,146	8.8%	59,190	10.0%	58,922	10.2%
Corporate Communications Customer	87,694	11.8%	79,853	13.5%	76,113	13.2%
Other Businesses(3)	4,172	0.6%	3,113	0.5%	2,621	0.5%
Mobile Communications(4)	139,850	18.8%	-	0.0%	-	0.0%
Total Operating Revenues	743,471	100.0%	592,904	100.0%	577,204	100.0%

(1) 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.

(2) Revenues from long-distance service include revenues from long-distance traffic and the rental of the long-distance network to other telecommunications operators.

(3) Revenues from other businesses include revenues from Tecnonáutica and t-gestiona, among others.

(4) On July 23, 2004, Telefónica Chile sold to TEM 100% of the Company s subsidiary, Telefónica Móvil de Chile S.A. The transaction was approved by shareholders in an extraordinary shareholders meeting held on July 15, 2004.

(5) Pay TV business launched on June 14, 2006

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$577,204 million (US$1,084.2 million) in 2006 from Ch$592,904 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.

Revenues from Fixed Telecommunications Services

Fixed telecommunications revenues, which accounted for 76.2% of the Company s operating revenues in 2006, decreased by 2.5% to Ch$439,548 million (US$825.6 million) compared to Ch$450,748 in 2005. The fixed telecommunications business segment includes revenues from (i) basic telephony that consists of traditional telephone service, (ii) broadband services, (iii) access charges and interconnections and (iv) other fixed telecommunications business (which includes directory advertising, ISP for companies and small and medium businesses, security services such as alarm monitoring through fixed lines, public telephones and interior installations, equipment sales and rental and others).

Basic Telephony. Revenues from basic telephony represented 60.1% of all revenues from fixed telecommunications services in 2006, which includes telephone line service fees (fixed monthly charges), variable charges, connections and other installations, plans of minutes associated to tariff flexibility and certain value-added services, among others. Basic telephony revenues decreased 12% in 2006 to Ch$264,380 million (US$496.6 million) from Ch$300,464 million in 2005, mainly due to: (i) a 36.0% decrease in revenues from fixed monthly charges to Ch$80,678 million (US$151.5 million) in 2006 from Ch$126,134 million in 2005, primarily because of a decrease in the number of lines that are charged fixed monthly and variable charges, as part of those with traditional lines (subject to tariff regulation) that have migrated to flexible plans such as minute plans and prepaid plans, which do not charge a monthly telephone line service fee (fixed charge); and (ii) a 29.4% decrease in revenues from variable charges to Ch$69,869 million (US$131.2 million) in 2006 from Ch$98,943 million in 2005, as a result of a 21.3% decrease in local traffic and the migration of traditional clients to flexible plans.

Additionally, basic telephony revenues were impacted by a 55.7% decrease in revenues from installations and connections, to Ch$1,482 million (US$2.8 million) in 2006 from Ch$3,349 million in 2005. They were also affected by a 16.7% decrease in value added services to Ch$16,562 (US$31 million) in 2006 from Ch$19,884 million in 2005. However, the implementation of minute plans allowed by new tariff flexibility generated revenues in the amount of Ch$90,429 million (US$169.9 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 part of those with traditional lines (subject to tariff regulation) have migrated to flexible plans, revenues from fixed monthly charge, variable charge and flexible plans together decreased 11.3% mainly because of the lower average traffic per line. As of December 31, 2006, average lines in service decreased 4.8% as compared to year 2005.

Other basic telephony revenues include revenues from, among other things, operator services and rural telephony and dedicated lines for the Internet. These revenues decreased 2% in 2006 to Ch$5,360 million (US$10.1 million) as compared to Ch$5,467 million in 2005.

Broadband Services. Broadband revenues represented 13.9% of all revenues from fixed telecommunications services in 2006, and include revenues from broadband Internet access provided by the Company through ADSL to residential, small and medium-sized companies and to corporate customers. Broadband revenues grew 39.9% to Ch$61,297 million (US$115.1 million) in 2006 as compared to Ch$43,802 million in 2005, owing to a 57.7% increase in ADSL connections in the year. As of December 31, 2006, the number of broadband connections totaled 495,479.

Access charges and interconnection. Access charges and interconnection include revenues from interconnection charges generated by long-distance 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$51,221 million (US$96.2 million) in 2006 from Ch$44,929 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 domestic long-distance and international long-distance access charges revenues, respectively, mainly due to an 18% decrease in access charges traffic.

Other fixed telecommunications business. Other fixed telecommunications business revenues represented 14.3% of all revenues from fixed telecommunications services in 2006, which includes revenues generated by the Company s contract with Publiguías. Pursuant to the agreement, Telefónica Chile receives a percentage of the revenues generated by the sale of advertisements in the Yellow Pages and the White Pages, published by Publiguías, revenues from Internet access provided by the subsidiary Telefónica Internet Empresas (TIE) to switched and dedicated customers, revenues originated in the subsidiary Telemergencia (home security services), and revenues from public telephones, interior installations and terminal equipment marketing that includes the sale and leasing of telecommunications equipment, such as telephones, facsimiles and multiple lines. These revenues increased by 1.8% in 2006 to Ch$62,650 million (US$117.7 million) as compared to Ch$61,553 million in 2005, mainly due to a 7.0% increase in revenues from home security services reaching Ch$8,825 million (US$16.6 million) in 2006 compared to Ch$8,251 million in 2005 and revenues from digital television services reaching Ch$3,792 million (US$7.1 million) during the present year. This was offset by 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.

Revenues from Long-Distance Services

Revenues from the long-distance business segment, which accounted for 10.2% of total revenues in 2006, decreased by 0.5% to Ch$58,922 million (US$110.7 million) compared to Ch$59,190 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 by a 13.5% increase of 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$2,612 million (US$4.9 million) in 2005.

Revenues from Corporate Customers Communications

Revenues from the Corporate Customers Communications and Data business segment, which accounted for 13.2% of the Company s revenues in 2006, decreased by 4.7% to Ch$76,113 million (US$143.0 million) compared to Ch$79,853 million in 2005. Corporate Customers Communications and Data includes revenues from (i) the sale and rental of telecommunications equipment to large corporate customers (i.e., fax, PABX, etc.), (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, Datared, 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$26,757 million (US$50.3 million) from Ch$28,709 million in 2005 together with a 17.1% decrease in revenues from terminal equipment marketing and a 8.3% fall in revenues from complementary services. Revenues from circuits and others partially compensated 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.

Revenues from Other Businesses

Revenues from other businesses, which accounted for 0.5% of the Company s revenues in 2006, decreased by 15.8% to Ch$2,621 million (US$4.9 million) as compared to Ch$3,133 million in 2005. Revenues from other businesses include revenues from other subsidiaries including Tecnonáutica and t-gestiona, among others.

Operating Costs and Administration and Selling Expenses

Operating costs and administrative and selling expenses decreased by 1.9% to Ch$494,580 million (US$929.0 million) in 2006, as compared to Ch$503,979 million in 2005. This was a result of a Ch$12,090 million (US$22.7 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$373,025 million (US$700.7 million) in 2006, as compared to Ch$380,888 million in 2005, mainly because of other operating costs, which represented 35.7% of total operating costs and expenses in 2006, decreased by 7.0% to Ch$133,577 million (US$250.9 million) from Ch$143,602 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$44,232 million (US$83.1 million) from Ch$43,612 million in 2005. In addition, depreciation, which accounted for 52.5% of total operating costs and expenses, increased 1.4% to Ch$196,146 million (US$368.4 million) in 2006 from Ch$193,673 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$121,555 million (US$228.3 million) from Ch$123,091 million in 2005, mainly due to salary savings due to personnel reductions at the beginning of 2006. Operating salaries and related costs, which represented 20.3% of total operating costs and expenses during 2006, decreased by 34.2% to Ch$24,416 million (US$45.9 million) from Ch$37,126 million in 2005. The above was partly offset by higher costs and sales commissions related to broadband business (ADSL), television and corporate communications.

Operating Income

Operating income decreased by 7.1% to Ch$82,624 million (US$155.2 million) during 2006 from Ch$88,925 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$4,437 million (US$8.3 million) in 2006 from Ch$8,153 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$19,480 million (US$36.6 million) in 2006 from Ch$30,121 million in 2005, mainly due to a small financial debt and a better international risk classification, varying from BAA2 to BAA1.

Price level restatement and exchange differences, net. Price level restatement and exchange differences, recorded a net gain in the amount of Ch$666 million in 2006, as compared to a gain of Ch$2,962 million in 2005.

Price level restatement registered a gain of Ch$501 million (US$0.9 million) in 2006 as compared to a gain of Ch$1,986 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$34.4) .

Exchange rate differences registered a gain of Ch$165 million (US$0.3 million) from exchange rate differences in 2006, as compared to a gain of Ch$976 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$29,713 million (US$55.8 million) in 2006, compared to a loss of Ch$29,089 million in 2005, resulting in a 2.1% increase in loss.

The Company recognized: (i) a charge of Ch$9,529 million (US$17.9 million) in 2006 as compared to Ch$2,071 million in 2005 for severance payments; (ii) a charge of Ch$2,534 million (US$4.8 million) in 2006 as compared to Ch$2,886 million in 2005 for provision for obsolete assets; (iii) a write-off of out-of-service property, plant and equipment, for Ch$1,516 million (US$2.9 million) in 2006 as compared to Ch$4,471 million in 2005; and (iv) lawsuit indemnities and other provisions for Ch$1,665 million (US$3.1 million) in 2006 as compared to Ch$1,189 million in 2005.

Income Taxes. The Company recorded an income tax charge in the amount of Ch$29,600 million (US$55.6 million) in 2006 corresponding to an effective consolidated tax rate for the Company of 55.9% compared to an income tax charge of Ch$34,093 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$13,815 million (US$26.0 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$2,621 million (US$4.9 million) and by other non-deductible items of Ch$3,618 million (US$6.8 million).

The income tax charge includes a charge of Ch$16,932 million (US$31.8 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$23,353 million (US$43.9 million) in 2006, as compared to a net income of Ch$25,712 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$5,789 million in fixed telephony; (ii) net income of Ch$15,122 million in long distance; (iii) net income of Ch$13,297 million in corporate customers communications and data; and (iv) a net income of Ch$723 million in other businesses.

Results of Operations for the Year Ended December 31, 2005 Compared to the Year Ended December 31, 2004

Results of operations for the year ended December 31, 2004, reflect the effects of the sale of our subsidiary Telefónica Móvil de Chile S.A. in July 2004, which produced a gain of approximately Ch$321,071 million. As of July 2004, the Company no longer consolidated the mobile operations. In order to assist the reader in understanding the effect after the sale of the mobile subsidiary on our reported results the following table shows operating results of the Company excluding the mobile operations.

	2003[(1)] (excluding mobile operations)	2004[(1)] (excluding mobile operations)	2005	04/03 Variation	05/04 Variation
Operating Revenues excluding mobile operations	635,095	609,792	592,905	-4.0%	-2.8%

Operating Expenses and Administrative and Selling Expenses	-524,669	-501,248	-503,980	-4.5%	0.5%
Operating Income excluding mobile operations	110,426	108,544	88,925	-1.7%	-18.1%
Operating Revenues from mobile operation	246,132	133,679	-		
Operating Expenses from mobile operation	-231,487	-137,363	-		
Operating Income	125,070	104,860	88,925	-16.2%	-15.2%

(1) The subsidiary Telefónica Móvil de Chile was sold in July 2004, thus year 2004 only includes 6 months of results for the mobile business. We believe that consideration of operating revenues and costs excluding mobile operations is important to an understanding of our operations because we sold our mobile subsidiary in July 2004 and as a result 2005 revenues and operating costs are not comparable to those including mobile operations in 2003 and 2004.

Operating Revenues

Operating revenues decreased by 20.3% to Ch$592,904 million (US$1,109.4 million) in 2005 from Ch$743,471 million in 2004. The decrease in revenues is mainly explained by the deconsolidation of Telefónica Móvil de Chile S.A. in July 2004. On July 23, 2004, the Company sold 100% of the shares of its mobile subsidiary, Telefónica Móvil de Chile S.A to TEM. Consequently, as of July 1, 2004, the Company no longer consolidated the mobile revenues in its operating activities. Excluding revenues of the mobile business in year 2004, total consolidated revenues would have decreased 2.9% mainly because of a 5.3% decrease in revenues from the fixed telecommunications business, explained by a drop in revenues from basic telephony, compensated in part by increases in revenues from broadband and access charges, as explained below.

Revenues from Fixed Telecommunications Services

Fixed telecommunications revenues, which accounted for 76.0% of the Company s operating revenues in 2005, increased by 0.9% to Ch$450,747 million (US$843.4 million) compared to Ch$446,609 in 2004. The fixed telecommunications business segment includes revenues from (i) basic telephony that consists of traditional telephone service, (ii) broadband services, (iii) access charges and interconnections and (iv) other fixed telecommunications business (which includes directory advertising, ISP for companies and small and medium businesses, security services such as alarm monitoring through fixed lines, public telephones and interior installations and equipment sales and rental).

Basic Telephony. Revenues from basic telephony represented 66.7% of all revenues from fixed telecommunications services in 2005, which includes telephone line service fees (fixed monthly charges), variable charges, connections and other installations, plans of minutes associated to tariff flexibility and certain value-added services, among others. Basic telephony revenues decreased 5.3% in 2005 to Ch$300,464 million (US$562.2 million) from Ch$317,169 million in 2004, mainly explained by a (i) 18.8% decrease in revenues from fixed monthly charges to Ch$126,133 million (US$236.0 million) in 2005 from Ch$155,283 million in 2004, mainly because of a decrease in the number of lines that are charged 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), which offset the 7.7% average increase in rates applied since May 2004, in accordance to the new Tariff Decree No. 169. See Item 4. Information on the Company Business Overview Licenses and Tariffs The Tariff System ; and (ii) a 20.9% decrease in revenues from variable charges to Ch$98,943 million (US$185.1 million) in 2005 from Ch$125,020 million in 2004, as a result of a 12.7% decrease in local traffic, the migration of traditional clients to flexible plans and the 18.3% average rates decrease applied since May 2004, in accordance with new Tariff Decree No. 169.

Additionally, basic telephony revenues were impacted by an 18.7% decrease in revenues from installations and connections, to Ch$3,348 million (US$6.3 million) in 2005 from Ch$4,121 million in 2004, principally because of a 26.4% drop in other installations, such as replacement of lines and charges for transferring and moving fixed lines, of Ch$1,842 million (US$3.4 million) in 2005 from Ch$2,503 million in 2004. The aforementioned were partially offset by a 10% increase in value added services to Ch$19,883 (US$37.2 million) in 2005 from Ch$18,074 million in 2004. Similarly, the implementation of minute plans allowed by new tariff flexibility, generated revenues in the amount of Ch$46,687 million (US$87.4 million). See Item 4. Information on the Company Business Overview Licenses and Tariffs The Tariff System. As part of those with traditional lines (subject to tariff regulation) have migrated to flexible plans, revenues from fixed monthly charge, variable charge and flexible plans together decreased 5.1% because of the lower average traffic per line. As of December 31, 2005 average lines in service increased 1.9% as compared to year 2004.

Other basic telephony revenues include revenues from, among other things, operator services and rural telephony and dedicated lines for the Internet. These revenues decreased slightly 0.2% in 2005 to Ch$5,467 million (US$10.2 million) as compared to Ch$5,477 million in 2004.

Broadband Services. Broadband revenues represented 9.7% of all revenues from fixed telecommunications services in 2005, and include revenues from broadband Internet access provided by the Company through ADSL to residential, small and medium-sized companies and to corporate customers. Broadband revenues grew 64.6% to

Ch$43,802 million in 2005 as compared to Ch$26,615 million in 2004, owing to a 56.5% increase in ADSL connections in the year. As of December 31, 2005, the number of broadband connections totaled 314,177.

Access charges and interconnection. Access charges and interconnection include revenues from interconnection charges generated by long-distance carriers, as well as those paid by other telecommunications operators that use Telefónica Chile s network and additionally data-processing services such as metering, rating, billing and collections offered to long-distance operators. Access charges and interconnection revenues increased by 34.5% to Ch$44,928 million (US$84.1 million) in 2005 from Ch$33,411 million in 2004. In spite of a decrease of 1.3% and 18.5% in domestic long-distance and international long-distance access charges revenues, respectively, mainly explained by a 23.5% decrease in access charges traffic, other interconnection services increased 61.9% mainly owing to a 38% increase in revenues from mobile to fixed-access charges from Ch$5,834 million in 2004 to Ch$8,027 million in 2005 (US$15.0 million). This increase in mobile to fixed access charges was associated with higher mobile penetration in Chile, which reached 69 lines per 100 inhabitants as of December 31, 2005, and that since July 2004 the Company began recognizing revenues from access charges and rental capacity from the former mobile subsidiary Telefonica Móvil de Chile S.A. Prior to the sale of the mobile subsidiary in July 2004, such revenues were accounted for as intercompany transactions and eliminated in consolidation. Revenues from unbundled services and other services provided to other telecom operators increased from Ch$1,382 million in 2004 to Ch$2,310 million (US$4.3 million) in 2005. The application of the new tariff decree since May 2004 had a positive effect in access charge revenues since the average access charge rate increased 49.1%, see Item 4. Information on the Company Business Overview Licenses and Tariffs The Tariff System.

Other fixed telecommunications business. Other fixed telecommunications business revenues represented 13.7% of all revenues from fixed telecommunications services in 2005, which includes revenues generated by the Company s contract with Publiguías. Pursuant to the agreement, Telefónica Chile receives a percentage of the revenues generated by the sale of advertisements in the Yellow Pages and the White Pages, published by Publiguías, revenues from Internet access provided by the subsidiary Telefónica Internet Empresas (TIE) to switched and dedicated customers, revenues originated in the subsidiary Telemergencia (home security services), revenues from public telephones, interior installations and terminal equipment marketing that includes the sale and leasing of telecommunications equipment such as, among other things, telephones, facsimiles and multiple lines. These revenues decreased by 11.3% in 2005 to Ch$61,553 million (US$115.2 million) as compared to Ch$69,412 million in 2004. This is mainly due to a 53.1% decrease in equipment marketing explained by lower sales of telecommunications equipment and PABX; (ii) a 5.3% decrease in revenues from interior installation; and (iii) a 12.5% decrease in public telephones due to a 24.6% decrease in traffic and a 15.0% decrease in average number of public telephones. These decreases were partly offset by a 16.8% increase in revenues of home security services.

Revenues from Long-Distance Services

Revenues from the long-distance business segment, which accounted for 10.0% of total revenues in 2005, decreased by 9.1% to Ch$59,189 million (US$110.8 million) compared to Ch$65,146 million in 2004. 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 21.5% decrease in ILD revenues and an 8.8% decrease in DLD revenues, partly compensated by a 12.8% increase in rental capacity. Revenues from rental capacity were positively affected by the incorporation of revenues from media and circuit rental to Telefónica Móvil de Chile S.A after the sale of the mobile subsidiary to TEM in July 2004. Prior to the sale these rentals were accounted for as intercompany transactions.

The decrease in ILD revenues is mainly due to (i) an extraordinary charge associated with incoming ILD traffic revenues of Ch$2,612 million (US$4.9 million) in 2005, which also had an effect on operating costs (excluding this effect ILD revenues decreased 11.2%); (ii) a 2.1% decrease in ILD traffic; and (iii) a 6.8% decrease average tariff for ILD. Similarly, the decrease in DLD revenues is explained by a 9.4% decrease in DLD traffic and a 5.6% decrease in average tariff for DLD as a result of increased competition and the effect of mobile and Internet substitution.

Revenues from Corporate Customers Communications

Revenues from the Corporate Customers Communications and Data business segment, which accounted for 13.5% of the Company s revenues in 2005, decreased by 8.9% to Ch$79,856 million (US$149.4 million) compared to Ch$87,694 million in 2004. Corporate Customers Communications and Data includes revenues from (i) the sale and rental of telecommunications equipment to large corporate customers (i.e., fax, PABX, etc.), (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, Datared, E1 Links and VSAT, housing and hosting and consulting services to large corporate customers.

The decrease in revenues was mainly due to (i) a 12.9% decrease in data services revenues to Ch$28,709 million (US$53.7 million) from Ch$32,948 million in 2004, mainly as a result of the reclassification of revenues from interconnection services to wholesalers (broadband for wholesalers), which were reclassified as fixed telecommunications revenues in the amount of Ch$1,606 million (US$3.0 million), and (ii) a 15.2% decrease in complementary services to corporate customers to Ch$14,974 million (US$28.0 million) from Ch$17.668 million in 2004 because of the reclassification of information of service income toward value added service of fixed telecommunication. Excluding those revenues in 2004, complementary service grew 8.7% because of an increase in sales levels in the high consumption plans associated with tariff flexibility, where lines with high consumption plans for voice grew 58.9% as compared to 2004. Revenues from terminal equipment marketing and circuits and others fell 4.9% and 0.9%, respectively, because of the migration from traditional technologies to more advanced data technologies. In 2005, ATM links and Datared decreased by 34.6% and 40.4%, while data links through the IP network (dedicated IP) grew 4.7%.

Revenues from Other Businesses

Revenues from other businesses, which accounted for 0.5% of the Company s revenues in 2005, decreased by 25.4% to Ch$3,112 million (US$5.8 million) as compared to Ch$4,172 million in 2004. Revenues from other businesses include revenues from other subsidiaries including Tecnonáutica and t-gestiona, among others.

Operating Costs and Administration and Selling Expenses

Operating costs and administrative and selling expenses decreased by 21.1% to Ch$503,980 million (US$94.0 million) in 2005, as compared to Ch$638,611 million in 2004. When the mobile operations are excluded in 2004, consolidated operating costs and administrative and selling expenses increased slightly by 0.6% in relation to 2004. We believe that consideration of operating costs and administrative and selling expenses excluding mobile operations is important to an understanding of our operating costs because we sold our mobile subsidiary in July 2004 and as a result operating costs and administrative and selling expenses including mobile operations are not comparable between 2004 and 2005.

Operating costs and expenses. Operating costs and expenses decreased by 19.0% to Ch$380,888 million in 2005, as compared to Ch$470,119 million in 2004, mainly because (i) operating salaries and related costs, which represented 11.5% of total operating costs and expenses during 2005, decreased by 14.1% to Ch$43,612 million from Ch$50,821 million in 2004, mainly due to lower salary costs as a consequence of deconsolidation of the mobile business as of July 2004, (ii) depreciation, which accounted for 50.9% of total operating costs and expenses, decreased 16.7% to Ch$193,673 million in 2005 from Ch$232,374 million in 2004, mainly due to the deconsolidation of the mobile business, and (iii) other operating costs, which represented 37.7% of total operating costs and expenses in 2005, decreased by 23.2% to Ch$143,602 million from Ch$186,924 million in 2004, due mainly to the deconsolidation of the mobile business as of July 2004, and reduction in uncollectible accounts costs mainly in the fixed telecommunications business. During 2005, the Company implemented stricter policies to control uncollectibles such as automatic disconnections of lines with more than 120-day past due invoices and stricter policies for admitting new customers. Provisions for doubtful accounts as a percentage of revenues was 3.7% as of December 31, 2005, compared to 4.6% in the previous year (excluding mobile operations).

Administrative and selling expenses. Administrative and selling expenses, which accounted for 24.4% of total operating costs and administrative and selling expenses in 2005, decreased by 26.9% to Ch$123,092 million (US$230.3 million) from Ch$168,491 million in 2004, mainly due to the deconsolidation of the mobile business as of July 2004. For the ongoing operations there were also salary savings due to personnel reductions in the administrative and sales areas partly offset by (i) a one-time charge related to the long-distance settlement rates, in the amount of Ch$8,235 (US$15.4 million) in 2005, and (ii) higher costs and sales commissions related to broadband business (ADSL) and corporate communications, and advertising campaigns launched in 2005 related to ADSL and flexible plans.

Operating Income

Operating income decreased by 15.2% to Ch$88,925 million (US$166.4 million) during 2005 from Ch$104,860 million in 2004, due to a 20.3% decrease in operating revenues and a 21.1% decrease in operating expenses, as explained above, taking into account the fact that the Company no longer consolidated the Mobile subsidiary beginning in July 2004.

Other Income (Expenses) or Non-Operating Results

Interest income. Interest income decreased by 17.0% to Ch$8,153 million (US$15.3 million) in 2005 from Ch$9,822 million in 2004, mainly explained by higher interest income in 2004 from financial investments made with available funds arising from the sale of the mobile subsidiary in July 2004.

Interest expense. Interest expense decreased by 47.3% to Ch$30,121 million (US$56.4 million) in 2005 from Ch$57,175 million in 2004, mainly due to (i) a 21.0% decrease in the Company s average interest-bearing debt, as well as lower average interest rates resulting from the renegotiation of spreads on outstanding loans and a decrease in local and international interest rates, (ii) the positive impact of the appreciation of the Chilean peso against the U.S. dollar (gains and losses from transactions entered into to hedge our foreign currency exposure are reflected under exchange differences, net), and (iii) a charge of Ch$8,561 million (US$15.5 million) recognized in 2004, related to the repurchase of US$182 million in Yankee Bonds carried out in fourth quarter of 2004, at a price above its par value.

Price level restatement and exchange differences, net. Price level restatement and exchange differences, recorded a net gain in the amount of Ch$2,962 million in 2005, as compared to a gain of Ch$9,501 million in 2004.

Price level restatement registered a gain of Ch$1,986 million (US$ 3.7 million) in 2005 as compared to a charge of Ch$4,407 million in 2004. 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 26 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, 2005, one UF was equal to Ch$17,974.81.

Exchange rate differences registered a gain of Ch$976 million (US$1.8 million) from exchange rate differences in 2005, as compared to a gain of Ch$13,908 million from exchange rate differences in 2004, as shown in Note 27 to the Audited Consolidated Financial Statements. The gain registered in 2004 was mainly due to the gain obtained through forward agreements contracted by the Company to hedge against exchange rate variations after receiving US$ dollars for the sale of Telefónica Móvil de Chile S.A. in July 2004. 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 devaluate 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 2005, appreciation of the inflation-adjusted Chilean peso against the U.S. dollar was 11.3% .

Other non-operating results. Other non-operating results recorded a loss of Ch$29,089 million in 2005, compared to a gain of Ch$291,066 million in 2004. This item was particularly impacted in 2004 by non-operating gain of Ch$350,090 million (net of goodwill amortization) and by Ch$6,878 million from the sale of subsidiary Telefónica Móvil de Chile S.A. and the sale of the participation in Publiguías. respectively.

In addition, the Company recognized (i) a charge of Ch$2,071 million (US$3.9 million) in 2005 as compared to Ch$6,584 million in 2004 for severance payments; (ii) a charge of Ch$2,265 million (US$4.2 million) in 2005 as compared to Ch$10,118 million in 2004 for provision for obsolete assets; and (iii) a write-off of out-of-service property, plant and equipment, for Ch$4,471 million (US$8.4 million) in 2005 as compared to Ch$8,465 million in 2004.

Income Taxes. The Company recorded an income tax charge in the amount of Ch$34,093 million (US$63.8 million) in 2005 translating into an effective consolidated tax rate for the Company of 57.0% compared to an income tax charge of Ch$65,999 million in 2004 translating into an effective consolidated tax rate for the Company of 16.7%. In 2004, income tax included taxes paid associated with the gain for the sale of Telefónica Móvil de Chile S.A. in July 2004, which amounted Ch$36,928 million (US$69.1 million). 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 7(c) to the Audited Consolidated Financial Statements. The Company s income tax charge of Ch$34,093 million in 2005 was composed of a Ch$24,561 million (US$46.0 million) current income tax expense, and a total of Ch$9,532 million (US$18.2 million) charge for deferred taxes, explained by Ch$13,896 million (US$26.1 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 Ch$4,364 million (US$8.2 million) of a reverse 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.

Net Income (Loss)

As a result of the above, Telefónica Chile s net results amounted to a net income of Ch$25,712 million (US$48.3 million) in 2005, as compared to a net income of Ch$329,627 million recorded in 2004. For 2005, the contribution to the consolidated net income by business segment was as follows: a net income of Ch$12,301 million in fixed telephony, net income of Ch$1,594 million in long distance, net income of Ch$11,004 million in corporate customers communications and data, and a net income of Ch$812 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 2006, 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 2006, the cash flow statements show net cash from operating activities totaling Ch$234,631 million (US$440.7 million), compared to Ch$226,267 million in 2005, as a result of: (i) a net income of Ch$23,353 million (US$43.9 million) in 2006 as compared to net income of Ch$25,712 million in 2005; (ii) a gain on sale of property, plant and equipment of Ch$369 million (US$0.7 million) in 2006, as compared to a loss on sale of property, plant and equipment of Ch$21 million in 2005; (iii) depreciation and amortization charges of Ch$209,931 million (US$394 million) as compared to Ch$205,761 million in 2005; (iv) an increase in operating assets of Ch$19,686 million (US$36.9 million) in 2006 compared to a decrease in operating assets of Ch$66,003 million in 2005; and (v) a decrease in operating liabilities of Ch$781 million (US$1.5 million), compared to a decrease of Ch$98,520 million in 2005. The smaller decrease in 2006 is due to the fact that, although accounts payable fell, in 2006 the amount of income tax payable dropped by less than it had between 2004 and 2005, offsetting the decrease in accounts payable. The effect of these factors was partly offset by lower charges to income that do not represent cash flows for a net amount of Ch$232,156 million (US$436.1 million) in 2006, compared to Ch$233,019 in 2005. The difference is due to lower price-level restatement and foreign currency translation differences in 2006, offset by higher depreciation and goodwill depreciation.

Net cash used in financing activities reached Ch$181,661 million (US$341.2 million) in 2006 as compared with Ch$205,394 million in 2005. Cash in 2006 was mainly used for dividend payments of Ch$25,340 million (US$47.6 million), a capital reduction of Ch$40,596 million (US$76.3 million) and payments of obligations with the public of Ch$188,405 million (US$353.9 million).

Net cash used in investing activities reached Ch$108.021 million (US$202.9 million) in 2006, compared to Ch$88,254 million in 2005. The cash used in investing activities in 2006 was principally associated with the acquisition of property, plant and equipment.

The Company s shareholders equity as of December 31, 2006 and 2005 was Ch$900,761 million (US$1,691.9 million) and Ch$945,012 million respectively. The decrease in shareholders equity as of December 31, 2006 was primarily attributable to the payment, during 2005, of dividends totaling Ch$25,183 million (US$47.3 million historic value), as well as a capital reduction of Ch$40,201 million historic value (US$75.5 million historic value), in order to distribute additional cash to shareholders.

On January 24, 2006, the Company s Board of Directors decided to call an extraordinary shareholders meeting for April 20, 2006, with the objective to decide on a capital reduction of Ch$40,200,513,570 (US$75,509,520) and a reform of the Company by-laws to reflect such a capital reduction. The capital reduction and amendment of the Company s by-laws were approved at the extraordinary shareholders meeting held on April 20, 2006, and the capital reduction was paid to shareholders on June 15, 2006. On March 14, 2006, an extraordinary Series F local bondholders meeting was held, where bondholders approved the elimination of the clause in the bond agreement that prohibits a capital reduction and also agreed to change some covenants to match the covenants of the Company s other debt agreements outstanding.

Outstanding Indebtedness

Following its privatization in 1988, the Company pursued an aggressive development plan to expand its fixed line network at that moment and develop other telecommunications services, such as long-distance 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.

During 2006, the Company issued Ch$73,000 million (US$137.1 million) of new debt through issuances of commercial paper and local debentures. Commercial paper is a public debt instrument in the local market, which can be issued as a credit line or as a fixed amount with maturities of up to 36 months in different currencies and rates, allowing financing flexibility. The detail of debt issued by the Company during 2006 is as follows:

- In March 2006, the Company issued commercial paper for Ch$12,000 million (US$22.5 million), which was drawn against the line registered with the Chilean Securities and Exchange Commission in May 2004. The term of the issuance was 260 days with an average monthly nominal rate of 0.48%.

- In March 2006, the Company issued local debentures for Ch$54,000 million (US$101.4 million). The term of the issuance is seven years with maturity in October 2012 and an average rate of 4.18%.

- In July 2006, the Company issued commercial paper for Ch$7,000 million (US$13.1 million), which was drawn against the line registered with the Chilean Securities and Exchange Commission in May 2004. The instrument s maturity date was September 27, 2006, with an average monthly nominal rate of 0.44%.

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During 2006, debt repayments equivalent to US$315 million, consisted of US$206 for the repayment of Yankee bonds in January and July, as well as US$107 million in commercial paper paid at maturity in March and April, and US$2 million for the repayment of local Series F bonds, in April and October.

The following table sets forth the Company s outstanding debt as of December 31, 2006:

	As of December 31, 2006							
	Total Debt Outstanding	**Short-Term Portion**	**Long-Term Portion**	**Type of Debt**	**Date Incurred**	**Original Principal Amounts Borrowed(1) (2)**	**Interest Rate**	**Maturity**
	(in millions of constant Chilean Pesos as of December 31, 2006, except as indicated)							
Long-Term Obligations including current maturities:								
Long-Term Obligations with Banks:								
Citibank	80,514	656	79,858	Syndicated loan	2005	US$150 mm	Libor +0.31	2008
Banco BBVA, Bancomer and Others	80,593	734	79,859	Syndicated loan	2005	US$150 mm	Libor +0.334	2011
CALYON, New York and Others	106,647	169	106,478	Syndicated loan	2004	US$200 mm	Libor +0.35	2009
Banco Santander	65,632	446	65,186	Bilateral loan	2005	3,555,000 UF	TAB360+ 0.45	2010
Total Long-Term Obligations with Banks	333,386	2,005	331,381					
Bonds and Debentures:								
Series F	12,598	1,465	11,133	Local bond	1991	1,500,000 UF	6.00%	2016
Series L	55,384	375	55,009	Local bond	2006	3,000,000 UF	3.75%	2012
Total Bonds and Debentures	67,982	1,840	66,142					
Capital Lease Obligations:								
Leasing Obligations	222	12	210	Leasing	-	-	8.10%	2015

Total Long-Term Debt (including current maturities)	**401,590**
Total Debt Outstanding	**401,590**

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(1) In original currency of debt as incurred.

(2) U.S. dollar and euro amounts expressed in millions.

In addition to available cash as of December 31, 2006, the Company has the ability to draw up to approximately Ch$1,200 million (US$2.3 million) from unused lines of credit granted by Chilean banks.

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 2006 approved by Telefónica Chile s shareholders at the General Annual Shareholders Meeting held in April 2006 specifies that the maximum consolidated debt-to-equity ratio may not exceed 1.6. As of December 31, 2006, 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, 2006, the Company had a leverage ratio of 0.79 and an interest coverage ratio of 18.7.

During 2006, the ratings agency Moody s upgraded its rating from Baa2 to Baa1 with a stable outlook, and Fitch Ratings reaffirmed Telefónica Chile s rating at BBB+ with a stable outlook.

Capital Expenditures and Other Liquidity Requirements

Debt Prepayment and Repayment

In 2006, the Company continued its strategy of strengthening its financial structure and reducing financial expenses. Telefónica Chile achieved a significant decrease in its total financial debt through greater cash flow, which enabled the Company to reduce its debt through repayments on Yankee bonds in the U.S. market and the maturity of commercial paper issued on the local market.

During 2006, the Company s sources of financing were operating resources, the issuance of local Series L bonds and the issuance of commercial paper. These sources allowed investments of US$205 million, debt repayments equivalent to US$315 million, and the payment of dividends equivalent to US$123 million. Debt repayments consisted of US$206 million for the repayment of Yankee bonds in January and July, as well as US$107 million in commercial paper paid at maturity in March and April, and US$2 million for the repayment of local Series F bonds, in April and October.

Debt Renegotiation

On March 14, 2006, a meeting of series F bondholders was held in order to amend the original credit agreement. The following amendments were agreed upon: (i) to change the limit of the consolidated and individual debt-to-equity ratio from 1.5 to 1.6 times; (ii) to eliminate the restriction on the interest coverage ratio; (iii) to amend the clause prohibiting capital reductions; and (iv) to eliminate the prohibition on stock repurchases. The objective of these amendments was to align the financial restrictions in the public debt contracts of the Company.

As of December 31, 2006, the Company s total interest-bearing debt of Ch$401,590 million (US$754.3 million) had decreased by 21% from the prior year-end, resulting in a ratio of total liabilities to equity of 0.79 and an interest coverage ratio of 18.7.

Capital Expenditures

Capital expenditures have been designated primarily for those business areas presenting the greatest potential. With regard to the Company s traditional business, investment was focused on maximizing installed capacity, marketing telephone lines, and starting a network improvement and plant modernization plan, aimed at a high standard of quality of service. In 2006, Telefónica Chile s investments totaled Ch$ 109,003 million (US$204.7 million) as compared with Ch$76,402 million (US$149.1 million) (historic value) in 2005.

The main focus of these investments was consolidating broadband growth and launching a new product, digital television. This new product complements Telefónica Chile s telecommunications and entertainment service bundles, integrating voice, data, and digital quality television into a flexible package that can be tailored to each customer s needs. Thus 23.9% of capital expenditures was invested in broadband, 20.9% in Television services, 17.9 in data transmission, 20.4% in local telephony and the remaining 16.9% was invested in other areas, including the Company s systems and long distance.

The investment plan for the year also included continuing the initiative to upgrade the Company s operational support systems by improving the tools that support its business, technical, and administrative management.

It is important to note that, this year, Telefónica Chile s networks were seriously impacted by an increase in thefts of copper cables. These thefts had to be absorbed into the investment plan by devoting US$13 million to the replacement of the affected networks.

The 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 TV 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 US 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 2006, 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$401,590 million (US$754.3 million) as of December 31, 2006, 33.3% was denominated in Chilean pesos and 66.7% was denominated in foreign currencies, mainly the U.S. dollar. It is important to note that US$156 million of 8.375% Yankee Bond matured on January 1, 2006, further reducing the Company s exposure to U.S. dollar fluctuations.

As of December 31, 2006, 16.7% 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 83.3% of the Company s interest-bearing debt was insulated from interest rate fluctuations: 66.3% was hedged and 17.0% was fixed-rate debt. As of December 31, 2006, the Company had outstanding cross-currency swaps of Ch$266,196 million (US$500 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 2.5%, 3.6% and 2.1% for the twelve-month periods ended November 30, 2004, 2005 and 2006, 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,			
	2004	2005	2006	2006
	(in millions of constant Ch$ as of December 31, 2006)			(US$ millions)
Price Level Restatement	(4,407)	1,986	501	0.9

Purchasing-power gain	10,030	19,857	10,949	20.6
Loss on indexation	(14,437)	(17,871)	(10,448)	(19.6)
Exchange Differences				
(gain (loss) on foreign currency transactions)	13,908	976	165	0.3
Price level restatement and exchange differences, net	**9,501**	**2,962**	**666**	**1.3**

Recent Accounting Pronouncements Under U.S. GAAP

(i) In February 2006, the FASB issued SFAS 155, Accounting for Certain Hybrid Financial Instruments - an amendment of FASB Statements No. 133 and 140 . The new statement:

a) permits fair value re-measurement of any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation;

b) clarifies which interest-only strips and principal-only strips are not subject to the requirements of SFAS 133, Accounting for Derivative Instruments and Hedging Activities ;

c) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation;

d) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives; and

e) amends SFAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities , to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument.

SFAS 155 generally is effective for all financial instruments acquired or issued after the beginning of an entity s first fiscal year that begins after September 15, 2006. The Company does not anticipate that the adoption of this statement will have a material effect on its financial position, results of operations or cash flows.

(ii) In June 2006, the FASB issued FASB Interpretation 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 . This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on derecognition, classification and other matters, FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company has not determined the effect, if any, the adoption of FIN 48 will have on the Company s financial position and results of operations.

(iii) 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. The Company is currently evaluating the impact that will result from the adoption of SFAS 157.

(iv) In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158 (SFAS 158), Employer s Accounting for Defined Pension and Other Postretirement Plans an amendment of FASBStatements No. 87, 88, 106 and 132(R) . This statement requires the recognition of the funded status of a benefit plan in the statement of financial position. It also requires the recognition as a component of other comprehensive income (OCI), net of tax, of the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to statements 87 or 106. The statement also has new provisions regarding the measurement date as well as certain disclosure requirements. The statement was effective at fiscal year end 2006 and the Company adopted the statement at that time. With the adoption of SFAS 158, the Company recorded ThCh$240,390 as a component of the ending balance of accumulated other comprehensive income, net of tax.

(v) 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 is currently determining the policy of adoption as well as the resulting effect of SFAS No. 159 on the consolidated 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 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. On December 20, 2006, the Office of the Undersecretary of Telecommunications announced a public consultation on a bill created to define the rules that govern the public voice over Internet service in order to identify matters that should be included in the rules. Telefónica Chile together with other industry operators, sent its comments and proposals on January 26, 2007, as required by the public consultation. Depending on their final outcome, these new regulations proposed by Subtel may adversely affect the Company s businesses. Nevertheless, the use of this technology may serve as a substitute for the Company s local and long-distance traffic. 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 2.2% in 2002, 3.9% in 2003, 6.2% in 2004, 6.3% in 2005 and 4.2% in 2006. The Central Bank s concern for price stability has translated into the application of an inflation-targeting monetary approach. Since 2001, the inflation target has been defined as a symmetrical range from 2.0% to 4.0%, centered on 3.0%, which must be met permanently over a medium-term horizon of two years. Due to this policy, the inflation reached 1.1% in 2003, 2.4% in 2004, 3.7% in 2005 and 2.6% in 2006. The current account had a surplus of 1.5% of GDP in 2004, 0.6% in 2005 and 2.7% in 2006. Annual average unemployment declined from 9.0% in 2002 to 8.0% in 2006 therefore, household spending is setting a foundation for the current expansion. During 2006, fiscal revenue reached record levels, driven by the high prices of commodities, particularly copper, resulting in a fiscal surplus equal to an estimated 8.2% of GDP. Meanwhile, domestic demand increased by approximately 7.3%, domestic consumption grew by approximately 7.1%, and investment grew by approximately 5.0%. In spite of the favorable economic climate, there can be no assurance that the consumption of our products and services will grow in the same proportion.

Increased Competition, New Entrants and M&A Activities. 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 68% in 2006. 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 cover nearly 90% of the paid TV 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 (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 TV market, where the dominant operator (the cable company VTR) covers approximately 90% of the market. Since its launch in June 2006, the Company s market share reached 9% as of December 31, 2006.

There is also an increase in competition with the entry of new operators in the market, primarily in the long-distance and data transmission businesses. Telefónica Chile competes with fifteen 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.

The mobile telephony market has continued to grow, reaching a penetration in the market of about 78 lines per 100 inhabitants as of December 31, 2006, 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 in domestic long-distance traffic.

See also 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 our financial condition, 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, 2006 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, 2006)				
Contractual Obligations:	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**More than 5 years**
Long-term debt, including current maturities(1)	401,334	3,811	188,956	147,664	60,903
Capital (Finance) Lease Obligations(1)	419	45	91	91	192
Operating Lease Obligations	-	-	-	-	-
Purchase Obligations	-	-	-	-	-
Other Long-Term Liabilities Reflected on the Company s Balance Sheet under the GAAP of the primary financial statements(2)	306,483	157,810	28,390	5,831	114,452
Other accounts payable and due to related company(1)	33,007	33,007	-	-	-
Total contractual obligations	741,243	194,673	217,437	153,586	175,547

(1) Includes accrued interest as of December 31, 2006.

(2) Other long-term liabilities include dividends payable, notes payable, miscellaneous accounts payable, accruals, withholdings and deferred taxes, severance indemnity obligations and other liabilities.

ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

A. Directors and Senior Management

The Company is managed by its Board of Directors, which, in accordance with the Company s *Estatutos*, or Bylaws, must consist of seven directors and their respective alternate directors. Six of the directors, together with their respective alternate directors, are elected by holders of the Series A Common Stock, each for a three-year term, at the General Annual Shareholders Meeting. Holders of the Series B Common Stock elect one director and one alternate director for a three-year term at the General Annual Shareholders Meeting.

If a vacancy occurs on the Board of Directors during the course of any three-year term (for example, upon resignation of a director), the alternate director corresponding to the vacant position serves as director for the balance of the term. If such an alternate director resigns, dies or by virtue of law becomes unable to serve as a director, the Board of Directors then appoints a new alternate director to serve until the date of the next General Annual Shareholders Meeting, when an election of the entire Board of Directors must take place.

Telefónica Chile s Board of Directors was elected for a three-year term at the General Annual Shareholders Meeting held April 14, 2005. Alternate directors, participate in discussions at the Board meetings but are entitled to vote only when their respective principal directors are absent. The Bylaws also require that the directors and alternate directors elected by the holders of Series B Common Stock be shareholders of the Company.

On April 27, 2006, Chairman of the Board Emilio Gilolmo was appointed, as was his alternate, Mr. José María Alvarez-Pallete. On the same date, the alternate directors Mr. Juan Carlos Ros and Mr. Guillermo Ansaldo, resigned their positions and Mr. Manuel Alvarez-Tronge and Mr. Manoel Amorim, respectively, were named as their replacements until the next General Shareholders Meeting. As a result of the change in Chairman, the entire Board of Directors must be renewed at the 2007 General Shareholders Meeting. On November 22, 2006, Mr. Manoel Amorim resigned as Series A alternate director.

The Board of Directors appoints a General Manager (also known as the Chief Executive Officer) and such other executive officers as are deemed appropriate to implement the Board s policies and decisions. The Chief Executive Officer of a public Chilean corporation cannot also serve as a director of such corporation.

The Board of Directors must meet at least once per month.

As of February 28, 2007, the Company s directors and executive officers were:

Directors [(1)]

Name	**Position**
Emilio Gilolmo López [(1)]	Chairman of the Board of Directors and Director Series A Common Stock
Narcís Serra Serra	Deputy Chairman of the Board of Directors and Director Series A Common Stock
Andrés Concha Rodríguez	Director Series A Common Stock
Fernando Bustamante Huerta	Director Series A Common Stock
Patricio Rojas Ramos	Director Series A Common Stock
Hernán Cheyre Valenzuela	Director Series A Common Stock
Marco Colodro Hadjes	Director Series B Common Stock
José María Alvarez-Pallete	Alternate Director Series A Common Stock
Manuel Alvarez-Tronge [(1)]	Alternate Director Series A Common Stock
Luis Cid Alonso	Alternate Director Series A Common Stock
Benjamín Holmes Bierwirth	Alternate Director Series A Common Stock
Carlos Díaz Vergara	Alternate Director Series A Common Stock
Alfonso Ferrari Herrero	Alternate Director Series B Common Stock

Executive Officers	
José Molés Valenzuela[2]	General Director and Chief Executive Officer
Cristián Aninat Salas	General Counsel and Secretary of the Board of Directors
Julio Covarrubias Fernández	Vice President Chief Financial Officer and General Manager of t-gestiona
Manuel Plaza Martin	Vice President Technology and Operations
César Valdés Morales [3]	Vice President Commercial and Administrative

		Services
Luis Fernando de Godoy	Vice President	Small Businesses and Professionals
Vacant (4)	Vice President	Strategy and Corporate Development
Francisco Javier de Miguel del Val (5)	Vice President	Internal Auditing
Rafael Zamora Sanhueza (6)	Vice President	Telefónica Empresas
Rubén Sepúlveda Miranda	Vice President	Human Resources
Diego Martínez-Caro	Vice President	Management Control and Chief Accounting Officer
Humberto Soto Velasco	Vice President	Regulation and Wholesalers
Juan Antonio Etcheverry (7)	Vice President	Residential Communications

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(1) The Board of Directors was elected for a three-year period at the General Shareholder s Meeting held on April 14, 2005. As of April 27, 2006, Mr. Bruno Philippi resigned as Chairman of the Company and the Board of Directors named Mr. Emilio Gilolmo as his replacement. On the same date, the alternate directors Mr. Juan Carlos Ros and Mr.Guillermo Ansaldo resigned their positions and Mr. Manuel Alvarez-Tronge and Mr.Manoel Luiz Ferrao de Amorim, respectively, were named as their replacements until the next General Shareholders Meeting. As a result of the change in Chairman, the entire Board of Directors must be renewed at the 2007 General Shareholders Meeting. On November 22, 2006, Mr. Manoel Amorim resigned as Series A alternate director.

(2) Appointed in September 2005.

(3) Effective February 19, 2007. Previously this position was held by Franco Faccilongo Forno, who resigned effective January 12, 2007.

(4) This position was held by Nicolás Domínguez until November 30, 2006.

(5) Effective February 1, 2007. Previously this position was held by Jesús Javier García Cuadrado, who resigned effective December 31, 2006.

(6) Effective January 1, 2007. This position was previously held by Ricardo Majluf.

(7) Effective January 1, 2007. This position was previously held by Rafael Zamora.

Certain of the Company s directors also serve as directors or officers of other companies, including related companies (where noted below) and other companies in the Chilean telecommunications industry. See Item 7. Major Shareholders and Related Party Transactions.

Set forth below is a brief biographical description of the directors and executive officers of the Company. All ages of directors and executive officers are stated as of March 31, 2007.

Directors

Emilio Gilolmo López, 65, became a Series A director and the Chairman of the Board of Directors in April 2006. Within the Telefónica Group he has served as member of the Board of Sogecable S.A. and Chairman of Lolafilms S.A. He has vast experience in the banking industry and as a professor in constitutional law at Complutense University of Madrid and the diplomatic academy. He is Vice President of the Spanish federation of human rights protection, of the Club Siglo XXI and sponsor of the Ortega y Gasset foundation. He holds a law degree and a political science degree from the Universidad de Madrid.

Narcís Serra Serra, 64, became a Series A director and Deputy Chairman of the Board in July 2004. He is the Chairman of Fundación CIDOB, of the National Museum of Art of Catalunya, Deputy Chairman of Catalunya s Advisory Board of Telefónica S.A., member of the Board of TELESP, Telefónica Internacional, S.A. and Caixa Catalunya. Currently, he is a professor of Economic Theory at Universidad Autónoma de Barcelona. He holds an economics degree from Universidad de Barcelona and a Ph.D. in economics from Universidad Autónoma de Barcelona.

Andrés Concha Rodríguez, 63, became a Series A director on April 26, 2001. He holds a bachelor s degree in economics from the University of Chile. At present he is the General Director of the Chilean Federation of Industry, member of the Board of Security Holdings, a financial institution, and a member of the Board of Pilmaiquen Electrical Co.

Fernando Bustamante Huerta, 67, became a Series A director on April 26, 2001. He is the Chairman of the Board of Metro S.A. He is a general manager and partner of Inversiones El Olivar Ltda. He holds an accounting degree from Universidad de Chile.

Patricio Rojas Ramos, 46, became a Series A director in April 2005. He is a partner of P. Rojas & Asociados, an economic consulting company. Currently, he is professor of the Department of Economics at the Universidad Católica de Chile. He holds an economics degree from the Universidad Católica de Chile and a Ph.D. from MIT.

Hernán Cheyre Valenzuela, 52, became a Series A director on April 15, 2004. He is the Chairman of Econsult, a consulting company. He holds a commercial engineering degree from the Universidad Católica de Chile and a master s degree in economics from the University of Chicago.

Marco Colodro Hadjes, 65, became a Series B director on January 28, 2005. He has been Manager of International Commerce of Banco Central de Chile, Deputy Chairman of Banco del Estado de Chile and Chairman of Televisión Nacional de Chile. He holds an economics degree from the Universidad de Chile and a doctorate from the University of Paris.

José María Alvarez-Pallete, 43, became a director on April 22, 2003. In September 1999 he became CFO of Telefónica, S.A. He was appointed Chairman and Chief Executive Officer of Telefónica Internacional on July 24, 2002. He is a member of the following Boards of Directors: Telefónica de España, Telefónica Móviles, Telefónica Móviles España, Telefónica Data, Telefónica Internacional, Telefónica de Argentina, Telesp, Telefónica Chile, Telefónica de Perú, Cointel, Compañía de Teléfonos de Chile Transmisiones Regionales, Telefónica Larga Distancia de Puerto Rico, China Netcom, and the Supervisory Board of Cesky Telecom. Mr. Álvarez-Pallete holds a graduate degree in economics from the Complutense University of Madrid. He also studied economics at the Université Libre de Belgique.

Manuel Alvarez Trongé, 50, became a Series A alternate director in April 2006. He also serves as Secretary of the Board of Telefónica Internacional S.A. in Spain. He worked as a lawyer at the Superintendencia de Seguros de la Nación (the National Superintendent of Insurance) and served as Counsel of the Ministry of Justice of Peru and a Legal Manager of Perez Companc S.A. He has also been a professor at Austral, Saint Andrews and Buenos Aires Universities. He holds a law degree from Universidad de Buenos Aires.

Luis Cid Alonso, 58, became an alternate Series B director in May 1995, a Series B director in December 1998 and a Series A Alternate director in February 2005. He is the Chairman of IEDE, UEA, OTIC and Past President of Cámara Oficial Española de Comercio de Chile. He is a member of the following Boards of Directors: Aenor Chile, Fundación Eurochile, Cogan, Grupo Norte (Chile) and Rutas del Pacífico.

Benjamin Holmes Bierwirth, 58, became an alternate Series A director in April 2005. He is a member of the Board of Zofri S.A., La Fuente Editores and Laboratorio City. He is also the Chairman of Sociedad de Inversiones y Asesorías Frutillar and founding partner of Portal del Arte S.A. He holds a commercial engineering degree from the Universidad de Chile.

Carlos Díaz Vergara, 44, became an alternate Series A director on April 15, 2004. He is a member of the Risk Rating Commission for securities that can be purchased by pension funds. Currently, he holds the positions of Dean and Professor at the School of Business and Economics at the Universidad de los Andes and Professor in the Department of Economics at the Universidad Católica de Chile. He holds a commercial engineering degree from the

Universidad Católica de Chile, and has a master s degree in economics from the University of California, Los Angeles.

Alfonso Ferrari Herrero, 65, became an alternate Series B director on April 26, 2001. He is a director of Telefónica S.A. (Spain), Telefónica Internacional S.A. and Telefónica de Perú S.A.A., the Chairman of the Commission of Appointments and Payments of Telefónica de S.A., and President of the Audit Committee of Telefónica de Perú S.A.A. He holds a Ph.D. in electrical engineering from the Madrid University s Politechnical School and a master s degree in business administration from Harvard University.

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There is one vacant alternate Series A director position as a result of Mr. Manoel Amorim s resignation on November 22, 2006.

Executive Officers

José Molés Valenzuela, 51, has been CEO of Telefónica Chile since September 1, 2005 and was appointed General Director of Telefónica Móviles México in 2003. Between 2000 and 2003 he was General Director of Telefónica Móviles operations in Argentina, Brazil and Chile. He holds a degree in electronic engineering from UNED in Spain, and an MBA from Universidad de Salvador, Argentina (recognized by Deusto, Spain) as well as a diploma in marketing from UADE, Buenos Aires, Argentina.

Cristián Aninat Salas, 52, the Secretary of the Board of Directors since 1997 and the current General Counsel of Telefónica Chile, joined the Company in 1994. He holds a law degree from the Universidad Católica de Chile.

Julio Covarrubias Fernández, 49*,* the Chief Financial Officer of Telefónica Chile and General Manager of t-gestiona, joined Telefónica Chile in May 1995. He holds an industrial civil engineering degree from the Universidad Católica de Chile and a master s degree in business administration from Cornell University.

Manuel Plaza Martin, 51, Vice President of Technology and Operations, joined Telefónica Chile in January 2006. He held the same executive position in Telefónica del Perú since January 2005. He holds a technical industrial engineering degree from Universidad de Valladolid de Madrid.

César Valdés Morales, 42, Vice President of Commercial and Administrative Services, joined Telefónica Chile in 1991. He has held executive positions at both the Company, in the Systems Development area, and within Telefónica Latin America, in Global Project Development and IT Services and Development. He holds a degree in industrial civil engineering from the Universidad Católica de Chile, as well as postgraduate degrees in company and IT management.

Luis Fernando de Godoy, 43, Vice President of Small and Medium Business and Professionals, joined Telefónica Chile in 2004. From 2001 to 2004 he worked as Business Director in Telefónica Brazil. He holds a marketing degree in Escola Superior de Propaganda e Marketing (ESPM) and a master s degree in business administration in Fundacão Getulio Vargas. (CEAG-FGV).

Juan Antonio Etcheverry, 40, Vice President of Residential Customers, joined Telefónica Chile in January 2007. He holds a degree in industrial civil engineering from the Universidad de Chile.

Francisco Javier de Miguel del Val, 39, Vice President of Internal Auditing, joined Telefónica Chile in February 2007. Prior to joining the Company, he held positions as head of financial management and manager of internal auditing for Telefónica Spain. He holds a degree in law from the Universidad Autónoma de Madrid, a master s degree in taxation from the Centro de Estudios Financieros and a master s degree in real estate law and legal practice from the Universidad Complutense de Madrid, Spain.

Rubén Sepúlveda Miranda, 41, the Vice President of Human Resources, joined the Company in June 2006. He holds a degree in commercial engineering and a master s degree in human resources management from the Universidad de Santiago de Chile, as well as a diploma in strategic human resources management from the Universidad Adolfo Ibañez.

Diego Martínez-Caro, 36*,* Vice President of Management Control and Chief Accounting Officer, joined Telefónica Chile in 2004. He held the same executive position in Telefónica del Perú since 2001. He holds a Degree in Economics from Universidad Complutense de Madrid and a master s degree in business administration from IESE -

Navarra University.

Humberto Soto Velasco, 48, the Vice President of Regulation and Wholesalers, joined Telefónica Chile in July 2002. He holds an electrical civil engineering degree from the Universidad de Chile.

Rafael Zamora Sanhueza, 41, the Vice President of Telefónica Empresas, joined Telefónica Chile in 1991. His experience at the Company includes head positions in the control and planning area, as well as the residential customers area. He holds a degree in civil industrial engineering and a master s degree in industrial engineering from the Universidad de Chile.

B. Compensation of Directors and Officers

Each director and alternate director, with the exception of the Chairman of the Board and the Deputy Chairman of the Board, receives compensation equal to 120 UTMs (US$7,259 as of December 31, 2006) per month for attending Board meetings and for expenses, provided he has attended at least one Board meeting in the month.

The Chairman of the Board of Directors receives twice the compensation received by other directors. The Deputy Chairman of the Board of Directors receives 1.5 times the compensation received by other directors.

The compensation for Board members and their alternate directors is decided at the General Annual Shareholders Meeting. For the year ended December 31, 2006, the compensation paid to directors and executive officers of the Company was as follows:

		In Thousands of Ch $	
Name	Position	Compensation 2006	Other Compensation 2006 (*)
Emilio Gilolmo López[1]	Chairman and Director Series A Common Stock	61,625	
Narcís Serra Serra[2]	Deputy Chairman and Director Series A Common Stock	69,333	
Andrés Concha Rodriguez	Director Series A Common Stock	34,698	1,650
Fernando Bustamante Huerta	Director Series A Common Stock	46,230	
Patricio Rojas Ramos[4]	Director Series A Common Stock	46,253	
Hernán Cheyre Valenzuela[3]	Director Series A Common Stock	46,253	1,650
Marco Colodro Hadjes[4]	Director Series B Common Stock	46,253	
José María Alvarez-Pallete[1]	Alternate Director Series A Common Stock	38,578	
Manuel Alvarez Tronge	Alternate Director Series A Common Stock	23,119	
Luis Cid Alonso	Alternate Director Series A Common Stock	46,253	
Benjamín Holmes Bierwirth[4]	Alternate Director Series A Common Stock	46,253	
Carlos Díaz Vergara[3]	Alternate Director Series A Common Stock	46,253	
Alfonso Ferrari Herrero	Alternate Director Series B Common Stock	46,222	551
Bruno Philippi Irarrázabal[1]		30,882	
Juan Carlos Ros Brugueras[1]		15,371	

Guillermo Ansaldo Lutz [(1)] [(4)]	17,219	
Manoel Luiz Ferrao de Amorin[(5)]	11,511	
Sub-Total (Directors)	**672,306**	**3,851**
Executives 70 persons	6,463,376	
Total	**7,135,682**	**3,851**

(*) Others refers to compensation paid to the Audit Committee (created in July 2005). The Audit Committee is responsible for matters such as External Auditing, Financial Statements and Internal Auditing.

(1) On April 27, 2006, the Board of Directors of Telefónica Chile approved various changes in its makeup. It accepted the resignations tendered by Series A director and Chairman of the Board Mr. Bruno Philippi and Series A alternate Mr. José María Alvarez-Pallete. Mr. Emilio Gilolmo López was appointed Series A director and Chairman of the Board, and Mr.

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José María Alvarez-Pallete was appointed as Mr. Gilolmo s alternate. On the same date, Series A alternate directors Messrs. Juan Carlos Ros and Guillermo Ansaldo resigned and were replaced, respectively, by Messrs. Manuel Alvarez Trongé and Manoel Amorín.

(2) Appointed as Deputy Chairman on July 20, 2004.

(3) Director since April 15, 2004, elected at the General Shareholders Meeting.

(4) Director since April 14, 2005, elected at the General Shareholders Meeting.

(5) Resigned on November 22, 2006.

As of April 2001, it was resolved at the shareholders meetings for each of the Company s significant subsidiaries (*i.e.*, subsidiaries in which the Company had more than a 50% stake) to eliminate directors fees. Consequently, during 2006, no fees were paid to directors of subsidiaries. In the case of each subsidiary, the decision to eliminate directors fees was adopted by the board of directors and approved by its shareholders.

The Company does not compensate directors by other means such as through bonuses, profit-sharing plans, stock option plans, or pension, retirement or similar benefits.

C. Board Practices

The Company s directors are elected for a three-year term at the General Annual Shareholders Meeting. The current Board of Directors was elected at the General Annual Shareholders Meeting held on April 14, 2005. Due to the appointment of a new Chairman of the Board in April 2006, the entire Board must be renewed at the 2007 General Shareholders Meeting. The Company has no service contracts with its directors.

Directors Committee

According to Law 19,705, effective as of December 20, 2000, all limited liability public companies with a market capitalization greater than UF1,500,000 (equivalent to approximately US$51.7 million as of December 31, 2006) must appoint a directors committee composed of three directors, the majority of whom must be independent from the controlling shareholder.

The Company s current directors committee (the Directors Committee) was created by the Company s Board on April 14, 2005. The budget for this committee and the monthly compensation of the committee members and alternate committee members for the year 2006 were approved at the General Annual Shareholders Meeting of the Company held on April 20, 2006.

The main functions of the Directors Committee are (i) to review the account inspectors report and the external auditors report, (ii) to propose external auditors and local credit-rating agencies to the Company s Board of Directors, (iii) to examine all applicable transactions involving directors and related parties under Articles 44 and 89 of the Chilean Corporations law and (iv) to review the salaries and bonuses of the Company s senior executives. In addition, Telefónica Chile s Directors Committee examines all transactions involving the Company s CEO and other senior executive officers. The Directors Committee examines, proposes and makes recommendations to the Board of Directors that are not binding upon the Board.

During 2006, the Directors Committee held monthly meetings to review the matters entrusted to it as is stipulated in the corresponding Committee acts. Additionally, the Committee approved the quarterly financial statements submitted to it by management.

Each member and alternate member of the Directors Committee receives compensation equal to UF30 (approximately US$1,033) per month for attending Directors Committee meetings, provided that he has attended at least one Directors Committee meeting in such month. The annual budget of the Directors Committee amounts to Ch$75 million (approximately US$140,874).

As of April 14, 2005, the Directors Committee comprises the following persons:

Regular Member	Alternate Member
Emilio Gilolmo López[1]	José María Alvarez-Pallete

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Patricio Rojas Ramos	Benjamín Holmes Bierwirth
Hernán Cheyre Valenzuela	Carlos Díaz Vergara

(1) Effective April 27, 2006, Mr. Bruno Philippi resigned. The Board of Directors named Mr. Emilio Gilolmo as his replacement.

For the year ended December 31, 2006, the following table lists the members of and the compensation paid to the Directors Committee:

Directors	Position	Total Compensation (in thousands of constant Ch$ as of December 31, 2006)
Emilio Gilolmo López[(1)]	Director Series A Common Stock	3,848
Patricio Rojas Ramos[(2)]	Director Series A Common Stock	6,598
Hernán Cheyre Ramos[(3)]	Director Series A Common Stock	6,598
José María Alvarez-Pallete	Alternate Director Series A Common Stock	0
Benjamín Holmes Bierwirth[(2)]	Alternate Director Series A Common Stock	6,598
Carlos Díaz Vergara[(3)]	Alternate Director Series A Common Stock	6,598
Bruno Philippi Irarrázabal[(1)]		2,202
Total		**32,443**

(1) Effective April 27, 2006, Mr. Bruno Philippi resigned. The Board of Directors named Mr. Emilio Gilolmo as his replacement.

(2) Position held since April 14, 2005.

(3) Position held since April 15, 2004.

Audit Committee

On July 21, 2005, an Audit Committee was created with a total of three independent members, in compliance with Rule 10A-3 of the Securities and Exchange Commission under the Sarbanes-Oxley Act. The Board of Directors named Mr. Andrés Concha, Mr. Alfonso Ferrari and Mr. Hernán Cheyre as audit committee members, with Mr. Cheyre serving as financial expert.

The audit committee supervises the process of financial reporting, internal control systems over financial reporting and general oversight of the external auditors, as well as dealing with any related complaints.

At the General Shareholders Meeting held on April 20, 2006, compensation for audit committee members was set at UF15 per session, with a maximum of six sessions per year. A detail of compensations paid in 2006 can be found under Compensation of Directors and Officers. The expense budget for the audit committee was set at Ch$37 million (approximately US$69,000) for the year 2006.

For further information please see Significant Differences in Corporate Governance Practices from U.S. Companies below.

Significant Differences in Corporate Governance Practices from U.S. Companies

The following is a comparison of corporate governance practices followed by U.S. companies listed with the NYSE and our practices:

According to the NYSE, listed U.S. companies must have a majority of independent directors who must meet at regularly scheduled executive sessions without management. According to Chilean law, our directors cannot serve as executives, accountants, auditors or CEO of the Company, though they need not be otherwise independent as defined by the NYSE. Our directors may meet individually or collectively with those they deem necessary to inform themselves and to make decisions regarding the Company. See Item 6. Directors, Senior Management and Employees for a list of our board members.

According to the NYSE, listed U.S. companies must adopt corporate guidelines that govern directors responsibilities, qualifications, compensation and education, management succession and an annual performance evaluation of the board. Chilean law, which we follow, dictates the composition, duration, duties and responsibilities of board members, as well as sanctions for non-compliance of these. Chilean law also requires that, at each Annual Shareholders Meeting, board remuneration must be approved, which we did on April 14, 2005. See Item 6. Directors, Senior Management and Employees Compensation of Directors and Officers.

According to the NYSE, listed U.S. companies must have an internal audit function to provide management with ongoing assessments of the company s risk management process and the system of internal controls. Although there is no local law requirement to do so, the Company does have an internal audit department that conducts the assessment.

According to the NYSE, listed U.S. companies, beginning the earlier of the first annual shareholders meeting after January 15, 2004 and October 31, 2004, must have an audit committee consisting of a minimum of three independent Board members who are financially literate and at least one who is a designated financial expert, while foreign companies, such as Telefónica Chile, have to meet this requirement starting on July 31, 2005. Listed U.S. companies must also have compensation and nominating and corporate governance committees composed entirely of independent directors. Chilean law does not require these committees. However, Chilean Law does require open stock companies with a market capitalization above UF1.5 million (approximately US$532 million) to have a Directors Committee, made up of three board members that are independent, as defined by Chilean law below, of the controlling shareholders and whose remuneration is determined by shareholders at the Annual Shareholders Meeting, to perform the following functions:

a) review and approve reports from account inspectors and external auditors, as well as the Company s balance sheet and financial statements;

b) propose external auditors and rating agencies to the board;

c) review and inform the board of related party transactions;

d) review compensation and compensation plans for company executives; and

e) any other matters stipulated according to company bylaws, board, or shareholders meeting decisions.

Chilean law states that a director is independent when, excluding the votes from the controlling shareholder and their related parties, the director would have been elected. Accordingly, a director that is independent under Chilean law may not be independent under the NYSE s corporate governance rules or under the SEC s audit committee independence rules. The Company s Directors Committee consists of three board members and their respective alternates, two of which are independent of the controlling shareholder, as defined by Chilean law. Chilean law has no requirement for members to be financial experts.

According to the NYSE, listed U.S. companies CEOs must certify to the NYSE each year that they are not aware of any violation by the company of NYSE corporate governance listing standards. According to Chilean law, there is no such requirement, and this provision of the NYSE does not apply to foreign private issuers, such as Telefónica Chile. However, according to the NYSE, all foreign private issuers, including Telefónica Chile, must report to the NYSE when they become aware of a violation of the corporate governance listing standards and must provide an annual written affirmation to the NYSE of its compliance with the applicable NYSE audit committee rules and disclosure of significant differences with NYSE corporate governance rules applicable to domestic companies.

D. Employees

As of December 31, 2006, Telefónica Chile (excluding its subsidiaries) employed 2,962 persons. Telefónica Chile s subsidiaries employed 698 persons as of December 31, 2006.

The table below sets forth the total number of employees as of December 31 of each year indicated, and the change from December 31 of the preceding year.

Year	Number of Employees	% Change
2004	3,774	-20.0%
2005	3,910	+3.6%
2006	3,660	-6.4%

The table below sets forth the breakdown of the Company s employees as of December 31 of each year indicated, and the change from December 31 of the preceding year.

Company	Number of Employees			% Change Between 2006 and 2005
	2004	2005	2006	
Parent Company	2,817	2,945	2,962	+0.6%
Long-Distance	149	143	29	-79.7%
Corporate Customer Communications	417	417	412	-1.2%
Others	391	405	257	-36.5%
Total	**3,774**	**3,910**	**3,660**	-6.4%

The 6.4% decrease in the parent company with respect to 2005 is due primarily to the implementation of a retirement plan in early 2006 and the ongoing pursuit of organizational efficiencies in the various areas of the Company.

In 2004, a new collective bargaining agreement was finalized with Federación Zonas (unions from regions), an umbrella organization grouping seven unions and representing 247 employees. This agreement maintained the changes that had already been introduced for other unions. Thus, over 97% of workers are currently subject to more flexible conditions allowing the Company to better adapt to customer needs, not only in scheduling, but also in compensation and incentives.

In 2005, 61.7% of the employees (2,431 persons) were members of 22 unions. During 2005, four unions negotiated contracts with the Company representing 286 employees. Only 74 employees elected to invoke Article 369 of the Chilean Labor Code and freeze the conditions of the previous labor contract for a period of 18 months starting in July 2005.

In 2006, eight collective bargaining agreements were finalized with 21 unions representing 2,141 Company employees. As of December 2006, 61% of Company employees were unionized, and 100% of these employees had signed a contract for a period of three to four years. The most relevant change introduced in these collective bargaining agreements was the inclusion of variable compensation linked directly to business targets. During this process, certain union organizations decided to discontinue application of Article 369 after having applied it since 2002. This article allowed unionized employees to freeze the conditions of their contracts until the next collective bargaining process.

As of December 31, 2006, the Company s severance indemnity provisions reached Ch$35,988 million (US$67.6 million). In the beginning of 2006, the Company carried out a structural reorganization. As a result, 589 employees were laid off and Ch$9,471 million was recognized in severance indemnities during the year. Under the law enacted in November 1980 that privatized the Chilean social security system, the Company is required to deduct from employees monthly wages a contribution to a personal pension fund owned by each employee, managed by Administradoras de Fondos de Pensiones or AFPs (Chilean Pension Funds), individually selected by the employee. Compulsory contribution, which currently amounts to approximately 13% of monthly taxable income (MTI) (up to a maximum MTI of UF60, equivalent to approximately US$2,066.5 per month), includes the costs of life insurance and disability insurance coverage. The Company s statutory social security obligation is fully satisfied by the deduction and delivery to the corresponding AFP of such monthly contributions on behalf of the respective employees.

Additionally, Chilean employees contribute 7% of their MTI (up to a maximum MTI of UF60, equivalent to approximately US$2,066.5 per month), to an ISAPRE (Chilean Health Insurance System) individually selected by the employee.

E. Share Ownership

As of March 31, 2007, 4,200 shares of Series A Common Stock and 3 shares of Series B Common Stock were owned by the persons listed in Item 6.A as directors and officers, including those who held their positions as of December 31, 2006 and who are no longer officers or members of Telefónica Chile s Board of Directors. None of these persons owns more than 1% of any class of the Company s outstanding shares. In addition, the persons listed in Item 6.A as directors and officers, including those directors who held their positions as of December 31, 2006 and who are no longer officers or members of Telefónica Chile s Board of Directors, own 56 shares of Telefónica Larga Distancia S.A.

As of March 31, 2007, 124 non-executive employees of the Company owned 339,528 shares of Series A Common Stock and 40 non-executive employees of the Company owned 124,831 shares of Series B Common Stock, collectively representing 0.05% of the Company s outstanding shares. There are no plans for employees to purchase stock options.

ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

A. Major Shareholders

The following table sets forth certain information, on a subscribed share basis, as of March 31, 2007, with respect to each shareholder known to the Company to own beneficially 5% or more of any class of the Company s shares of common stock and all directors and executive officers of the Company as a group:

Name and Address of Beneficial Owner	Series of Common Stock	Number of Shares Beneficially Owned	% of Series	% of Total
Telefónica Internacional Chile	A	387,993,524	44.39	40.5
Avenida Santa María 0792, 4 Piso	B	41,739,487	50.19	4.4
Santiago, Chile				
Citibank, N.A., as depositary(1) (73 registered holders)	A	116,158,091	13.29	12.4
111 Wall Street				
New York, NY 10043, USA				
AFP Habitat S.A	A	61,152,400	6.99	6.4
Avenida Providencia 1909	B	5,813,466	6.99	0.6
Santiago, Chile				
AFP Provida S.A	A	61,079,380	6.89	6.4
Avenida Pedro de Valdivia 100	B	4,626,981	5.56	0.5
Santiago, Chile				
All directors and executive officers, as a group (4 persons)	A	4,200	(2)	(2)
	B	3	(2)	(2)

(1) Pursuant to the requirements of Chilean law, all shares of Series A Common Stock represented by ADSs are registered to Citibank, N.A., as depositary (the Depositary).

(2) Represents less than 1%.

The following table provides information, as of March 31, 2007, with respect to the shares owned by the persons listed in Item 6.A as directors and officers, as well as those who held their positions as of December 31, 2006 and who are no longer officers or members of Telefónica Chile s Board of Directors:

Name	Number of Series A Shares	Number of Series B Shares	Total
Marco Colodro Hadjes		2	2
Franco Faccilongo Forno (1)	2,100	0	2,100

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Name	Number of Series A Shares	Number of Series B Shares	Total
Alfonso Ferrari Herrero		1	1
Rafael Zamora Sanhueza	2,100	0	2,100

(1) Resigned effective January 12, 2007.

The table below sets forth certain information, as of December 31, 2006, with respect to the twelve largest shareholders of Series A and B Common Stock:

	Number of Series A Shares	Number of Series B Shares	Total	% of Total
Telefónica Internacional Chile S.A	387,993,524	41,739,487	429,733,011	44.9%
Citibank N.A. (1)	105,307,375	0	105,307,375	11.0%
AFP Provida S.A. (2)	61,179,123	5,819,981	66,999,104	7.0%
AFP Habitat S.A. (2)	61,152,400	5,813,466	66,965,866	7.0%
AFP Cuprum S.A. (2)	38,061,323	3,859,418	41,920,741	4.4%
AFP Bansander S.A. (2)	31,656,237	2,295,763	33,952,000	3.5%
Citibank Chile Cta. De Terceros Cap. XIV Res	33,756,939	0	33,756,939	3.5%
AFP Santa María S.A	24,379,690	2,238,363	26,618,053	2.8%
Celfin Capital S.A. Corredores de Bolsa	9,773,121	519,693	10,292,814	1.1%
AFP Planvital S.A	8,937,995	627,281	9,565,276	1.0%
Banchile Corredores de Bolsa S.A	8,120,696	643,385	8,764,081	0.9%
Ultra Fondo de Inversiën	8,048,354	0	8,048,354	0.8%
Subtotal	778,366,777	63,556,837	841,923,614	88.0%
Other Shareholders	95,628,670	19,604,801	115,233,471	12.0%
Total	873,995,447	83,161,638	957,157,085	100.0%

(1) Depositary Bank acting on behalf of the Company s ADS holders.

(2) Pension fund.

In July 2004, Telefónica Internacional increased the percentage of ownership from 43.6% to 44.9% .

As of December 31, 2004, 2005 and 2006, Citibank, N.A., as Depositary for the Company s American Depositary Receipts (ADRs), owned approximately 11.64%, 11.51%, and 11.00% of the Company s shares, respectively. AFP Habitat, a Chilean pension fund, owned approximately 6.99%, 7.00%, and 7.00% as of December 31, 2004, 2005 and 2006, respectively. AFP Provida, a Chilean pension fund, owned approximately 6.59%, 6.75%, and 7.00% as of December 31, 2004, 2005 and 2006, respectively. During the year ended December 31, 2006, life insurance companies decreased their investment in the Company to 0.6%, from 1.4% in December 2005, whereas general insurance companies increased their investment to 0.7%, from 0.01% in December 2005.

As of March 31, 2007, ADR holders (through the Depositary) held 12.14% of Telefónica Chile s total shares, represented by 63 registered shareholders. The remaining 87.86% of the Company s total shares were held locally, in Chile, represented by 12,462 shareholders. All of the Company s shareholders have identical voting rights. The Company s Series A Shareholders vote to elect six of the seven members of the board of directors and the Series B shareholders elect one member to the board of directors.

Controlling Shareholder

Telefónica Internacional Chile owns 44.9% of all shares of the Company. Telefónica Internacional Chile is a 99.9% owned subsidiary of Telefónica Chile Holding B.V., which is indirectly wholly owned by Telefónica S.A., through its subsidiary TISA.

B. Related Party Transactions

Article 89 of the Chilean Corporations Law requires that a company s transactions with related parties (defined as entities that belong to the same group of companies) be on similar terms to those customarily prevailing in the market. Directors and executive officers of companies that violate Article 89 are liable for losses or damages resulting from such violations. In addition, Article 44 of the Chilean Corporations Law provides that any transaction in which a director has a personal interest or is acting on behalf of a third party may be approved in advance by the board of directors only if the board of directors is informed of such director s interest and if the terms of such transaction are similar to those prevailing in the market. If a transaction involves an amount greater than UF20,000 (approximately US$688,833), the board of directors must be presented with a report as to whether the terms of the proposed transaction are comparable to those prevailing in the market before such transaction takes effect. If it is impossible for the board of directors to determine the prevailing market terms, the board can appoint two independent appraisers and make a decision regarding the transaction in question only after the reports of both appraisers are received. If the opinions of two independent appraisers significantly differ, or if the terms and conditions of the action or contract in question are unfavorable to the shareholders of the Company, shareholders representing at least five percent of the issued voting stock may request that the board of directors summon a special meeting of shareholders to approve such transaction. Two-thirds of the issued voting stock must approve the transaction at such meeting. Resolutions approving such transactions must be reported to the Company s shareholders at the next shareholders meeting. Violation of Article 44 may result in imposition of administrative or criminal sanctions upon responsible parties, and the Company, its shareholders, or interested third parties who suffer losses as a result of such violation have the right to receive compensation in certain situations.

In accordance with Section 402 of the Sarbanes-Oxley Act of 2002, since July 2002, the Company has not and will not extend any loans to directors and officers. As of December 31, 2006, the Company does not have any outstanding loans to its directors or executive officers.

In the ordinary course of its business, the Company engages in a variety of transactions with certain of its affiliates, primarily for the purchase, at fair market prices negotiated on an arm s-length basis, of goods or services that may also be provided by other suppliers. The Directors Committee is informed of all such transactions in advance, and such transactions are approved by the Board of Directors. See Item 6. Directors, Senior Management and Employees Directors Committee. Below are descriptions of such transactions with affiliates that are material to either the Company or the related counterparty. Financial information concerning these transactions is also set forth in Note 6 to the Audited Consolidated Financial Statements. As of December 31, 2006, the receivables from related parties amounted to Ch$17,421 million (US$32.7 million) and the accounts payable to related parties amounted to Ch$33,007 million (US$62 million). The income and expenses from related party transactions resulted in a net expense of Ch$49,604 million (US$93 million).

Transactions with Telefónica España

Since June 30, 1992, the Company, through its subsidiary Telefónica Larga Distancia, has had a correspondence agreement with Telefónica providing for the exchange of international long-distance traffic between Chile and Spain. This agreement, which has an indefinite term subject to cancellation by either party on six months notice, generated income of Ch$200 million, Ch$657 million and Ch$438 million for the years ended December 31, 2004, 2005 and 2006, respectively. The outstanding balances under the agreement in favor of the Company, as of December 31, 2005 and 2006, were Ch$819 million and Ch$702 million (US$1.3 million), respectively. There were balances payable by the Company amounting to Ch$35 million (ThUS$66) as of December 31, 2006. There were no outstanding balances payable by the Company as of December 31, 2005.

Transactions with Telefónica Internacional Chile

In 1997, the Company entered into an agreement of technical service with Telefónica Internacional Chile (TISA) through which Telefónica Internacional Chile coordinates certain joint activities among the members of the Telefónica Group on behalf of the Company. Under the agreement, the Company incurred expenses of Ch$574 million in 2004, Ch$583 million in 2005 and Ch$581 million (US$1.1 million) in 2006. There were no outstanding balances in favor of the Company as of December 31, 2005 and 2006. There were balances payable at December 31, 2005 and 2006 amounting to Ch$286 million and Ch$286 million (US$0.5 million), respectively.

On December 20, 1996, the Company entered into a current account agreement with Telefónica Internacional Chile, which provides for transfer of funds between the two parties. This short-term loan was fully paid in July 2004. These transactions with Telefónica Internacional Chile generated expenses of Ch$275 million in 2004. There were no income or expenses generated in the years 2005 and 2006. There was no interest payable for 2005 and 2006. There were no outstanding balances in favor of Telefónica Chile as of December 31, 2005 and 2006.

Transactions with Terra Networks Chile S.A.

On April 30, 1998, the Company entered into an agreement with Terra Networks Chile S.A. (Terra Networks Chile) a subsidiary of Telefónica S.A., pursuant to which the Company provided collection services to Terra Networks Chile. Furthermore, on June 1, 1999, the Company entered into an agreement with Terra Networks Chile pursuant to which Terra Networks Chile provides internet access to certain Chilean schools, the costs of which are to be paid by the Company to Terra Networks Chile. Telefónica Chile also has an agreement to purchase online advertising from Terra Networks Chile for itself and its subsidiaries for the five years between 1999 and 2004. This contract was renewed and expires in December 2005. The Company recorded a net income of Ch$3,689 million, Ch$4,394 million and Ch$5,413 million (US$10.2 million) in the years 2004, 2005 and 2006, respectively, under these agreements. The Company had balances receivable from Terra Networks Chile of Ch$1,137 million and Ch$1,894 million (US$3.6 million) as of December 31, 2005 and 2006, respectively. Balances payable to Terra Networks Chile from the Company under these agreements amounted to Ch$4,242 million and Ch$5,336 million (US$10.0 million) as of December 31, 2005 and 2006, respectively.

Transactions with Atento Chile

On September 1, 1999, the Company and Atento Chile, a 28.84% affiliate of the Company, signed an outsourcing agreement. The agreement comprises several contracts for services to be provided by Atento Chile to the Company s business units and customers. Such services include directory assistance, technical assistance and customer complaint management, as well as general commercial and sales information. These contracts were all in effect during 2006. Certain contracts expired on December 31, 2006, and the remaining contracts will expire on June 30, 2007. Similar agreements, involving all of the Company s subsidiaries, were also in effect during 2006. Pursuant to all of the agreements discussed above, the Company recorded total net expenses of Ch$16,861 million, Ch$14,032 million and Ch$15,870 million (US$29.8 million) in 2004, 2005 and 2006, respectively. The outstanding balances payable to Atento Chile were Ch$675 million and Ch$3,310 million (US$6.2 million) as of December 31, 2005 and 2006, respectively. The outstanding balances payable in favor of the Company as of December 31, 2005 and 2006 were Ch$419 million and Ch$478 million (US$0.9 million), respectively.

Transactions with Correspondents of Telefónica Group

In the year 2004, correspondent agreements were entered into with members of Telefónica Group. These members are Telefónica Argentina, Telefónica Sao Paulo, Telefónica Guatemala, Telefónica Perú, Telefónica Puerto Rico and Telefónica El Salvador. These agreements generated net income of Ch$250 million, Ch$166 million and Ch$259 million (US$0.5 million) for the years ended December 31, 2004, 2005 and 2006, respectively. The outstanding balances payable by the Company as of December 31, 2005 and 2006 were Ch$260 million and Ch$1,086 million (US$2.0 million), respectively. The outstanding balances in favor of the Company as of December 31, 2005 and 2006 were Ch$1,848 million and Ch$2,204 million (US$4.1 million), respectively.

Transaction with Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U..

During 2002, the Company sold to Telefónica Procesos de Tecnología de Información S.A. (TPTI), an affiliate of the Company, the ATIS license related to certain billing and customer care relationship applications that were developed by Telefónica Chile for the use of Telefónica Group for US$21.7 million (equivalent to Ch$11,553 million as of December 31, 2006). TPTI then granted Telefónica Chile a license to use these applications. Subsequently, in 2004, Telefónica Soluciones de Informática y Comunicaciones de España, S.A.U. (T.Soluciones) purchased TPTI s consulting, technology and systems business areas. As a result, the contract between the Company and TPTI was transferred to T.Soluciones. This agreement generated income of Ch$22 million (approximately US$41,000) for the year ended December 31, 2006, and it did not generate income or expenses for 2004 or 2005. There was an outstanding balances in favor of the Company of Ch$1,366 as of December 31, 2005, and there were no balances in favor of the Company as of December 31, 2006. There were no balances payable by the Company as of December 31, 2005 or 2006.

Transactions with Telefónica Móviles S.A.

In July 23, 2004, Telefónica Chile sold 100% of its participation in Telefónica Móvil de Chile S.A. to Telefónica Móviles S.A. (TEM). The final price of the sale totaled US$1.321 million, which included a US$1.058 million payment for Telefónica Móvil de Chile S.A. s outstanding equity, equivalent to Ch$736,325 million, and TEM s assumption of Ch$168,000 million (US$263 million) (historic value) of the existing debt of Telefónica Móvil de Chile S.A. with Telefónica Chile. For this transaction, the Company reported a net gain of Ch$321,071 million (Ch$303,540 historic value, equivalent to US$470.0 million) in 2004. There were no balances in favor or payable to us with respect to this transaction. All the amounts disclosed in this paragraph are historic values as of July 23, 2004.

Transactions with Telefónica Móviles de Chile S.A.

After the sale of Telefónica Móvil de Chile S.A., this company changed its name to Telefónica Móviles de Chile S.A. As of December 31, 2005 and 2006, respectively, the Company recognized a balance in favor of Ch$6,636 million and Ch$8,458 million (US$15.9 million), mainly related to access charges and rental of capacity. As of December 31, 2005 and 2006, respectively, the Company recognized a balance payable of Ch$14,979 million and Ch$14,592 million (US$27.4 million), mainly related to mobile interconnections (CPP). Transactions with Telefónica Móviles de Chile for the years ended December 31, 2004, 2005 and 2006 generated net expenses of Ch$12,265 million, Ch$29,095 and Ch$28,043 (US$52.7), respectively.

Transactions with Telefónica Móviles Chile Companies

As a result of long-distance contracts with Telefónica Móviles Chile Inversiones S.A., Telefónica Móviles Chile S.A. and Telefónica Móviles Chile Larga Distancia S.A., the Company recognized a total balance in favor of Ch$1,174 million and Ch$1,086 million (US$2.0 million) as of December 31, 2005 and 2006, respectively, and a total balance payable of Ch$4,531 million and Ch$2,530 (US$4.6 million). For the years ended December 31, 2005 and 2006, these contracts generated total net expenses of Ch$9,968 million and Ch$7,561 million (US$14.2 million), respectively. No income or expenses were generated in the year ended December 31, 2004.

Transactions with Telefónica International Wholesale Services Group

The Company has an agreement with companies belonging to the Telefónica Wholesale International Services (TIWS) Group, including Telefónica Wholesale International Services Chile (formerly Emergia Chile S.A.), Telefónica Wholesale International Services Spain and Telefónica Wholesale International Services Uruguay, for international data traffic services. The agreements with the TIWS companies were all effective during 2006 and have different expiration dates, depending on the nature of each specific contract. These agreements generated net expenses of Ch$1,537 million, Ch$2,800 million and Ch$3,850 million for the years ended December 31, 2004, 2005 and 2006, respectively. The outstanding balances under the agreement in favor of Telefónica Chile as of December 31, 2005 and 2006 were Ch$566 million and Ch$881 million (US$1.7 million), respectively. The Company had balances payable of Ch$912 million and Ch$5,108 million (US$9.6 million) in 2005 and 2006, respectively.

C. Interest of Experts and Counsels

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See Item 18 for a listing of the Company s Audited Consolidated Financial Statements, included in this Annual Report.

Legal Proceedings

Unless expressly stated otherwise in this section, the amounts of judgments and claims for damages, as stated in Chilean pesos, do not include readjustment for inflation, interest and costs, which may be required at final judgment. When a judgment or claim is stated in a readjusting unit of currency, such as the UF, no further inflation readjustment is required.

Claims presented by VTR Telefónica S.A.

On June 30, 2000, VTR Telefónica S.A. filed a plenary suit, charged in Chilean pesos, requesting payment of Ch$2,204 million (US$4.1 million), plus sums accrued during the suit, to cover access charges for the use of its networks. VTR bases its complaint on the differences that occurred as a result of the reduction of access charge tariffs after Tariff Decree No. 187 came into effect. Telefónica Chile responded to the complaint by arguing that the tariffs for access charges that both parties must pay for the reciprocal use of their networks are regulated under a contract signed between Telefónica Chile and VTR. VTR, however, does not recognize this contract. VTR s complaint has been accepted and their requested compensation has been ordered. The Company filed an appeal for annulment before the Court of Appeals of Santiago, which is currently pending.

In connection to the above proceeding, two additional judicial proceedings are underway. The first was filed before Subtel in 2002 by VTR for alleged non-payment of invoices for access charges set by D.S. 26. VTR has requested that Telefónica Chile be forced to pay such invoices and pay the fines imposed by the General Telecommunications Laws. This case has been suspended by order of the Minister until a sentence is provided in the judicial proceeding filed by VTR in 2000. The second judicial proceeding underway was filed by Telefónica Chile on June 6, 2003, for VTR s non-payment of access charges in accordance with the contract signed between the parties. This case has been suspended until a sentence is provided in the 2002 suit.

In turn, on December 21, 2005 Telefónica Chile sued VTR for non-payment of automatic reversal of charges service (800 service) in the amount of Ch$1,500 million (US$2.8 million), plus sums accrued during the course of the trial. Based on the same argument, VTR filed a countersuit for the same concepts in the amount of Ch$1,200 million (US$2.1 million). This judicial process is in the first stage of processing.

Labor lawsuits

In the course of normal operations, labor lawsuits have been filed against the Company.

To date, among others, there are labor proceedings involving former employees, who claim wrongful dismissal. These employees did not sign termination releases or receive staff severance indemnities. On various occasions, the Supreme Court has reviewed the judgments handed down on the matter, accepting the argument of the Company and ratifying the validity of the terminations.

There are, in addition, other lawsuits involving former employees, whose staff severance indemnities have been paid and their termination releases signed, and who, in spite of having chosen voluntary retirement plans or having been terminated due to company needs, intend to have the terminations voided. Of these lawsuits, to date, two have received a judgment favorable to the Company, rejecting the annulments.

Certain unions have filed complaints before the Santiago Labor Courts, requesting damage payments for various concepts.

Lawsuits against the Government

(i) On October 31, 2001, Telefónica Chile filed an administrative motion before the Ministry of Transport and Telecommunications and the Ministry of Economy, requesting correction of the errors and illegalities in Rate Decree No. 187 of 1999. On January 29, 2002, the Ministries issued a joint response rejecting the administrative recourse, after having carefully evaluated, only the viability and timeliness of the petition made, considering the set of circumstances that concur in the problem stated and the prudence that must orient public actions , adding that such rejection has had no other motivation than to protect the general interest and progress of the telecommunications services .

Upon extinguishing the administrative instances to correct the errors and illegalities involved in the tariff setting process of 1999, in March 2002, Telefónica Chile filed a lawsuit for damages against the State of Chile for the sum of Ch$181,038,411,056, plus readjustments and interest, which covers past and future damages until May 2004. A decision is still pending in this case.

(ii) Telefónica Chile and Telefónica Larga Distancia filed a plenary damage indemnity lawsuit against the Government of Chile, claiming damages due to modification of telecommunications networks related to work performed by highway concessionaries from 1996 to 2000.

The Government of Chile forced both companies to pay for the transfer of their communications networks due to the construction of public works on concession under the Concessions Law. The related damages amount to:

a. Compañía de Telecomunicaciones de Chile S.A.: Ch$1,929,207,445

b. Telefónica Larga Distancia S.A.: Ch$2,865,208,840

The process is currently at the final sentencing stage.

Voissnet Accusation

On January 20, 2005, Telefónica Chile responded to a claim made by Voissnet filed before the National Economic Attorney General s Office based on alleged anti-competitive practices. Such practices were said to be with respect to the development and growth of Internet technology, mainly of broadband telephony, and access to broadband, since they prohibit carrying voice using the Internet broadband access provided by Telefónica Chile. Voissnet wants the TDLC to compel Telefónica Chile to allow third parties to provide IP Telephony through the ADSL Internet owned by Telefónica Chile.

On October 26, 2006, the Company was notified of the Antitrust Commission s decision, which, in part, accepted Voissnet S.A. s claim as well as the requirement of the National Economic Attorney General s Office. Telefónica Chile was fined 1,500 UTA.

On November 8, 2006, Telefónica Chile S.A. filed an appeal before the Supreme Court asking that the sentence be revoked and the Company be exonerated from any sanction. The appeal was accepted for processing and, at this time, the Supreme Court has not set a date to hear the allegations of the parties.

Manquehue Net

On June 24, 2003, Telefónica Chile filed a forced contract compliance with damage indemnity complaint against Manquehue Net in the amount of ThCh$3,647,689 in addition to the sums accrued during substantiation of the proceeding, before the mixed arbitration court of Mr. Víctor Vial del Río. Likewise, and on the same date, Manquehue Net filed a discounts compliance complaint (in the amount of UF107,000), in addition to an obligation to perform complaint (signing of 700 service contract). On June 5, 2004, following the evidence presentation stage, the arbitrator summoned the parties to hear sentencing.

On April 11, 2005, the Court notified the first instance sentence that accepted the complaint filed by Telefónica Chile, condemning Manquehue Net to pay approximately Ch$452 million and at the same time accepted the complaint filed by Manquehue Net condemning Telefónica Chile to pay UF47,600.

Telefónica Chile filed an appeal for annulment, which is currently pending before the Court of Appeals of Santiago.

Chilectra and CGE

In June 2006, Telefónica Chile filed complaints against Chilectra S.A. and Río Maipo (currently CGE Distribución) in which it requests a readjusted refund of the Reimbursable Financial Contributions (AFR) (Aportes Financieros Reembolsables) made by the Company between 1992 and 1998 in relation to the Electrical Law. The restitution amounts claimed are ThCh$899,658 and ThCh$117,350, respectively. The lawsuits are currently in the discussion stage.

Protection Motion

On June 28, 2006, the television channels UCTV and TVN filed a petition for protection against Telefónica Chile. These channels are included in the Company s Digital Television Plan. In their petition, they requested a court order prohibiting their inclusion in the Digital Television Plan. On June 30, 2006, the Court of Appeals declared the petition inadmissible. The decision was confirmed on July 4, 2006, when the motion to set aside was rejected.

Dividend Policy and Dividends

Dividend Policy

Telefónica Chile s dividend policy (including the policy set by the Board of Directors with respect to the payment of interim dividends for each year) is announced at the General Annual Shareholders Meetings of the Company. At such meetings, the Board of Directors presents for the shareholders consideration and approval its proposals for a final dividend for the preceding year.

The Company implements its dividend policy in compliance with Chilean law, pursuant to which the Company s Bylaws provide that the Company must distribute a cash dividend in an amount at least equal to 30% of its net income for the relevant year, unless otherwise decided by unanimous vote of the shareholders of the issued and subscribed shares.

On September 21, 2004, Telefónica Chile s Board of Directors amended the Company s dividend policy, increasing the distribution of dividends to 100% of annual profits, and approved the proposal to the shareholders of the distribution of accumulated retained earnings as of December 31, 2004. This policy has been maintained during 2005 and 2006.

The dividend policy for future years will be in line with the Company s Financial Plan, which focuses primarily on a gradual increase in the rate of self-financing, so as to adjust the financial structure of the Company to the requirements of the Development Plan. However, this dividend policy will depend on several factors, including the amount of net income generated each year, economic projections that may periodically be made, or certain other events that may affect the Company s ability to distribute dividends. The availability of funds will also determine the degree of compliance with the dividend policy. Telefónica Chile s Board of Directors plans to maintain a dividend policy keeping the Company s cash flow for the coming years and the projected performance of its financial indicators. Therefore, the 2007 dividend policy contemplates distributing 100% of net profits for each fiscal year through the payment of an interim dividend in November and a final dividend in May of the following year, subject to approval at the respective General Annual Shareholders Meeting.

At its meeting on February 26, 2007, the Company s Board of Directors voted to modify the dividend policy by adding the following: In addition to paying dividends equivalent to 100% of net income, for the following fiscal year, to the extent that there is a free cash flow and the Company s business-related obligations have been fulfilled, the Board s intention is to distribute a portion of this free cash flow to shareholders. This distribution will be proposed at a shareholders meeting to be called for this purpose.

Dividends

Dividends are paid to shareholders of record on the fifth business day (including Saturdays) prior to the payment date. The following table sets forth the amounts per share of annual dividends paid out of the Company s earnings in the years 2002 through 2006. These amounts represent, for each year, a sum of the interim dividends plus the final dividend paid with respect to such year. No dividends were paid in 2002 and 2003 (the dividend paid in July 2003 was charged against retained earnings).

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	Dividends Paid Per Share(1)		Total Dividends Paid Per Share(1)		Per ADS
Fiscal Year	Dividends against Net Income	Additional Dividends	Total (Ch$)(2)	Total (US$)(3)	Total (US$)(3)
2002	0.0	0.0	0.0	0.000	0.000
2003	0.0(4)	17.5(5)	17.5	0.029	0.116
2004	264.6(6)	394.3(7)	658.9	1.182	4.728
2005	69.8(8)	51.0(9)	120.8	0.236	0.943
2006	16.3(10)	42.0(11)	58.3	0.110	0.440

(1) Represents dividend amounts paid with respect to Series A and B Common Stock. Per share information does not take into account any Chilean withholding tax.

(2) Amounts shown are presented in Chilean historic pesos.

(3) Translated into U.S. dollars at the Observed Exchange Rates as of December 31 of the respective year. Per ADS information is based on four underlying shares of Series A Common Stock per one ADS and does not take into account any Chilean or U.S. withholding tax.

(4) As a result of a net loss sustained by the Company in year 2002, the Company did not distribute any dividends with respect to net income for the year 2002.

(5) Extraordinary dividend charged to retained earnings as of December 31, 2002.

(6) Includes a final dividend corresponding to the period 2003 for an amount of Ch$3.2 per share, and interim dividends of Ch$131.44 and Ch$130.00 per share charged against 2004 net income.

(7) Dividend charged to retained earnings as of December 31, 2003.

(8) Includes a final dividend of Ch$58.8 charged to net income as of December 31, 2004. It also includes an interim dividend of Ch$11 per share charged to 2005 net income.

(9) Dividend charged to retained earnings as of December 31, 2004.

(10) Includes a final dividend of Ch$15.31 per share charged to 2005 net income and an interim dividend of Ch$11.0 per share, charged to 2006 net income.

(11) At the extraordinary shareholders meeting held April 20, 2006, a capital reduction was approved in the amount of Ch$40.2 billion, equivalent to Ch$42 per share, and was paid on June 15, 2006.

The final dividend corresponding to 2006 net income will be submitted for shareholder approval at the Shareholders Meeting of April 2007. The total amount of the proposed dividend is Ch$12,866,433,152, equivalent to Ch$13.4 per share.

On July 11, 2003, the extraordinary shareholders meeting of Telefónica Chile approved the payment of an extraordinary dividend amounting to Ch$17.5 per share. The gross dividend amounted to Ch$70.0 per ADR and was paid in Chile on July 30, 2003 and paid to ADR holders by Citibank N.A. on August 1, 2003.

On May 7, 2004, a final dividend charged against net income of the period 2003 was paid for an amount of Ch$3.2 per share.

On July 15, 2004, as a result of the Telefónica Móvil de Chile S.A. sale, shareholders agreed to approve the dividend payment of US$800 million. The Board of Directors agreed to pay US$200 million of the dividend as an interim dividend for 2004 and shareholders approved a US$600 million dividend to be charged against retained earnings. Therefore, the distribution was an interim dividend of US$0.21 per share, charged against fiscal year 2004 profits and a dividend of US$0.63 per share, charged against accumulated retained earnings. These dividends were paid on August 31, 2004. See Item 4. Information On The Company Divestitures.

On November 4, 2004, in line with the dividend policy approved in September 2004, the Company distributed an interim gross dividend of Ch$130 per share or US$0.21 per share, charged against fiscal year 2004.

Dividends paid during 2004, as part of the Telefónica Móvil de Chile S.A. transaction and the new dividend policy, resulted in the distribution of 29% of the value of the stock.

On May 30, 2005, a final dividend charged against net income 2004 was paid for an amount of Ch$58.8 per share or US$0.10 per share. Also, on May 30, 2005, an interim dividend of Ch$51.0 per share or US$0.10 per share was paid and charged to 2004 retained income.

On November 30, 2005, an interim dividend of Ch$11 per share or US$0.01 per share was paid and charged to 2005 net income.

On June 22, 2006, a final dividend of Ch$15.31 per share or US$0.03 per share was paid and charged to 2005 net income.

On June 15, 2006, a capital reduction of Ch$42.0 per share or US$0.08 per share was paid to shareholders.

On November 23, 2006, an interim dividend of Ch$11.0 per share or US$0.02 per share was paid to shareholders and charged to 2006 net income.

At its meeting on February 26, 2007, the Company s Board of Directors agreed to propose a capital reduction of Ch$48,815,011,335 (Ch$51 per share) at the extraordinary shareholders meeting to be held on April 13, 2007.

Dividends received by the Company s shareholders that are not Chilean residents, including holders of ADSs, are subject to Chilean withholding tax. See Item 10. Additional Information Taxation Chilean Tax Considerations.

As a general requirement, shareholders who are not residents of Chile must register with the Central Bank to have dividends, sale proceeds, or other amounts with respect to their shares remitted outside of Chile through the formal currency market. Under the Foreign Investment Contract (as defined below in Item 10. Additional Information Exchange Controls and Other Limitations Affecting Security Holders), the Depositary has been granted access to the Formal Exchange Market to convert cash dividends from pesos to dollars and to pay such dollars to ADR holders outside of Chile.

B. Significant Changes

No undisclosed significant change has occurred since the date of the Audited Consolidated Annual Financial Statements.

ITEM 9. THE OFFER AND LISTING

A. Offer and Listing Details

Common Stock Prices and Related Matters

Shares of Series A Common Stock and Series B Common Stock are currently traded in Chile on the *Bolsa de Comercio de Santiago* (the Santiago Stock Exchange). Such shares are also listed on the *Bolsa de Corredores-Bolsa de Valores* (the Valparaíso Stock Exchange) and on the *Bolsa Electrónica de Chile-Bolsa de Valores* (the Electronic Stock Exchange). The Santiago Stock Exchange is Chile s principal exchange accounting for approximately 89% of all equity traded in Chile during 2006. Approximately 11% of equity trading in Chile during 2006 was conducted on the Electronic Stock Exchange, an electronic trading market that was created by banks and non-member brokerage houses, and less than 1% of equity was traded on the Valparaíso Stock Exchange.

Since July 20, 1990, shares of Series A Common Stock are traded in the United States on the New York Stock Exchange (the NYSE) in the form of ADSs, which are evidenced by ADRs. Originally, each ADS represented 17 shares of Series A Common Stock. Effective January 2, 1997, this ratio was changed to four shares of Series A Common Stock per ADS. Pursuant to the requirements of Chilean law, all shares of Series A Common Stock represented by ADSs are owned of record by Citibank, N.A., as Depositary.

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The table below sets forth, for the periods indicated, the reported high and low closing sales prices for the shares of the Company s Series A Common Stock and Series B Common Stock on the Santiago Stock Exchange and the high and low sales prices of the ADSs as reported by the NYSE.

	Santiago Stock Exchange				**NYSE**	
	(Ch$ per Share(1))				**(US$ per ADS(2))**	
	High		**Low**		**High**	**Low**
	Series A	**Series B**	**Series A**	**Series B**		
2002	2,620	1,855	1,450	1,100	15.75	7.90
2003	2,600	2,200	1,610	1,200	15.91	8.81
2004	2,390	2,150	1,450	1,240	16.83	9.40
2005	1,710	1,610	1,091	1,000	11.88	8.55
2006	1,264	1,080	860	779	9.70	6.40
2005						
First quarter	1,710	1,610	1,550	1,450	11.88	10.80
Second quarter	1,650	1,600	1,410	1,325	11.52	9.57
Third quarter	1,588	1,465	1,434	1,330	11.67	10.20
Fourth quarter	1,459	1,351	1,091	1,000	11.10	8.55
2006						
First quarter	1,264	1,060	1,055	1,000	9.70	8.02
Second quarter	1,195	1,080	910	900	9.18	6.47
Third quarter	995	861	860	779	7.53	6.40
Fourth quarter	1,082	990	935	845	8.28	6.94
October	1,020	900	935	845	7.59	6.94
November	1,082	990	975	875	8.15	7.53
December	1,075	951	1,050	935	8.28	7.97
2007						
First quarter	1,260	1,100	1,055	970	9.43	8.04
January	1,260	1,080	1,055	970	9.43	8.04
February	1,255	1,100	1,110	1,000	9.27	8.42
March	1,245	1,070	1,106	1,025	9.32	8.20

(1) Chilean pesos are reflected at historic values.

(2) 1 ADS = 4 shares of Series A Common Stock.

On April 30, 2006, there were 29,039,523 ADSs (equivalent to 116,158,091 shares of Series A Common Stock) outstanding, held by approximately 63 holders of record. On that date, such ADSs represented 12.14% of the total number of issued and outstanding shares of the Company s common stock.

Debt Securities

The Company s 7.625% Notes due July 15, 2006 and 8.375% Notes due January 1, 2006 (together, the Debt Securities) were traded primarily in the over-the-counter market. However, these Notes matured in 2006, and as of December 31, 2006, the Company does not have debt securities that trade in the over-the-counter market in the United

States.

B. Plan of Distribution

Not applicable.

C. Markets

See Item 9. A. The Offer and Listing Offer and Listing Details Common Stock Prices and Related Matters.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

B. Memorandum and Articles of Association

Set forth below is certain information concerning Telefónica Chile s capital stock and a brief summary of certain significant provisions of the Company s Bylaws and Chilean law. This description does not purport to be complete and is qualified by reference to the Bylaws, which have been attached as an exhibit to this Annual Report.

Organization and Register

Telefónica Chile is a publicly held stock corporation (*sociedad anónima abierta*) organized under the laws of Chile and was incorporated on November 18, 1930, as recorded on page 426 No. 158 of the Commercial Record of Santiago of the year 1931, and has a duration through August 10, 2068. The purpose of the Company is to provide a broad range of telecommunications and related broadcasting services, as more fully set forth in Article Four of the Bylaws.

Shareholders Rights

Shareholders rights in Chilean companies are governed generally by a company s bylaws (which effectively serve the purpose of both the articles, or certificate, of incorporation and the bylaws of a corporation in the United States). Additionally, the Chilean Corporations Law and the Supreme Decree 587 (the Regulations on Corporations) govern the operation of companies and provide for the upholding of shareholder rights. Finally, Decree-Law 3500, which regulates the pension funds, permits the investment by pension funds in stock of qualified companies, indirectly affects corporate governance and prescribes certain rights of shareholders.

The Chilean securities markets are principally regulated by the SVS (Chilean Security and Exchange Commission) under the Securities Market Law and the Corporations Law. These two laws contain disclosure requirements, impose restrictions on insider trading and price manipulation, and provide protection of minority investors. The Corporations Law clarifies rules and requirements for establishing open corporations while eliminating authority supervision of closed companies. Open corporations are those which: (i) have 500 or more shareholders, (ii) have 100 or more shareholders who own as a group together at least 10% of the subscribed capital (excluding those whose individual holdings exceed such percentage), or (iii) register in the securities record on a voluntary basis or in compliance with a legal requirement. Telefónica Chile is an open corporation. The Securities Market Law establishes requirements for public offerings, stock exchanges and brokers and outlines disclosure requirements for companies that issue publicly offered securities.

Under Articles 12 and 54 and Title XV of the Securities Market Law, certain information regarding transactions in shares of open corporations must be reported to the SVS and be informed to the Chilean exchanges on which such shares are listed. Holders of shares of open corporations are required to report the following to the SVS and the Chilean exchanges:

(i) any acquisition or sale of shares that results in the holder s acquiring or disposing of 10% or more of an open corporation s capital; and

(ii) any acquisition or sale of shares or options to buy or sell shares, in any amount, if made by a holder of 10% or more of an open corporation s capital or if made by a director, liquidator, main officer, general manager or manager of such corporation.

Persons or entities intending to acquire control of an open corporation are also required to inform the public in advance through a notice published in a Chilean newspaper. The notice must disclose the price and conditions of any negotiations. Prior to such publication, a written communication to such effect must be sent to the SVS and the Chilean exchanges.

The Company s Bylaws (Article 5 Bis), as well as Decree-Law 3500 (Article 112), establish rules regarding limits of concentration of the Company s share capital. According to the law, the maximum amount of shares that a person can accumulate, directly, indirectly or through related persons, is 65% of the capital with voting rights. However, the Company s Bylaws establish a concentration limit of 45% of the capital with voting rights. With the objective of maintaining the concentration limits, the Company cannot issue a quantity of shares that surpasses the concentration limit.

If a shareholder accumulates more than 45% of the capital with voting rights, such shareholder must sign a commitment to deconcentrate this ownership stake. Said commitment must be in the form of a public deed and an extract of the commitment must be published in the Official Gazette and in a newspaper of nationwide circulation (Decree-Law 3500, Articles 124 and 128). The commitment must include a time limit within which the deconcentration of the ownership must be realized, which may not exceed five years from the date of the signing of the commitment. If the deconcentration does not occur within the agreed time period, the issuer must sell in a stock exchange, on behalf and at the risk of the shareholder, the number of shares necessary to reduce such shareholder s ownership to the 45% limit.

The Bylaws (Article 40 Bis) and Decree-Law 3500 (Article 116) also establish the following regulations related to concentration of capital: no shareholder may exercise, personally or through others, the right to vote the shares held in excess of the maximum limit of concentration established in the Bylaws, that is, more than 45% of the capital with voting rights; and no person may represent shareholders that, as a group, own more than 45% of the Company s capital with voting rights. One share represents the right to one vote and, when a shareholder gives another person the right to represent him in a shareholders meeting, this representation must be for the total amount of shares that he owns.

Under articles 28, 29, and 67 No. 5 of the Chilean Corporate Law, a capital reduction requires the approval of shareholders by a shareholders meeting with a minimum quorum of two thirds of the outstanding shares with voting rights. In addition, there must be a publication of the reform extract accepting a capital reduction and after a 30-day waiting period, the capital reduction will become effective through either the allotment of capital or the company s purchase of its own shares. The 30-day time period provides third parties and minority shareholders the opportunity to exercise their corresponding rights through revocable shares. In addition, under Article 69 of the Tax Code, a company cannot realize capital reductions without previous authorization of the Internal Tax Service.

Capitalization

Under Chilean law, a corporation issues its stock as soon as the shareholders authorize an increase in such corporation s capital. When a shareholder subscribes for shares, the shares are registered with such shareholder s name, and the shareholder is treated as a shareholder for all purposes, except receipt of dividends, unless otherwise stipulated in the Bylaws of the corporation. The shareholder becomes eligible to receive dividends once such shareholder has paid for the shares. If a shareholder does not pay for shares for which such shareholder has subscribed on or prior to the date agreed upon for payment, the corporation is entitled to auction the shares on the stock exchange, and has a cause of action against the shareholder for the difference between the subscription price and the price received at auction. However, until such shares are sold at auction, the shareholder continues to exercise all his rights (except the right to receive dividends). Authorized shares that have not been paid for within the maximum period of three years from the date of issuance determine that the capital of the corporation is automatically reduced to the amount effectively paid within such period.

The Company s Bylaws authorize two classes of common stock, Series A Common Stock and Series B Common Stock. The rights of both series of shares are identical, except that the holders of Series B Common Stock are entitled as a class only to (i) elect one of seven directors and an alternate director for that director and (ii) name one of three liquidators of Telefónica Chile in the event of its dissolution.

Director Requirements

The Bylaws establish that the Board of Directors shall consist of seven directors, six to be elected by the holders of Series A Common Stock and one to be elected by the holders of Series B Common Stock. One alternate director will be elected for each director and will replace that director if the director is unable to attend a meeting or serve a full term. Only the director and alternate director elected by the holders of the Series B Common Stock are required to be stockholders in the Company.

The Company s Bylaws (Article 18), as well as the Chilean Corporations Law (Article 38), stipulate that the Board of Directors can only be fully dissolved by a General or Special Shareholders Meeting (as defined below). The individual or collective dissolution of the Board of Directors by one or more of the Board members is not allowed.

The Bylaws require that any act or contract by the Company in which a director or an officer, or a party related to them, holds an interest must be previously approved by two-thirds of the Board of Directors, and the terms of the act or contract must be adjusted to similar equity conditions to those prevailing in the market.

The Company s Bylaws include a chapter governing the creation and functions of the Directors Committee, which was created by the Board of Directors on April 26, 2001. For more information on the Directors Committee, see Item 6. Directors, Senior Management and Employees Board Practices Directors Committee.

Preemptive Rights and Increases of Share Capital

The Chilean Corporations Law grants certain preemptive rights to shareholders of all Chilean companies. Thus, options to purchase shares from capital increases or convertible securities have to be offered, at least one time, preferentially to shareholders on a pro rata basis.

Dividend and Liquidation Rights

In accordance with Chilean Corporate law, the Company must distribute mandatory cash dividends of at least 30% of its net income of the year calculated in accordance with Chilean GAAP, unless otherwise decided by a unanimous vote of the shareholders. See Item 8. Financial Information Dividend Policy and Dividends. In addition, under Chilean Law dividends can only be paid from net income or retained earnings.

At the option of the Company, the portion of any dividend that exceeds the mandatory limits established pursuant to Chilean law may be paid in cash, in shares of the Company or in shares of open corporations held by the Company. Shareholders who do not expressly elect to receive a dividend other than in cash are legally presumed to have decided to receive the dividend in cash.

Dividends that are declared but not paid within the appropriate time period set forth in the Bylaws for payment of such dividends (as to minimum dividends, 30 days after declaration; as to optional dividends, the date set for payment at the time of declaration) are adjusted to reflect the change in the value of the UF from the date set for payment to the date such dividends are actually paid. Such dividends also accrue interest for operations readjustable during such period. The right to receive a dividend lapses if it is not claimed within five years after the time the dividend becomes due. In the event of a liquidation of the Company, the holders of fully paid shares would participate in a *pro rata* distribution of assets available after all creditors have been paid.

Shareholders Meetings and Voting Rights

The General Annual Shareholders Meeting of the Company is held during the first four months of each year. Extraordinary meetings of shareholders may be called by the Board of Directors when deemed appropriate or when requested by shareholders representing at least 10% of the issued voting shares or by the SVS. Notice to convene the General Annual Shareholders Meeting or a Special Shareholders Meeting is given by means of a notice published in a newspaper of Telefónica Chile s corporate domicile (currently, Santiago) or in the Official Gazette in the prescribed manner by the law and its rule. Notice must also be mailed to each shareholder and given to the SVS at least 15 days prior to the meeting.

The quorum to constitute a shareholders meeting is established by the presence, in person or by proxy, of shareholders representing at least the absolute majority of the issued voting shares of the Company; if a quorum is not present at the first meeting, the meeting can be reconvened and shareholders present at the reconvened meeting are deemed to constitute a quorum regardless of the percentage of the shares represented. The agreements will be adopted by the absolute majority of the present or represented shares with voting rights. However, if a shareholders meeting is called for the purpose of: (i) transformation, merger or division of the Company, (ii) an amendment to the term of duration or early dissolution, (iii) a change in corporate domicile, (iv) a decrease of corporate capital, (v) approval of capital contributions or assessments of assets other than cash, (vi) modification of the faculties reserved to shareholders or limitations of attributions on the Board of Directors, (vii) reduction in the number of Directors comprising the Board, (viii) the sale, transfer or disposition of 50% or more of the Company s assets, either including or excluding their corresponding liability, or the formulation or modification of any business plan which includes the sale, transfer or disposition of the Company s asset in such percentage, (ix) the form of distributing corporate benefits, (x) real or personal guarantees to caution liabilities of any third party, in an amount exceeding 50% of the Company s total assets, (xi) the purchase by the Company of the Company s issued stock in accordance with Articles 27A and 27B of Law 18,046, (xii) corrections of formal defects with regard to the Company s incorporation or amendments to the Bylaws relating to any of the matters enumerated above, or (xiii) any other alluded to in the Bylaws, the vote required at such meeting is two-thirds of the issued voting Shares as established in Article 44 of the Bylaws of the Company.

The Company s Bylaws (Article 45 Bis), as well as Decree-Law 3500 (Article 121), state that the approval of 75% of voting shares is required in a Special Shareholders Meeting, in order to modify the following provisions or bylaws:

(a) the share concentration limit of 45% of the capital with voting rights;

(b) the quorum of two-thirds of the Board of Directors that is required for the prior approval of the agreements and contracts between the Company and its majority shareholders, board members and executive officers, or persons related to them;

(c) the obligation of the Board of Directors to always act within the limits determined by the investment and financing policy approved by the General Annual Shareholders Meeting;

(d) the obligation of the General Annual Shareholders Meeting to approve the investment and financing policy proposed by management;

(e) the fact that the following matters are subject to approval of a Special Shareholders Meeting: the sale of assets or rights of the Company that have been declared essential to its operations in the investment and financing policy, as well as the creation of encumbrances upon such assets, and the modification of the investment and financing policy approved at the General Annual Shareholders Meeting;

(f)

the requirement that no shareholder may exercise, personally or through others, the right to vote shares held in excess of 45% of the capital with voting rights and that no person may represent shareholders that, as a group, own more than 45% of the capital with voting rights;

(g) the rules that regulate the withdrawal rights of the AFPs;

(h) the obligation to present to the General Annual Shareholders Meeting and to send to shareholders a copy of the account inspectors report and of the investment and financing policy; and

(i) the obligation of the General Annual Shareholders Meeting to designate two account inspectors and two alternate account inspectors to examine the accounts, inventory, balance sheet and other financial statements.

Chilean law does not require a publicly traded company to provide the level and type of information that United States securities laws require a reporting company to provide to its shareholders in connection with a solicitation of proxies. Under Chilean law, a notice of a shareholders meeting listing matters to be addressed at the meeting must be mailed not later than 15 days prior to the date of a meeting. In the case of a General Annual Shareholders Meeting, an annual report of the Company s activities, which includes audited financial statements for the Company, must also be mailed to certain shareholders (corresponding to the higher value between (i) those shareholders owning 90% of the shares, and (ii) those shareholders representing 35% of total shareholders which have an investment higher than 120 UF). Additionally, the Company regularly provides, and management intends to continue to provide, a proposal for the final dividend, a statement of the proposed dividend policy for interim dividends for the then current year and a statement of Telefónica Chile s Investment and Financing Policy required by Decree-Law 3500 discussed below. See Item 8. Financial Information Dividend Policy and Dividends.

The Chilean Corporations Law provides that, whenever shareholders representing 10% or more of the issued voting shares so request, a summary of the comments and proposals that shareholders requested in relation to the businesses of the company must be included as an exhibit to the company s annual report. The Chilean Corporations Law also provides that, whenever the board of directors of an open company convenes a general meeting of shareholders, solicits proxies for the meeting, and distributes information supporting its decisions or other similar materials, it must include pertinent comments and proposals requested by such shareholders.

Only shareholders registered as such with the Company at least five days prior to the date of a shareholders meeting are entitled to attend and vote their shares. Shareholders may appoint another individual (who need not be a shareholder) as their proxy to attend and vote on their behalf. Every shareholder entitled to attend and vote at a shareholders meeting has one vote for each share subscribed. The Company s Bylaws (Article 46), as well as the Chilean Corporations Law (Article 68), stipulate that the shares belonging to shareholders who, during a period of over five years, have not collected dividend payments that the Company has distributed and have not attended shareholders meetings that were held, are not considered for quorum purposes or for the voting majorities required at the shareholders meetings. When one of the mentioned conditions ceases to occur, those shares must again be considered for the above-mentioned purposes.

Subject to the terms of the Deposit Agreement among the Company, the Bank of New York, as Depositary, and the owners and holders of ADRs, dated as of July 19, 1990, as amended and restated in the Amended and Restated Deposit Agreement among the Company, Citibank, N.A., as Depositary, and the owners and holders of ADRs, dated as of January 2, 1997, and the Second Amended and Restated Deposit Agreement, dated as of June 1, 1998, among Telefónica Chile, Citibank, N.A., as Depositary, and the owners and holders of ADRs, the holders of ADRs have the right to instruct the Depositary as to the exercise of voting rights with respect to the underlying common shares. The Depositary is not permitted to vote any of the underlying shares as to which it has received no instructions from the holders of ADRs.

Approval of Financial Statements and Investment and Financing Policy

The Board of Directors is required to submit the Company s financial statements to the shareholders annually for their approval. If the shareholders reject the financial statements, the Board of Directors must submit new financial statements not later than 60 days from the date of the meeting. If the shareholders reject the new financial statements, the entire Board of Directors is deemed removed from office and a new Board of Directors is elected at the same meeting. Directors who individually approved such financial statements rejected by the Company s shareholders are disqualified for re-election for the ensuing period.

As mandated by Decree-Law 3500 (discussed below) and as required by Telefónica Chile s Bylaws, at each General Annual Shareholders Meeting, shareholders of the Company must consider for approval a statement of general investment directives and limitations proffered by management. At the General Annual Shareholders Meeting held in April 2006, the Investment and Financing Policy for 2006 was approved by Telefónica Chile s shareholders.

The Company s current Investment and Financing Policy requires that the maximum consolidated debt-to-equity ratio of Telefónica Chile and its subsidiaries not exceed 1.6.

Under the terms of the Investment and Financing Policy notwithstanding the restrictions imposed by law or by the Bylaws on the grant of real or personal guarantees to secure third-party obligations, the Company s management may not agree to grant real or personal guarantees to secure obligations of the Company or of third parties, other than subsidiaries, except upon shareholder approval at an extraordinary shareholders meeting. Cash obligations arising from amounts payable for the purchase of goods or real estate are exempt from the foregoing, if they are secured by the assets purchased. The Company may agree to restrictions on the distribution of dividends with lenders only after shareholder approval at a General Annual Shareholders Meeting or at an extraordinary shareholders meeting.

The Investment and Financing Policy for 2006 also contains restrictions on the disposition of assets or property rights that are essential for the functioning of the Company, including the networks, central switches, equipment and parcels of land used to provide services pursuant to government licenses. Such assets may, however, be modified or replaced for reasons of technical or economic obsolescence. As of the General Annual Shareholders Meeting held in April 2006, the Company s essential assets also included 51% of the shares of subsidiaries Telefónica Empresas and Telefónica Larga Distancia.

Finally, the Investment and Financing Policy, approved at the General Annual Shareholders Meeting, established that the Company will concentrate investment resources in all areas of its business defined in its Bylaws.

Right of Dissenting Shareholders to Tender Their Shares

The Chilean Corporations Law provides that, at an extraordinary shareholders meeting upon any of the resolutions enumerated below, dissenting shareholders acquire the right to withdraw from a Chilean company and to compel that company to repurchase their shares, subject to certain terms and conditions.

Dissenting shareholders are defined as (i) shareholders who vote against a resolution and thus acquire the right to withdraw from the company, or (ii) shareholders who are absent from a shareholders meeting and who state in writing to the company their opposition to the resolution adopted at such a meeting. Dissenting shareholders must manifest their withdrawal rights by tendering their stock to the company within 30 days of adoption of the resolution in question (except in the case of pension fund shareholders, as discussed below).

The price paid to a dissenting shareholder of a public (open) company for such shares is the weighted average of the closing sale prices for the company s shares, as reported on the relevant stock exchanges, for the 60-day period preceding the event giving rise to the withdrawal right.

Under the Chilean Corporations Law, a dissenting shareholder s right to withdraw arises upon adoption of resolutions concerning the following matters:

(a) transformation of the company;

(b) merger of the company with another entity;

(c) disposition of 50% or more of the corporate assets under the terms described in Item 10. Additional Information Memorandum and Articles of Association Shareholders Meetings and Voting Rights ;

(d) grant of real or personal guarantees to secure third-party obligations in an amount exceeding 50% of the corporate assets;

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(e) creation of preferential rights for a class of shares or modification of those already existing, in which case the right to withdraw only accrues to the dissenting shareholder of the class or classes of shares adversely affected;

(f) corrections of formal defects with regard to the company s incorporation or amendments to the Bylaws relating to any of the matters enumerated above;

(g) such other causes as may be established by the Company s bylaws and the Chilean Law;

Registrations and Transfers

The Company s shares are registered by the Company acting as its own transfer agent, as is customary among Chilean corporations. In the case of jointly owned shares, an attorney-in-fact must be appointed to represent the joint owners in the Company.

C. Material Contracts

There were no material contracts signed in the year 2006.

D. Exchange Controls and Other Limitations Affecting Security Holders

Telefónica Chile has outstanding ADRs and Debt Securities. Each of these securities is subject to requirements as to issuance and other matters established by the Central Bank.

The Central Bank is, among other things, responsible for monetary policies and for exchange controls in Chile. Appropriate registration of a foreign investment in Chile permits the investor to access the formal currency market. Foreign investments can be registered with the Foreign Investment Committee under Decree-Law 600 of 1974, as amended, or with the Central Bank under the Central Bank Act. The Central Bank Act is an organic constitutional law requiring a special majority vote of the Chilean Congress to be modified.

Chapter XIV of Title I of the Compendium of Rules on Foreign Exchange (the Compendium) issued by the Central Bank authorizes qualifying Chilean issuers to offer convertible debentures or debt securities both in Chile and abroad. Pursuant to an amendment of the Compendium issued by the Central Bank on April 19, 2001, any new international issue of convertible debentures or debt securities must be carried out through the Formal Exchange Market, and the participants must inform the Central Bank of the issuance. However, all issuances of debt made prior to the April 19, 2001 amendment of the Compendium, including certain of the Debt Securities of the Company, remain subject to the rules and regulations as in effect at the time of their respective issuances.

The following is a summary of the relevant portions of the Central Bank s regulations regarding issuance of convertible debentures and debt securities denominated in currencies other than pesos in the international markets. This summary does not purport to be complete and is qualified in its entirety by reference to Resolution No. 254-15-921029, which has been incorporated by reference as an exhibit to the Company s Registration Statement on Form F-3 (File No. 333-5184), as filed with the Commission on July 22, 1996 and as amended on January 7, 1999, and by reference to the resolutions of the Central Bank authorizing the issuance of the debt securities which are the subject of the above-referenced Registration Statement.

Debt securities must have an average weighted term of not less than four years, weighted on the basis of principal installments and on the assumption that, if the issuer has the ability to call the debt securities, they will be deemed to have been called at the earliest possible date for purposes of this requirement. Convertible debt securities offered internationally must first be offered to existing shareholders of the issuer in a preemptive rights offering. Subscribers in such an offering must purchase the debentures with pesos and receive peso-payable debt securities whereas international investors must purchase the debt securities in a foreign currency. Persons not residing or domiciled in Chile may exchange their peso-payable debt securities for the foreign-currency payable debt securities, subject to compliance with certain conditions.

The Compendium also requires that the foreign currency proceeds from the international sale of debt securities either be brought to Chile and exchanged for Chilean pesos in the Formal Exchange Market or be held outside of

Chile and used for (i) direct payment abroad of expenses incurred in connection with import operations, contracting services abroad, issue of securities abroad; (ii) repayment at maturity of external indebtedness registered with, and approved by, the Central Bank; and (iii) direct investment in financial instruments abroad. If the foreign currency proceeds are used to finance investments outside of Chile or to repay obligations of foreign branches and/or subsidiaries, no access to the Formal Exchange Market is given.

Until September of 1998, the Compendium made foreign loans granted to (including international debt offerings issued by) Chilean individuals or companies subject to a mandatory deposit of an amount equal to 30% of the proceeds of the loan in a one-year, non-interest bearing U.S. dollar account with the Central Bank (or to payment of a charge to the Central Bank on the next business day after the time the foreign currency is converted into Chilean pesos in an amount equal to interest on such deposit at the rate of the twelve-month LIBOR for U.S. dollar deposits plus 4.0% for one year). On June 26, 1998, the Central Bank lowered the amount of this mandatory deposit to 10% of loan proceeds, and further reduced this amount to 0% on September 17, 1998. Although the mandatory deposit was eliminated from the Compendium on April 19, 2001, it is still within the Central Bank s powers, according to its organic law, to reinstate such mandatory deposit requirement.

International investors must purchase internationally offered debt securities with foreign currency and receive foreign currency-payable securities.

A foreign investment and exchange contract was entered into by the Central Bank, the Company and The Bank of New York as depositary in 1990 (the Foreign Investment Contract) pursuant to Article 47 of the Central Bank Act and to Chapter XXVI of the Compendium (Chapter XXVI). On December 30, 1996, the Foreign Investment Contract was amended to incorporate the designation of Citibank N.A. as the successor depositary for Telefónica Chile s ADR program. Although an amendment made by the Central Bank on April 19, 2001, repealed Chapter XXVI, it continues to be enforceable with respect to contracts entered into pursuant to Chapter XXVI, such as the Foreign Investment Contract.

The following is a summary of certain provisions of the Foreign Investment Contract. This summary does not purport to be complete and is qualified in its entirety by reference to Chapter XXVI and the Foreign Investment Contract.

Under the Chapter XXVI and the Foreign Investment Contract, the Central Bank grants to the Depositary, on behalf of ADR holders, and to any non-Chilean investor who withdraws shares of Series A Common Stock upon delivery of ADRs (such shares being referred to herein as Withdrawn Shares) access to the formal currency market to convert pesos to dollars (and remit such dollars outside of Chile) with respect to shares of Series A Common Stock represented by ADSs or Withdrawn Shares, including amounts received as (a) cash dividends, (b) proceeds from the sale in Chile of Withdrawn Shares (subject to receipt by the Central Bank of a certificate from the holder of the Withdrawn Shares (or from an institution authorized by the Central Bank) that such holder s residence and domicile are outside of Chile and a certificate from a Chilean exchange (or from a brokerage or securities firm established in Chile) that such Withdrawn Shares were sold on a Chilean exchange), (c) proceeds from the sale in Chile of rights to subscribe for additional shares of Series A Common Stock, (d) proceeds from the liquidation, merger or consolidation of the Company, and (e) other distributions, including without limitation, those resulting from any re-capitalization, as a result of holding shares of Series A Common Stock represented by ADSs or Withdrawn Shares. Transferees of Withdrawn Shares are not entitled to any of the foregoing rights under Chapter XXVI. Investors receiving Withdrawn Shares in exchange for ADRs have the right to redeposit such shares in exchange for ADRs, provided that the conditions to redeposit are satisfied.

Shares of Series A Common Stock acquired as described above may be deposited for ADRs and receive the benefits of the Foreign Investment Contract, subject to receipt by the Central Bank of a certificate from the Depositary stating that such deposit has been made and that the related ADRs have been issued along with a declaration from the person making such deposit waiving the benefits of the Foreign Investment Contract with respect to the deposited shares.

Access to the Formal Exchange Market under any of the circumstances described above is not automatic. Pursuant to Chapter XXVI, such access requires the Central Bank s approval of a request presented through a banking institution established in Chile. The Foreign Investment Contract provides that, if the Central Bank has not acted on such request within a period of seven business days, the request will be deemed approved.

The Central Bank regulations provide that a person who brings foreign currency to Chile for the purpose of purchasing shares of Series A Common Stock must convert such currency into pesos on the same date and has five banking business days within which to invest in such shares in order to receive the benefits of the Foreign Investment Contract. If such person decides within such period not to acquire the shares, such person can access the Formal Exchange Market to reacquire dollars, provided that the applicable request is presented to the Central Bank within seven banking business days of the initial conversion into pesos. Shares of Series A Common Stock acquired as described above may be deposited for ADSs and receive the benefits of the Foreign Investment Contract, subject to: (i) receipt by the Central Bank of a certificate from the Depositary stating that such deposit has been made and that the related ADRs have been issued, and (ii) receipt by the custodian bank for the ADRs of a declaration from the person making such deposit waiving the benefits of the Foreign Investment Contract with respect to the deposited shares.

Under current Chilean law and judicial precedents, the Foreign Investment Contract cannot be changed unilaterally by the Central Bank. While the authorization to issue the Debt Securities is a unilateral act of the Central Bank, other authorizations of the Central Bank have not been historically rescinded. Although this area was significantly liberalized as a result of the amendment made by the Central Bank on April 19, 2001, additional Chilean restrictions applicable to the holders of Debt Securities or ADRs, to the disposition of any such security, or the repatriation of the proceeds from such disposition, may be imposed in the future. There can be no assessment of the duration or impact of such restrictions, if imposed.

The Central Bank regulations that became effective on July 4, 1995 (the New Central Bank Regulations) required persons bringing foreign currency into Chile for the purpose of acquiring pesos to purchase securities to either (1) establish a non-interest bearing deposit with the Central Bank of Chile for a one-year term in an amount equal to 30% of foreign currency brought into Chile, or (2) pay a charge to the Central Bank at the time the foreign currency is converted into pesos in an amount equal to interest on such deposit for one year at the rate of 12-month LIBOR plus 4%. The New Central Bank Regulations were amended in October of 1996 to make them applicable to persons bringing foreign currency into Chile for the purpose of purchasing securities from certain issuers thereof as part of a capital increase by the issuer. However, these rules do not apply to foreign investments made for purposes of purchasing newly issued shares under Chapter XXVI and an ADR investment contract. The New Central Bank Regulations apply to subsequent transactions in which foreign currency is brought into Chile to purchase securities in secondary market transactions. On September 17, 1998, the Central Bank eliminated this mandatory deposit requirement. Despite this elimination, the Central Bank may at any time reinstate its deposit requirements in any amount up to 40%. Although the mandatory deposit was eliminated from the Compendium on April 19, 2001, its imposition still constitutes one of the Central Bank s powers.

The New Central Bank Regulations may affect the price and volume of trading in securities in Chile, including the price and volume of trading in the Company s common stock. The New Central Bank Regulations may also affect the amount of any differential in prices between American Depositary Shares evidencing securities of Chilean issuers, including the Company s ADSs, and prices of the underlying securities in Chile, including the common stock. However, the Company is unable to assess at this time the impact of the New Central Bank Regulations on the securities markets in Chile, the market for the Company s common stock in Chile or the market for its ADRs. The Company is unable to predict whether (and, if so, how or when) the New Central Bank Regulations will be modified or terminated or what effect any such modifications or termination will have on the securities markets in Chile, the market for the Company s common stock or the market for its ADRs.

E. Taxation

The following discussion contains a description of the material Chilean and U.S. federal income tax consequences of the acquisition, ownership and disposition of shares of Series A common stock or ADSs (evidenced by ADRs) representing shares of Series A Common Stock by certain holders. This summary is based upon the tax laws of Chile and the United States as in effect on the date of this annual report, which are subject to change, possibly with retroactive effect, and to differing interpretations. You should consult your own tax advisors as to the

Chilean, U.S. federal or other tax consequences of the acquisition, ownership and disposition of shares of Series A Common Stock or ADSs, including, in particular, the effect of any state, local or non-U.S., or non-Chilean tax laws.

Chilean Tax Considerations

The following discussion summarizes the principal Chilean tax consequences of the acquisition, ownership and disposition of shares of Series A Common Stock, or any ADSs representing such Series A Common Stock by an individual holder who is not domiciled or resident in Chile or by a legal entity not organized under the laws of Chile and with no permanent establishment in Chile (a Foreign Holder). For purposes of Chilean taxation, an individual holder is a resident of Chile if such holder has resided in Chile for more than six consecutive months in any one calendar year, or for a total of more than six months in two consecutive years. A Chilean citizen generally will be treated as a domiciliary and resident of Chile for Chilean tax purposes unless such person can demonstrate the contrary.

To date, there is no income tax treaty in force between Chile and the United States.

Deposit and Withdrawal of Series A Common Stock in Exchange for ADSs

The deposit and withdrawal of shares of Series A Common Stock in exchange for ADSs is not subject to any Chilean taxes. As to the tax basis of shares of Series A Common Stock received by a Foreign Holder in exchange for ADSs, the Company has obtained a Ruling (the Ruling) from the Chilean tax authorities that provides that the Chilean tax authorities will abide by the valuation procedure set forth in the Depositary Agreement, which values shares at the highest price at which shares of Series A Common Stock were traded on the Santiago Stock Exchange on the date of the withdrawal of the shares of Series A Common Stock from the Depositary.

Taxation of Dividends

Cash dividends paid by the Company with respect to the shares of Series A Common Stock held by Foreign Holders will be subject to a Chilean withholding tax at the rate of 35% (the Withholding Tax), which is withheld and paid over by the Company. A credit against the Withholding Tax is available based on the level of corporate income tax actually paid by the Company on the income to be distributed (the First Category Tax). Full applicability of the First Category Tax credit at the 17.0% rate results in an effective Withholding Tax rate of 21.7%. Consequently, the Withholding Tax rate with respect to dividends fluctuates between 21.7% and 35.0%, depending on whether or not the Company is subject to the First Category Tax.

The First Category Tax credit, if available, does not reduce the Withholding Tax on a one-for-one basis because it also increases the base on which the Withholding Tax is imposed. In addition, if the Company distributes less than all of its distributable income, the credit for First Category Tax paid by the Company is reduced proportionately. The example below illustrates the effective Chilean Withholding Tax burden on a cash dividend received by a Foreign Holder, assuming a Withholding Tax rate of 35%, an effective First Category Tax at the maximum rate of 17.0%, and a distribution of 100% of the Company s net income that is distributable after payment of the First Category Tax.

Example:	**Ch$**
Company taxable income	100
First Category Tax (17% of Ch$100)	(17)

Net distributable income	83
Dividend distributed by the Company	83
Withholding Tax	
(35% of the Company s taxable income)	(35)
Credit for First Category Tax	17
Net Withholding Tax	(18)
Net dividend received	65 (83-18)
Effective dividend withholding tax rate	21.7% (18/83)

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The foregoing tax consequences apply to cash dividends paid by the Company to the Depositary as representative of the holders of ADSs. The Ruling provides that disbursements of such cash dividends by the Depositary to the holders of ADSs will not be subject to Chilean taxation. Dividend distributions made in property (other than shares of Series A Common Stock) will be subject to the same Chilean tax rules as cash dividends based on the fair market value of such property. Stock dividends are not subject to Chilean taxation.

A capital reduction, such as the one that was approved by the Company s shareholders at the April 20, 2006 shareholder s meeting, is generally tax free to holders of Series A Common Stock or ADSs except in certain circumstances, such as the existence of: (i) pending taxable net income from prior periods, (ii) pending net income (retained earnings), and (iii) capitalized share premiums generated by above market price capital increases on which the Company elected to not pay taxes at the time of issuance. The effective tax rate applicable to the capital reduction paid in 2006 was 29.41%, due to the fact that condition (i), pending taxable net income from prior periods, was met. The average First Category Tax credit rate applicable to the capital reduction was 8.59691255% of the amount paid, as detailed in the example below.

Example: Effective Tax Rate for Capital Reduction Payment	**Ch$**
Amount of Dividend Received	100.00
Withholding Tax	
35% of the dividend received + Credit for First Category Tax =100+8.59691255	(38.00)
Credit for First Category Tax	8.59
Net Withholding Tax	(29.41)

Taxation of Capital Gain on the Sale of Shares of Series A Common Stock and ADSs

(1) The Ruling provides that gains from sales or other dispositions of ADSs are not subject to any Chilean taxes, provided that such sales occur outside of Chile.

(2) Taxation of shares acquired on or before April 19, 2001

A gain recognized on a sale or exchange of shares (as distinguished from sales or exchanges of ADSs representing such shares) will be subject to both a 17% Chilean income tax and the 35% Chilean withholding tax (the former being creditable against the latter) if either the foreign holder:

Has held the shares for less than one year since exchanging ADSs for the shares; or

Acquired and disposed of the shares in the ordinary course of its business or as an habitual trader ofshares.

In all other cases, gain on the disposal of shares will be subject to a 17% Chilean income tax but will not be subject to the 35% Chilean withholding tax.

This rule also applies for the disposal of shares not qualifying for the exemption in (3), below.

(3) Taxation on shares acquired after April 19, 2001

On November 7, 2001, the income tax law was amended in order to create a tax exemption on capital gains arising from the sale of shares of listed companies traded in the stock markets. Although there are certain restrictions established in the amended income tax law, in general terms, the amendment provides that in order to have access to the capital gain exemption: (i) the shares must be of a public stock corporation with a certain minimum level of trading in a stock exchange, (ii) the sale must be carried out in a Chilean stock exchange, or in another stock exchange authorized by the SVS, or in a tender offer subject to Chapter XXV of the Chilean Securities Market Law, (iii) the shares which are being sold must have been acquired on a stock exchange, or in a tender offer subject to Chapter XXV of the Chilean Securities Market Law, or in an initial public offering (due to the creation of a company or to a capital increase), or due to the exchange of convertible bonds, and (iv) the shares must have been acquired after April 19, 2001.

The tax basis of shares received in exchange for ADSs will be the acquisition value of the shares. The valuation procedure set forth in the deposit agreement, which values shares at the highest price at which they trade on the Santiago Stock Exchange on the day of the exchange, will determine the acquisition value for this purpose. Consequently, the conversion of ADSs into shares and the immediate sale of the shares for the value established under the deposit agreement will not generate a capital gain subject to taxation in Chile.

The distribution and exercise of preemptive rights relating to shares of Series A Common Stock will not be subject to Chilean taxes, however, amounts received in exchange for the sale of preemptive rights will be subject to Chilean income taxes at an effective rate of 35%.

Other Chilean Taxes

Although there is no direct authority on this point, as a practical matter there are no Chilean inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of ADSs by a Foreign Holder, but such taxes generally will apply to the transfer at death or by gift of the shares of Series A Common Stock by a Foreign Holder. There are no Chilean stamp, issue, registration or similar taxes or duties payable by holders of debt securities and holders of shares of Series A Common Stock or ADSs.

Withholding Tax Certificates

Upon request, the Company will provide to Foreign Holders appropriate documentation evidencing the payment of the Chilean Withholding Tax (net of the applicable First Category Tax). For further information, the investor should contact:

Citigroup
Depositary Receipt Services
388 Greenwich Street 14th floor
New York, New York 10013, USA

U.S. Federal Income Tax Considerations

The following discussion is a summary of the material U.S. federal income tax consequences of the acquisition, ownership and disposition of shares of Series A Common Stock or ADSs by U.S. Holders, as defined below, but does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular investor s decision to acquire such securities. This discussion deals only with shares of Series A Common Stock and ADSs held as capital assets for U.S. federal income tax purposes and it does not describe all of the tax consequences that may be relevant to U.S. Holders subject to special rules, such as:

- certain financial institutions;
- insurance companies;
- dealers and traders in securities or foreign currencies;
- persons holding shares of Series A Common Stock or ADSs as part of a hedge or similar transaction;
- persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
- partnerships or other entities classified as partnerships for U.S. federal income tax purposes;

- persons liable for the alternative minimum tax;
- tax-exempt organizations;
- persons holding shares of Series A Common Stock or ADSs that own or are deemed to own ten percent or more of the Company s voting stock; or

- persons who acquired shares of Series A Common Stock or ADSs pursuant to the exercise of any employee stock option or otherwise as compensation.

This discussion is based on the Internal Revenue Code of 1986, as amended (referred to herein as the Code), final, temporary and proposed Treasury regulations, administrative pronouncements of the U.S. Internal Revenue Service (the IRS) and judicial decisions, all as currently in effect, all of which are subject to change, possibly with retroactive effect. This discussion is also based in part on representations by the depositary and assumes that each obligation under the Deposit Agreement and any related agreement will be performed in accordance with its terms. Holders of shares of Series A Common Stock or ADSs should consult their own tax advisors regarding the application of the U.S. federal income tax laws to their particular situations as well as any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction.

As used herein, the term U.S. Holder means a beneficial owner of Series A Common Stock or ADSs that is for U.S. federal income tax purposes:

- a citizen or resident of the United States;

- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States or of any political subdivision thereof; or

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

The U.S. federal income tax treatment of a partner in a partnership that holds Series A Common Stock or ADSs will depend on the status of the partner and the activities of the partnership. Partners in such partnerships should consult their own tax advisors.

General

In general, for U.S. federal income tax purposes, a U.S. Holder of ADSs will be treated as the beneficial owner of the shares of the Series A Common Stock represented by those ADSs. Accordingly, deposit and withdrawals of shares of Series A Common Stock in exchange for ADSs will not result in the realization of gain or loss for U.S. federal income tax purposes.

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

This discussion assumes that the Company has not been, and will not become, a passive foreign investment company, a PFIC, for U.S. federal income tax purposes, as described more fully below.

Taxation of Dividends

Distributions made by the Company of cash or property (other than certain pro rata distributions of common shares) generally will constitute a taxable dividend to the extent paid out of the Company s current or accumulated earnings and profits, as determined under U.S. federal income tax principles. Since the Company does not maintain calculations of its earnings and profits under U.S. federal income tax principles, a U.S. Holder will generally be required to treat such distributions as taxable dividends. The full amount of any dividend paid in respect of shares of Series A Common Stock or ADSs (including the amount of Chilean taxes withheld therefrom) will be included in the gross income of a U.S. Holder as foreign source dividend income at the time that the dividend is received by the U.S. Holder, in the case of shares of Series A Common Stock, or by the depositary, in the case of ADSs. Subject to applicable limitations and the discussion above regarding concerns expressed by the U.S. Treasury, under current law, dividends paid to non-corporate U.S. Holders in taxable years beginning prior to January 1, 2011 will be subject to taxation at a maximum rate of 15%. Dividends paid by us will not be eligible for the dividends received deduction generally allowed to U.S. corporations under the Code.

The amount of any dividend paid in Chilean pesos generally will be calculated by reference to the exchange rate for converting Chilean pesos into U.S. dollars in effect on the date that the dividend is received by the U.S. Holder, or, in the case of ADSs, by the depositary, regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, U.S. Holders generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. A U.S. Holder may recognize foreign currency gain or loss, which would be treated as ordinary gain or loss, if the dividend is not converted into U.S. dollars on the date of receipt. U.S. Holders should consult their own tax advisors regarding the calculation and U.S. federal income tax treatment of foreign currency gain or loss. The amount of any distribution of property other than cash will be the fair market value of such property on the date of distribution.

Subject to certain limitations and restrictions that may vary depending on a holder s particular circumstance, and subject to the discussion above regarding concerns expressed by the U.S. Treasury, a U.S. Holder will be entitled to a foreign tax credit against its U.S. federal income tax liability for the net amount of Chilean income taxes (after reduction for the credit for First Category Tax) withheld. The limitation on foreign taxes eligible for credit is determined separately with respect to specific classes of income. U.S. Holders should consult their own advisors regarding the availability of foreign tax credits in light of their particular circumstances. Instead of claiming a credit, U.S. Holders may, at their election, deduct such otherwise creditable Chilean taxes in computing their taxable income, subject to generally applicable limitations under U.S. law.

Taxation of Capital Gains or Losses

Upon a sale or other disposition of Series A Common Stock or ADSs, a U.S. Holder generally will recognize gain or loss equal the difference between the amount realized on such sale or other disposition (including any Chilean taxes withheld) and the holder s adjusted tax basis in the shares of Series A Common Stock or ADSs. Such gain or loss will be capital gain or loss, and will be long-term capital gain or loss if the U.S. Holder held the shares of Series A Common Stock or ADSs for more than one year. The deductibility of capital losses is subject to limitations under the Code.

Any capital gain or loss recognized by a U.S. Holder generally will be treated as U.S. source income or loss for U.S. foreign tax credit purposes. Subject to certain conditions and limitations under U.S. federal tax law, any Chilean tax imposed on the sale or other disposition of shares of Series A Common Stock or ADSs will generally not be available as a credit against such holder s U.S. federal income tax liability, unless the holder has other income from foreign sources, in the appropriate category, for purposes of the foreign tax credit rules. Instead of claiming a credit, a U.S. Holder may, at its election, deduct such otherwise creditable Chilean taxes in computing its taxable income, subject to generally applicable limitations under U.S. law. U.S. Holders should consult their own tax advisors regarding the application of the foreign tax credit limitation rules to the sale or other disposition of Series A Common Stock or ADSs.

Passive Foreign Investment Company Rules

The Company believes that it will not be considered a PFIC for U.S. federal income tax purposes for 2006, and does not expect to be considered a PFIC in the foreseeable future. However, because PFIC status depends upon the composition of a company s income and assets (including, among others, less than 25 percent owned equity investments) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. Holder held a share of Series A Common Stock or an ADS, certain adverse consequences would apply to the U.S. Holder, including the imposition of higher amounts of tax than would otherwise apply to a U.S. Holder and additional tax form filing requirements. U.S. Holders are urged to consult their own tax advisors regarding the U.S. federal tax consequences if the Company were considered a PFIC.

Information Reporting and Backup Withholding

Payment of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and backup withholding unless (i) the holder is a corporation or other exempt recipient or (ii) in the case of backup withholding, the holder provides a correct taxpayer identification number and certify that it is not subject to backup withholding. The amount of any backup withholding from a payment to a holder will be allowed as a credit against such holder s U.S. federal income tax liability, if any, and may entitle such holder to a refund, provided that the required information is timely furnished to the IRS.

U.S. HOLDERS AND PROSPECTIVE PURCHASERS OF SHARES OF OUR SERIES A COMMON STOCK OR ADSs SHOULD CONSULT THEIR OWN TAX ADVISORS AS TO THE CHILEAN, U.S. FEDERAL, STATE, LOCAL AND OTHER TAX CONSEQUENCES OF THE ACQUISITION, OWNERSHIP AND DISPOSITION OF SHARES OF OUR SERIES A COMMON STOCK OR ADSs BASED UPON THEIR PARTICULAR CIRCUMSTANCES.

F. Dividends and Paying Agents

Not applicable.

G. Statement by Experts

Not applicable.

H. Documents on Display

Telefónica Chile will provide without charge to each person to whom this Annual Report is delivered, upon written, e-mail or oral request from any such person, a copy of any or all of the documents referenced in this Annual Report. Written requests for such copies should be directed to either of the following contacts:

Compañía de Telecomunicaciones de Chile S.A.
Avenida Providencia 111, 22nd floor
Santiago, Chile
Attention: Sofia Chellew
Head of Investor Relations

E-mail and oral requests for copies of such documents may be made to Telefónica Chile at sofia.chellew@telefonicachile.cl or at 56-2-691-3867.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Overview

The following discussion about the Company s risk management activities includes forward-looking statements that involve risk and uncertainties. Actual results could differ materially from those projected in such forward-looking statements.

The Company faces market risk exposure in two categories: interest rate fluctuations and exchange rate fluctuations.

The primary interest rate risk that the Company faces is the effect on its fluctuating rate loans of a rise in the LIBOR rate. The Company had outstanding as of December 31, 2006, long-term fluctuating rate-based loans in the amount of Ch$333,386 million (US$626.2 million), including current maturities and accrued interest. As of December 31, 2005, long-term fluctuating rate-based loans in the amount of Ch$328,221 million (US$616.5 million), including current maturities and accrued interest, were outstanding.

The primary exchange rate risk that the Company faces is the depreciation of the peso against the U.S. dollar, due to the fact that, although a substantial portion of the Company s long-term liabilities are dollar-denominated, the Company s revenues are largely denominated in Chilean pesos. The Company had, as of December 31, 2006, Ch$267,754 million (US$502.9 million) in dollar-denominated, interest-bearing, long-term liabilities (including current maturities and accrued interest) compared to Ch$374,878 million (US$704.1 million) in dollar-denominated, interest-bearing, long-term liabilities, including current maturities and accrued interest as of December 31, 2005.

The Company periodically reviews its exposure to risks arising from fluctuations in foreign exchange rates and interest rates, and determines at its senior management level how to hedge such risks. Subject to this review process, the Company manages foreign currency and interest rate risks through hedging transactions in the Chilean and foreign derivative markets and through other mechanisms, such as the purchasing in the Chilean capital markets of dollar-denominated marketable securities with floating LIBOR-based interest rates. The Company has entered into interest rate swaps, forward rate agreements, cross-currency swaps, interest rate collars and foreign currency forward contracts with respect to a portion of its borrowings. The Company uses such derivative instruments to reduce risk by offsetting market exposure. The derivative instruments held by the Company are not leveraged and are not held for trading.

In the normal course of business, the Company also faces risks that are either non-financial or non-quantifiable. Such risks principally include political risk, credit risk and legal risk, and are not represented in the tables below. See Item 3. Key Information Risk Factors.

Risk of Variations in Floating Interest Rates

The major part of Chilean peso-denominated debt is variable-rate UF-denominated. In 2006, of the total Chilean peso-denominated debt, 49.0% was floating-rate debt and 51.0% was fixed-rate debt. Of the Company s long-term interest-bearing debt denominated in foreign currencies, as of December 31, 2006, 100% was floating-rate debt, compared to 29.9% fixed-rate debt and 70.1% floating-rate debt as of December 31, 2005. In 2006 and 2005, all of the Company s foreign currency long-term floating-rate debt was tied to LIBOR.

In order to reduce the impact of interest rate fluctuations on its debt obligations, the Company can enter into interest rate swaps (derivatives), which are contracts in which two parties agree to exchange periodic interest payments, whereby the Company typically agrees to make payments, based on a fixed interest rate applied to a notional principal amount on designated dates, to a counterparty that, in turn, agrees to make payments based on a floating rate, such as LIBOR, applied to the same notional amount.

As of December 31, 2006, 16.7% 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 83.3% of the Company s interest-bearing debt was insulated from interest rate fluctuations: 66.3% was hedged through the instruments set forth in the following table, and 17.0% was fixed-rate debt. As of December 31, 2006, the Company had outstanding cross-currency swaps for a liability of Ch$266,196 million (US$500 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.

As of December 31, 2005, 23.9% 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 76.1% of the Company s interest-bearing debt was insulated from interest rate fluctuations: 48.3% was hedged through the instruments set forth in the following table, and 27.8% was fixed-rate debt. As of December 31, 2005, the Company had outstanding cross-currency swaps for a liability of Ch$219,770 million (US$412.8 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.

The following table summarizes the long-term interest-bearing debt obligations (including current maturities and accrued interest) and derivative instruments held by the Company as of December 31, 2006 and 2005. The Company enters into interest rate swaps and/or cross-currency swaps and/or zero-cost collar contracts or any other hedging instrument to achieve synthetically the appropriate level of variable and fixed-rate debt approved by senior management. For debt, the tables present principal payment obligations by maturity date and the related average interest rate. For collars, the tables present the notional amounts and cap and floor rates by contractual dates. Average interest rates for liabilities are calculated based on the prevailing interest rate as of December 31 of each year, for each loan. Dollar-denominated liabilities have been converted into Chilean pesos based on the Observed Exchange Rate as of December 31, 2006, which was Ch$532.39 = US$1.00.

As of December 31, 2006 Expected Maturity Date

	Average Interest Rate(2)	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total Long-Term Debt (including current portion)**	**Fair Value(1)**
	(in millions of constant Chilean pesos as of December 31, 2006)								
Long-Term Interest-Bearing Debt:									
Fixed rate									
(Ch$-denominated) (3)	4.18%	1,852	1,335	1,335	1,335	1,335	61,012	68,204	68,175
(US$-denominated)(2)	-	-	-	-	-	-	-	-	-
Variable rate									
(Ch$-denominated) (3)	3.16%	446	-	-	65,186		-	65,632	65,632
(US$-denominated)(2)	5.70%	1,559	79,859	106,478	-	79,858	-	267,754	267,754
Interest Rate Derivatives Cross-currency Swaps:									
Notional amount of variable to		-	79,859	106,478	-	79,859	-	-	-

fixed (US$-denominated)[3]									
Average pay rate	-	-	2.49%	3.46%	-	4.17%	-	-	-
Average received rate	-	-	5.73%	5.79%	-	5.75%	-	-	-

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(1) These figures were calculated based on the discounted value of future cash flows expected to be received or paid, considering current discount rates that reflect the different risks involved. See Additional Disclosure Requirements to Note 37 of the Audited Consolidated Financial Statements for more information regarding the fair value of financial instruments and derivatives.

(2) Average interest rate means, for variable rate debt, the average prevailing interest rate as of December 31, 2006 on Telefónica Chile s variable rate debt and, for fixed rate debt, the average prevailing interest rate as of December 31, 2006 on Telefónica Chile s fixed rate debt.

(3) These figures were calculated based on the Observed Exchange Rate as of December 31, 2006, which was Ch$532.39 = US$1.00.

	As of December 31, 2005 Expected Maturity Date								
	Average Interest Rate[2]	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**	**Total Long-Term Debt (including current portion)**	**Fair Value[1]**
		(in millions of constant Chilean pesos as of December 31, 2006)							
Long-Term Interest-Bearing Debt:									
Fixed rate									

	As of December 31, 2005 Expected Maturity Date									
	Average Interest Rate[2]	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**	**Total Long-Term Debt (including current portion)**	**Fair Value[1]**
(Ch$-denominated)	6.05%	1,500	1,330	1,330	1,330	1,330	7,362	14,182	14,182
(US$-denominated)[2]	8.19%	112,228	-	-	-	-	-	112,228	111,766
Variable rate									
(Ch$-denominated)	2.32%	329	-	-	-	65,242	-	65,571	65,571
(US$-denominated)[2]	4.75%	1,019	-	78,489	104,653	-	78,489	262,650	262,650
Interest Rate Derivatives Cross-currency Swaps:									
Notional amount of variable to fixed (US$-denominated)[3]	-	-	-	78,489	104,653	-	36,628	-	-
Average pay rate	-	-	-	2.49%	3.46%	-	4.47%	-	-
Average received rate	-	-	-	4.65%	4.90%	-	4.64%	-	-

(1) These figures were calculated based on the discounted value of future cash flows expected to be received or paid, considering current discount rates that reflect the different risks involved. See Additional Disclosure Requirements to Note 37 of the Audited Consolidated Financial Statements for more information regarding the fair value of financial instruments and derivatives.

(2) Average interest rate means, for variable rate debt, the average prevailing interest rate as of December 31, 2005 on Telefónica Chile s variable rate debt and, for fixed rate debt, the average prevailing interest rate as of December 31, 2005 on Telefónica Chile s fixed rate debt.

(3) These figures were calculated based on the Observed Exchange Rate as of December 31, 2005, which was Ch$512.50 = US$1.00.

Risk of Variations in Foreign Currency Exchange Rates

The Company does not hedge its Chilean peso-denominated debt. The part of Chilean peso-denominated debt is UF-denominated, and therefore indexed to Chilean inflation.

As of December 31, 2006, 66.7% of the Company s interest-bearing debt (including current portion) was dollar-denominated and fully hedged against exchange rate variations between the peso-UF and the U.S. dollar through the instruments set forth in the tables below. The remaining 33.3% of the Company s interest-bearing debt is

UF- or Chilean peso-denominated and, therefore, not subject to exchange rate risk. As of December 31, 2005, 82.5% of the Company s interest-bearing debt (including current portion) was dollar-denominated and fully hedged against exchange rate variations between the peso-UF and the U.S. dollar through the instruments set forth in the tables below. The remaining 17.5% of the Company s interest-bearing debt is UF- or Chilean peso-denominated and therefore not subject to exchange rate risk.

Telefónica Chile enters into forward contracts pursuant to which it agrees to purchase dollars for UF at an agreed exchange rate on a particular date. The maturities of the forward contracts match certain of Telefónica Chile s foreign exchange-denominated liabilities in order to hedge those liabilities. The purpose of the Company s foreign-currency hedging activities is to protect the Company from the risk of devaluation of the Chilean peso against the dollar. Telefónica Chile s risk is the replacement cost, at current market value, of the transactions in the event of default by counterparties. Management believes that the risk of incurring such losses is remote and that any losses would be immaterial, although no assurance can be given to this effect.

As of December 31, 2006, the Company had the equivalent of Ch$267,754 million (US$502.9 million) in U.S. dollar-denominated, interest-bearing, long-term debt (including current portion) outstanding. Most of Telefonica Chile s debt denominated in foreign currencies is in U.S. dollars. To reduce the impact of any depreciation of the Chilean peso against the dollar, as of December 31, 2006, the Company had entered into, on a short-term basis, exchange rate forward contracts for U.S. dollars in exchange for Chilean pesos or UF in the amount of Ch$21,098 million (US$39.6 million), and had entered into a cross-currency interest rate swap for the purchase of U.S. dollars in the equivalent amount of Ch$294,405 million (US$553 million).

As of December 31, 2005, the Company had the equivalent of Ch$374,878 million (US$704.1 million) in U.S. dollar-denominated, interest-bearing, long-term debt (including current portion) outstanding. Most of Telefonica Chile s debt denominated in foreign currencies is in U.S. dollars. To reduce the impact of any depreciation of the

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Chilean peso against the dollar, as of December 31, 2005, the Company had entered into, on a short-term basis, exchange rate forward contracts for U.S. dollars in exchange for Chilean pesos or UF in the amount of Ch$60,347 million (US$113.4 million), and had entered into a cross-currency interest rate swap for the purchase of U.S. dollars in the equivalent amount of Ch$245,785 million (US$461.7 million).

The tables below provide information about the Company s borrowings and derivative financial instruments that are sensitive to foreign currency exchange rates. For the U.S. dollar-denominated debt, the tables present principal cash flows by maturity date. For the forward contracts, the tables present the amount of foreign currency that Telefónica Chile has contracted to purchase and the average UF-US$ exchange rates by contractual dates.

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	As of December 31, 2006 Expected Maturity Date								
	Average Interest Rate(1)	**2007**	**2008**	**2009**	**2010**	**2011**	**Thereafter**	**Total Long-Term Debt (including 2007 Maturities)**	**Fair Value(3)**
	(Ch$ equivalent in millions, except exchange rates)								
On-Balance Sheet Financial Instruments:									
Liabilities long-term interest-bearing debt:									
Fixed rate (US$)(2)	-	-	-	-	-	-	-	-	-
Variable rate (US$)	5.70%	1,559	79,859	106,478	-	79,858	-	267,754	267,754
Anticipated Transactions and Related Derivatives Forward Exchange Agreements				**Expected transaction date**					
(Receive US$/pay Ch$):									
Liability		7,040	-	-	-	-	-	7,040	7,040
Average contractual exchange rate		1.009							
(Ch$/US$)			-	-	-	-	-	-	-
(Receive Ch$/pay US$):									
Liability		14,058	-	-	-	-	-	14,058	14,058
Average contractual exchange rate		0.0019							
(US$/Ch$)			-	-	-	-	-	-	-
(Receive Real/pay US$):									

Liability		71	-	-	-	-	-	71	71
Average contractual exchange rate		2.4675							
(US$/Real)			-	-	-	-	-	-	-
Cross-Currency Swaps (Receive US$/pay UF)									
Liability		-	90,138	120,358	-	83,909	-	294,405	294,405
Average contractual exchange rate			0.0326	0.0328		0.0304			
(UF/US$)	-	-			-		-	-	-

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(1) Average interest rate means, for variable rate debt, the average prevailing interest rate as of December 31, 2006 on Telefónica Chile s variable rate debt and, for fixed rate debt, the average prevailing interest rate as of December 31, 2006 on Telefónica Chile s fixed rate debt.

(2) The UF-dollar exchange rate differs from the peso-dollar exchange rate in that the UF automatically adjusts in accordance with Chilean inflation and is tied in part to the peso-dollar exchange rate.

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	As of December 31, 2005 Expected Maturity Date								
	Average Interest Rate(1)	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**	**Total Long-Term Debt (including 2006 Maturities)**	**Fair Value**
	(Ch$ equivalent in millions, except exchange rates)								
On-Balance Sheet Financial Instruments:									
Liabilities long-term interest-bearing debt:									
Fixed rate (US$)(2)	8.19%	112,228	-	-	-	-	-	112,228	111,766
Variable rate (US$)	4.75%	1,019	-	78,489	104,653	-	78,489	262,650	262,650
Anticipated Transactions and Related Derivatives Forward Exchange Agreements				**Expected transaction date**					
(Receive US$/pay UF):(2)									
Liability		35,835	-	-	-	-	-	35,835	35,835
Average contractual exchange rate		0.0308							
(UF/US$)			-	-	-	-	-	-	-
(Receive US$/pay Ch$):									
Liability		24,512	-	-	-	-	-	24,512	24,512
Average contractual exchange rate		1.0184							
(Ch$/US$)			-	-	-	-	-	-	-
(Receive Real/pay US$):									
Liability		71	-	-	-	-	-	71	71
Average contractual exchange rate		2.6081							

(US$/Real)			-	-	-	-	-	-	-
Cross-Currency Swaps									
(Receive US$/pay UF)									
Liability		-	-	87,435	118,794	-	39,556	245,785	245,785
Average contractual exchange rate				0.0317	0.0324		0.0308		
(UF/US$)	-	-	-			-		-	-

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(1) Average interest rate means, for variable rate debt, the average prevailing interest rate as of December 31, 2005 on Telefónica Chile s variable rate debt and, for fixed rate debt, the average prevailing interest rate as of December 31, 2005 on Telefónica Chile s fixed rate debt.

(2) The UF-dollar exchange rate differs from the peso-dollar exchange rate in that the UF automatically adjusts in accordance with Chilean inflation and is tied in part to the peso-dollar exchange rate.

In addition, during 2006, the Company held U.S. dollar-denominated marketable securities such as U.S. dollar-denominated debentures of the Chilean Central Bank (BCD and BCU). The total fair value of these securities is Ch$16,278 million.

During 2005, the Company held U.S. dollar-denominated marketable securities such as U.S. dollar-denominated debentures of the Chilean Central Bank (BCD and BCU). The total fair value of these securities is Ch$16,081 million.

The tables below provide information about the Company s U.S. dollar-denominated marketable securities that are sensitive to foreign currency exchange rates and present principal cash flows by maturity date.

As of December 31, 2006
Maturity Date(1)

Average Interest Rate(2)	**2007**	**2008**	**2009**	**2010**	**2011**	**No Contractual Maturity**	**Fair Value**
		(in Ch$ millions as of December 31, 2005)					

	As of December 31, 2006 Maturity Date(1)							
	Average Interest Rate(2)	**2007**	**2008**	**2009**	**2010**	**2011**	**No Contractual Maturity**	**Fair Value**
Marketable securities:								
BCD	5.00%	14,315	-	-	-	-	-	14,315
BCU	5.00%	-	-	1,963	-	-	-	1,963
Total		-	-	-	-	-	-	16,278

(1) These figures, calculated based on the Observed Exchange Rate as of December 31, 2006, which was Ch$532.39 = US$1.00, reflect the amount Telefónica Chile would receive if the U.S. dollar-denominated marketable securities were held to maturity.

(2) Securities coupon. Effective average rates for BCD and BCU are 5.35% and 2.9%, respectively.

	As of December 31, 2005 Maturity Date(1)							
	Average Interest Rate(2)	**2006**	**2007**	**2008**	**2009**	**2010**	**No Contractual Maturity**	**Fair Value**
			(in Ch$ millions as of December 31, 2005)					
Marketable securities:								
BCD	5.00%	-	14,097	-	-	-	-	14,097
BCU	5.00%	-	-	-	1,984	-	-	1,984
Total		-	-	-	-	-	-	16,081

(1) These figures, calculated based on the Observed Exchange Rate as of December 31, 2005, which was Ch$512.50 = US$1.00, reflect the amount Telefónica Chile would receive if the U.S. dollar-denominated marketable securities were held to maturity.

(2) Securities coupon. Effective average rates for BCD and BCU are 5.06%, and 3.14%, respectively.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

Not applicable.

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

ITEM 15. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Under the supervision and with the participation of our management, including our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer, we have evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2006. Based on that evaluation, our Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer have concluded that these controls and procedures are effective in ensuring that all material information required to be filed in this Annual Report has been made known to them in a timely fashion.

Management s Annual Report on Internal Control over Financial Reporting. The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Securities Exchange Act of 1934 as a process designed by, or under the supervision of, the Company s Chief Executive Officer, Chief Financial Officer and Chief Accounting Officer and effected by the Company s Board of Directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

Pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transaction and dispositions of the assets of the Company;

Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use of disposition of the Company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company s management assessed the effectiveness of the Company s internal control over financial reporting as of December 31, 2006. In making this assessment, the Company s management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management believes that, as of December 31, 2006, the Company s internal control over financial reporting is effective based on those criteria.

Management s assessment of the effectiveness of internal control over financial reporting as of December 31, 2006, has been audited by Ernst & Young Ltda., an independent registered public accounting firm, as stated in their report, which is included under Item 18 Financial Statements .

Changes in internal controls. No significant changes in our internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses, were made as a result of the evaluation.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

On July 21, 2005, an Audit Committee was created with a total of three independent members pursuant to the requirements of the Sarbanes-Oxley Act. The members of this Committee are Mr. Andrés Concha, Mr. Alfonso Ferrari and Mr. Hernán Cheyre. Mr. Hernán Cheyre was appointed as Audit Committee Financial Expert as defined by the Securities and Exchange Commission.

ITEM 16B. CODE OF ETHICS

We have adopted a code of ethics that applies to our Principal Executive Officer, Principal Financial Officer, Principal Accounting Officer, Controller, and to persons performing similar functions. The complete code of ethics is available on the Telefónica Chile website (www.telefonicachile.cl).

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Ernst &Young Ltda. has served as the Company s independent public accountants for each of the financial years in the two-year period ended December 31, 2006, for which audited financial statements appear in this annual report on Form 20-F.

The following table presents the aggregate fees for professional services and other services rendered by Ernst & Young Ltda (the current audit firm) to the Company in 2005 and 2006.

	As of December 31,	
	2005	**2006**
	(in thousands of Chilean pesos as of December 31, 2006)	
Audit Fees(1)	291,030	645,277
Audit-Related Fees(2)	-	-
Tax Fees(3)	-	-
All Other Fees(4)	-	-
Total	**291,030**	**645,277**

(1) Audit Fees consist of fees billed for the annual audit services engagement and other audit services, which are those services that only the external auditor reasonably can provide, and include the group audit, statutory audits, comfort letters and consents, attest services, and assistance with and review of documents filed with the SEC.

(2) Audit-related Fees consist of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our financial statements or that are traditionally performed by the external auditor, and include consultations concerning financial accounting and reporting standards, internal control reviews of new systems, programs and projects, review of security controls and operational effectiveness of systems, review of plans and controls for shared service centers, due diligence related to acquisitions, accounting assistance and audits in connection with proposed or completed acquisitions, and employee benefit plan audits.

(3) Tax Fees include fees billed for tax compliance services, including the preparation of original and amended tax returns and claims for refund, tax consultations, such as assistance and representation in connection with tax

audits and appeals, tax advice related to mergers and acquisitions, transfer pricing, and requests for rulings or technical advice from taxing authorities, tax-planning services, and expatriate tax-planning and services.

(4) All Other Fees include fees billed for training, forensic accounting, data security reviews, treasury control reviews and process improvement and advice, and environmental, sustainability and corporate social responsibility advisory services.

Audit Committee Pre-Approval Policies and Procedures

According to Article 52 of Chilean Corporations Law No. 18,046, the engagement of external auditors is approved by shareholders each year at the Company s General Annual Shareholders Meeting. As such, the Board of Directors of the Company does not have a policy for hiring external auditors. The Company s Directors Committee is responsible for proposal of external auditors made by the Board to shareholders at the General Annual Shareholders Meeting in accordance with the Chilean Corporations Law. At the General Annual Shareholders Meeting held in April 2005, Company Shareholders approved the engagement of Ernst & Young Ltda. for the twelve-month period ending April 2006. At the General Annual Shareholders Meeting held on April 20, 2006, Company shareholders approved the engagement of Ernst & Young Ltda. for the next twelve-month period ending April 2007, for the amounts of UF20,000 for the audit and between UF7,700 to UF12,000 for compliance work relating to the Sarbanes-Oxley Act requirements.

During 2006, the Company s principal accountants did not render any non-audit services. The Company has not permitted the principal accountants to render any non-audit services. The Company s Directors Committee approves all audit, audit-related services, tax services and other services provided by auditing firms. The Audit Committee s main duties are related to Independent Audits, disclosure of Financial Statements and Internal Audits.

ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Not applicable.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

PART III

ITEM 17. FINANCIAL STATEMENTS

Not applicable.

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ITEM 18. FINANCIAL STATEMENTS

The following financial statements (beginning on page F-1), together with the related Reports of Independent Registered Public Accounting Firm, are filed as part of this Annual Report.

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ITEM 19. EXHIBITS

Exhibit No.	Description
1.1	English translation of the Bylaws (Estatutos) of the Company, as amended, which includes its corporate charter. (4)
2.1	The instruments defining the rights of holders of the outstanding long-term debt securities of the Company and its subsidiaries are omitted pursuant to Instruction 2(b)(i) of the Instructions to the Exhibits of Form 20-F. The Company hereby agrees to furnish copies of these instruments to the Securities and Exchange Commission upon request.
4.1	English translation of Contract for the Sale of Sonda Shares between Telefónica Empresas CTC Chile S.A. and Inversiones Pacífico II Limitada dated September 26, 2002.(1)
4.2	English translation of Contract for the Sale of Sonda Shares between Telefónica Empresas CTC Chile S.A. and Inversiones Santa Isabel Limitada dated September 26, 2002.(1)
4.3	English translation of the Option Agreement between Telefónica Empresas CTC Chile S.A. and Inversiones Santa Isabel Limitada dated September 26, 2002.(1)
4.4	English translation of Contract for the Sale of Sonda Shares between the seller Telefónica Empresas CTC Chile S.A. and the buyers Inversiones Pacífico II Limitada, Inversiones Atlántico Limitada and Santa Isabel Limitada dated August 27, 2003.(2)
4.5	English translation of Contract for the Sale of 9% ownership interest in Publiguías between the seller Telefónica Chile S.A. and the buyer Telefónica Publicidad e Información S.A. (TPI) dated April 26, 2004. (3)
4.6	English translation of Contract for the Sale of Telefónica Móvil de Chile S.A. shares between the seller Telefónica Chile S.A. and the buyer Telefónica Móviles S.A. (TEM) dated July 23, 2004. (3)
8.1	List of Subsidiaries of the Company.
11.1	Code of Ethics(2)
12.1	Certification of the Chief Executive Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.2	Certification of the Chief Financial Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
12.3	Certification of the Chief Accounting Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
13.1	Certification of the Chief Executive Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the

Sarbanes-Oxley Act of 2002.

13.2 Certification of the Chief Financial Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

13.3 Certification of the Chief Accounting Officer of Compañía de Telecomunicaciones de Chile S.A. furnished pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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(1) Filed as an Exhibit to the Company s annual report on Form 20-F for the fiscal year ended December 31, 2002 and incorporated by reference hereto.

(2) Filed as an Exhibit to the Company s annual report on Form 20-F for the fiscal year ended December 31, 2003 and incorporated by reference hereto.

(3) Filed as an Exhibit to the Company s annual report on Form 20-F for the fiscal year ended December 31, 2004 and incorporated by reference hereto.

(4) Filed as an Exhibit to the Company s annual report on Form 20-F for the fiscal year ended December 31, 2005 and incorporated by reference hereto.

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SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE, S.A.

By: /s/ Julio Covarrubias

Name: Julio Covarrubias
Title: Chief Financial Officer

Date: April 13, 2007

COMPAÑIA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES

Audited Consolidated Financial Statements as of
December 31, 2005 and 2006 and for each of the three years in the period ended December 31, 2006
together with the Reports of Independent Registered Public Accounting Firms

(Translation of financial statements originally issued in Spanish)

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Ch$: Chilean peso
ThCh$: Thousands of Chilean pesos.
UF : The Unidad de Fomento, or UF, is an inflation-indexed peso-denominated monetary unit in Chile. The daily UF rate is fixed in advance based on the change in the Chilean Consumer Price Index of the previous month.
US$: United States dollars
ThUS$: Thousands of United States dollars.

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Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of
Compañía de Telecomunicaciones de Chile S.A.:

We have audited the accompanying consolidated balance sheets of Compañía de Telecomunicaciones de Chile S.A. and its subsidiaries (the Company) as of December 31, 2005 and 2006, and the related consolidated statements of operations, changes in shareholders equity and cash flows for each of the two years in the period ended December 31, 2006. Our audits also included the financial statement Schedule II - Valuation and Qualifying Accounts. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Compañía de Telecomunicaciones de Chile S.A. and subsidiaries at December 31, 2005 and 2006, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2006, in conformity with accounting principles generally accepted in Chile, which differ in certain respects from US generally accepted accounting principles (see Note 37 to the consolidated financial statements). Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As described in Note 3 to the financial statements, beginning on January 1, 2005, the Company implemented changes in estimates regarding its accounting for staff severance indemnities to record the future obligation using actuarial valuation, and regarding its process to record accounts receivable and payable from international traffic.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company s internal control over financial reporting as of December 31, 2006, based on the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated January 24, 2007, except for internal control over financial reporting related to Notes 35 and 37 of the 2006 consolidated financial statements as to which the date is April 12, 2007, expressed an unqualified opinion thereon.

ERNST & YOUNG LTDA.

Santiago, Chile
January 24, 2007
(Except as to Notes 35 and 37 as to which the date is April 12, 2007)

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of Compañía de Telecomunicaciones de Chile S.A.:

We have audited the accompanying consolidated statements of operations and cash flows of Compañía de Telecomunicaciones de Chile S.A. and Subsidiaries (the Company) for the year ended December 31, 2004 (all expressed in constant Chilean pesos). Our audit also included the financial statement schedules listed in the index to Item 18. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the results of the operations and the cash flows of Compañía de Telecomunicaciones de Chile S.A. and subsidiaries for the year ended December 31, 2004, in conformity with accounting principles generally accepted in Chile. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

As detailed in Note 26 a), on July 23, 2004, the Company sold its subsidiary Telefónica Móvil de Chile S.A. As a result of this transaction, the Company recognized a gain on disposal of ThCh$303,540,170 (historical), net of taxes and goodwill write-off.

Accounting principles generally accepted in Chile vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 37 to the consolidated financial statements.

Deloitte.
Santiago, Chile

June 10, 2005

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Report of Independent Registered Public Accounting Firm on Internal Control over Financial Reporting

The Board of Directors and Shareholders of Compañía de Telecomunicaciónes de Chile S.A.:

We have audited management s assessment, included in the accompanying management s report on internal control over financial reporting, that Compañía de Telecomunicaciónes de Chile S.A. and subsidiaries (the Company) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management s assessment and an opinion on the effectiveness of the Company s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management s assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management s assessment that the Company maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the 2005 and 2006 consolidated financial statements of Compañía de Telecomunicaciones de Chile S.A. and our report dated January 24, 2007, except as to Notes 35 and 37 as to which the date is April 12, 2007 expressed an unqualified opinion thereon.

ERNST & YOUNG LTDA.

Santiago, Chile
January 24, 2007
(Except for internal control over financial reporting related to Note 35 and 37 of the 2006 consolidated financial statements as to which the date is April 12, 2007)

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COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2005 and 2006
(Restated for general price-level changes and expressed in thousands of constant Chilean pesos as of December 31, 2006 except as stated)

		As of December 31,		
ASSETS	**Notes**	**2005**	**2006**	**2006**
		ThCh$	ThCh$	ThUS$ (Note 2)
CURRENT ASSETS:				
Cash		6,424,238	10,074,960	18,924
Time deposits	(4)	86,753,294	27,543,715	51,736
Marketable securities, net	(5)	16,078,005	16,263,602	30,548
Accounts receivable, net	(6)	151,965,200	176,310,318	331,168
Notes receivable, net	(6)	3,433,457	4,125,379	7,749
Other receivables	(6)	12,271,773	10,524,404	19,768
Due from related companies	(7a)	14,546,828	17,421,462	32,723
Inventories, net		2,867,731	5,259,293	9,879
Prepaid taxes		4,731,578	2,965,213	5,570
Prepaid expenses		2,655,976	922,191	1,732
Deferred taxes, net	(8b)	11,930,838	13,932,290	26,169
Other current assets	(9)	11,333,038	10,948,558	20,565
TOTAL CURRENT ASSETS		**324,991,956**	**296,291,385**	**556,531**
PROPERTY, PLANT AND EQUIPMENT	(11)			
Land		27,852,723	27,858,064	52,326
Buildings and improvements		791,790,968	785,112,256	1,474,694
Machinery and equipment		2,723,729,586	2,762,527,493	5,188,917
Other property, plant and equipment		264,559,181	316,701,911	594,868
Technical revaluation		9,948,548	9,463,656	17,776
Accumulated depreciation		(2,490,072,578)	(2,672,072,073)	(5,019,013)
TOTAL PROPERTY, PLANT AND EQUIPMENT, NET		**1,327,808,428**	**1,229,591,307**	**2,309,568**
OTHER NON-CURRENT ASSETS				
Investment in related companies	(12)	7,996,697	8,109,310	15,232
Investment in other companies		4,179	4,179	8
Goodwill, net	(13)	18,838,807	15,954,977	29,969
Long term receivables	(6)	15,706,980	13,607,076	25,558
Intangibles,net	(14)	37,809,712	35,272,664	66,253

Other non-current assets	(15)	13,897,470	17,945,351	33,707
TOTAL OTHER ASSETS		**94,253,845**	**90,893,557**	**170,727**
TOTAL ASSETS		**1,747,054,229**	**1,616,776,249**	**3,036,826**

The accompanying notes 1 to 37 are an integral part of these consolidated financial statements

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2005 and 2006
(Restated for general price-level changes and expressed in thousands of constant Chilean pesos as of December 31, 2006 except as stated)

		As of December 31,		
LIABILITIES AND SHAREHOLDERS EQUITY	**Notes**	**2005**	**2006**	**2006**
		ThCh$	ThCh$	ThUS$ (Note 2)
CURRENT LIABILITIES:				
Current maturities of long-term debt	(16)	1,347,294	2,005,114	3,766
Commercial paper	(18a)	58,285,826	-	-
Current maturities of bonds payable	(18b)	113,712,131	1,839,758	3,456
Current maturities of other long-term obligations		16,862	11,722	22
Dividends payable		1,755,595	1,598,709	3,003
Trade accounts payable	(19)	78,087,761	107,216,258	201,387
Other payables	(20)	20,939,772	13,926,967	26,159
Due to related companies	(7b)	26,408,461	33,007,160	61,998
Accruals	(21)	10,299,309	8,381,697	15,744
Withholdings		12,584,338	16,586,668	31,155
Deferred Revenue		10,981,319	10,099,258	18,970
Other current liabilities		849,241	-	-
TOTAL CURRENT LIABILITIES		**335,267,909**	**194,673,311**	**365,660**
LONG-TERM LIABILITIES				
Long-term debt with banks and financial institutions	(17)	326,873,609	331,380,831	622,440
Bonds payable	(18b)	12,453,342	66,141,943	124,236
Other accounts payable	(23)	26,013,822	28,210,503	52,988
Accruals	(21)	36,078,910	35,525,488	66,728
Deferred taxes, net	(8b)	59,588,547	55,064,116	103,428
Other liabilities		4,095,910	3,788,895	7,116
TOTAL LONG-TERM LIABILITIES		**465,104,140**	**520,111,776**	**976,936**
CONTINGENCIES AND COMMITMENTS	(31)	-	-	-
MINORITY INTEREST	(24)	**1,670,081**	**1,230,287**	**2,311**
SHAREHOLDERS' EQUITY	(25)			
Paid-in capital		931,859,276	890,894,953	1,673,388

Other reserves	(1,788,017)	(3,000,511)	(5,636)
Retained earnings	14,940,840	12,866,433	24,167
TOTAL SHAREHOLDERS' EQUITY	**945,012,099**	**900,760,875**	**1,691,919**
TOTAL LIABILITIES, MINORITY INTEREST AND SHAREHOLDERS' EQUITY	**1,747,054,229**	**1,616,776,249**	**3,036,826**

The accompanying notes 1 to 37 are an integral part of these consolidated financial statements

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For the years ended December 31, 2004, 2005 and 2006
(Restated for general price-level changes and expressed in thousands of constant Chilean pesos as of December 31, 2006 except as stated)

		For the years ended December 31,			
	Notes	**2004**	**2005**	**2006**	**2006**
		ThCh$	ThCh$	ThCh$	ThUS$ (note 2)
OPERATING REVENUES		743,470,466	592,904,274	577,203,534	1,084,174
Operating costs		(470,119,649)	(380,887,804)	(373,024,912)	(700,661)
Gross profit		**273,350,817**	**212,016,470**	**204,178,622**	**383,513**
Administrative and selling expenses		(168,491,083)	(123,091,244)	(121,554,811)	(228,319)
OPERATING RESULTS		**104,859,734**	**88,925,226**	**82,623,811**	**155,194**
NON-OPERATING RESULTS:					
Interest income		9,822,201	8,152,458	4,436,559	8,333
Equity in earnings of equity-method investees	(12)	761,908	1,748,329	1,949,359	3,662
Other non-operating income	(26a)	502,951,353	3,170,833	1,616,867	3,037
Equity in losses of equity-method investees	(12)	(187,934)	(33,193)	(33,628)	(63)
Amortization of goodwill	(13)	(148,511,412)	(1,616,816)	(2,222,691)	(4,175)
Interest expense and other		(57,175,378)	(30,120,752)	(19,480,089)	(36,590)
Other non-operating expenses	(26b)	(26,095,860)	(13,351,580)	(16,644,682)	(31,264)
Price-level restatement, net	(27)	(4,407,261)	1,985,668	500,929	941
Foreign exchange gain, net	(28)	13,908,037	976,129	164,889	310
NON-OPERATING (LOSS) INCOME, NET		**291,065,654**	**(29,088,924)**	**(29,712,487)**	**(55,809)**
INCOME BEFORE INCOME TAXES AND MINORITY INTEREST		**395,925,388**	**59,836,302**	**52,911,324**	**99,385**
INCOME TAXES	(8c)	(65,998,904)	(34,093,408)	(29,599,897)	(55,598)

INCOME BEFORE MINORITY INTEREST		**329,926,484**	**25,742,894**	**23,311,427**	**43,787**
MINORITY INTEREST	(24)	(299,385)	(30,724)	41,619	78
NET INCOME FOR THE YEAR		**329,627,099**	**25,712,170**	**23,353,046**	**43,865**

The accompanying notes 1 to 37 are an integral part of these consolidated financial statements

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COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY
For the years ended December 31, 2004, 2005 and 2006
(Restated for general price-level changes and expressed in thousands of constant Chilean pesos as of December 31, 2006 except as stated)

	Paid-in capital ThCh$	**Other reserves ThCh$**	**Net income (loss) for the year ThCh$**	**Retained Earnings ThCh$**	**Interim dividend ThCh$**	**Total shareholders' equity ThCh$**
2004						
Balances as of December 31, 2003	859,490,281	(791,199)	10,133,882	421,404,583	-	1,290,237,547
Transfer of 2003 net income to retained earnings	-	-	(10,133,882)	10,133,882	-	-
Accumulated adjustment for conversion differences	-	(425,240)	-	-	-	(425,240)
Final dividend 2003	-	-	-	(3,062,903)	-	(3,062,903)
Final dividend	-	-	-	(385,685,783)	-	(385,685,783)
2004 interim dividend	-	-	-	-	(252,992,348)	(252,992,348)
Price-level restatement	21,487,256	(21,212)	-	6,016,572	(2,311,551)	25,171,065
Net income for the year	-	-	311,628,674	-	-	311,628,674
Balances as of December 31, 2004	**880,977,537**	**(1,237,651)**	**311,628,674**	**48,806,351**	**(255,303,899)**	**984,871,012**
Balances as of December 31, 2004 restated	**931,859,276**	**(1,309,132)**	**329,627,099**	**51,625,211**	**(270,049,231)**	**1,041,753,224**
2005						
Balances as of December 31, 2004	880,977,537	(1,237,651)	311,628,674	48,806,351	(255,303,899)	984,871,012
Transfer of 2004 net income to retained earnings	-	-	(311,628,674)	311,628,674	-	-
Accumulated adjustment for conversion differences	-	(469,034)	-	-	-	(469,034)
	-	-	-	(255,303,899)	255,303,899	-

Absorption interim dividend						
Final dividend 2004	-	-	-	(56,324,775)	-	(56,324,775)
Final dividend	-	-	-	(48,806,351)	-	(48,806,351)
2005 interim dividend	-	-	-	-	(10,528,728)	(10,528,728)
Price-level restatement	31,715,192	(44,556)	-	-	(21,058)	31,649,578
Net income for the year	-	-	25,183,320	-	-	25,183,320
Balances as of December 31, 2005	**912,692,729**	**(1,751,241)**	**25,183,320**	**-**	**(10,549,786)**	**925,575,022**
Balances as of December 31, 2005 restated	**931,859,276**	**(1,788,017)**	**25,712,170**	**-**	**(10,771,330)**	**945,012,099**
2006						
Balances as of December 31, 2005	912,692,729	(1,751,241)	25,183,320	-	(10,549,786)	925,575,022
Transfer of 2005 net income to retained earnings	-	-	(25,183,320)	25,183,320	-	-
Capital Decrease	(40,200,514)	-	-	-	-	(40,200,514)
Absorption interim dividend	-	-	-	(10,528,728)	10,528,728	-
Final dividend 2005	-	-	-	(14,654,592)	-	(14,654,592)
2006 interim dividend	-	-	-	-	(10,528,728)	(10,528,728)
Adjustment of foreign investment conversion reserve	-	(530,149)	-	-	-	(530,149)
Price-level restatement, net	18,402,738	(44,867)	-	-	63,173	18,421,044
Other reserves	-	(674,254)	-	-	-	(674,254)
Net income for the year	-	-	23,353,046	-	-	23,353,046
Balances as of December 31, 2006	**890,894,953**	**(3,000,511)**	**23,353,046**	**-**	**(10,486,613)**	**900,760,875**
ThUS$ (note 2)	**1,673,388**	**(5,637)**	**43,865**	**-**	**(19,697)**	**1,691,919**

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COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended December 31, 2004, 2005 and 2006
(Restated for general price-level changes and expressed in thousands of constant Chilean pesos as of December 31, 2006 except as stated)

	For the years ended December 31,			
	2004	**2005**	**2006**	**2006**
	ThCh$	ThCh$	ThCh$	ThUS$ (note 2)
Net income for the year	329,627,099	25,712,170	23,353,046	43,865
Sales of assets:				
(Gain) loss on sales of property, plant and equipment	16,181	21,738	(369,370)	(694)
Gain on sales of investments	(498,573,176)	-	-	-
Debits (credits) to income that do not represent operating cash flows:				
Depreciation in operating income for the year	241,080,624	198,189,266	204,027,048	383,229
Other depreciation	6,701,327	2,724,767	879,772	1,652
Amortization of intangibles	2,724,861	4,847,335	5,024,127	9,437
Provisions and write offs	37,603,098	24,902,211	18,166,959	34,123
Equity in earnings of equity method investees	(761,908)	(1,748,329)	(1,949,359)	(3,662)
Equity in losses of equity method investees	187,934	33,193	33,628	63
Amortization of goodwill	148,511,412	1,616,816	2,222,691	4,175
Price-level restatement, net	4,407,261	(1,985,668)	(500,929)	(941)
Foreign exchange (loss) gain	(13,908,037)	(976,129)	(164,889)	(310)
Other credits to income that do not represent cash flows	(1,062,897)	(291,238)	(348,448)	(654)
Other debits to income that do not represent cash flows	12,228,052	5,706,348	4,765,168	8,951
Changes in operating assets (increase) decrease:				
Trade accounts receivable	(14,296,772)	(6,020,873)	(25,378,648)	(47,669)
Inventories	(14,278,177)	2,248,105	(1,691,020)	(3,176)
Other assets	24,067,225	69,775,880	7,383,569	13,869
Changes in operating liabilities increase (decrease):				
Accounts payable related to operating activities	(65,365,732)	(74,456,219)	9,437,998	17,728
Interest payable	(7,760,572)	1,748,841	1,090,622	2,049
Income taxes payable (net)	46,847,566	(23,756,730)	(16,247,098)	(30,517)
Other accounts payable related to non-operating activities	(6,769,161)	1,727,998	5,574,141	10,470
V.A.T. and other similar taxes payable	3,211,066	(3,783,493)	(636,558)	(1,196)
Minority interest	**299,385**	**30,724**	**(41,619)**	**(78)**

NET CASH FLOWS FROM OPERATING ACTIVITIES	**234,736,659**	**226,266,713**	**234,630,831**	**440,714**
NET CASH USED IN FINANCING ACTIVITIES				
Issuance of Commercial papers and Bonds	36,873,322	70,465,529	73,366,735	137,806
Dividends paid	(670,458,928)	(118,171,643)	(25,340,206)	(47,597)
Capital Decrease	-	-	(40,596,288)	(76,253)
Loans repaid	(18,176,890)	(35,093,202)	-	-
Repayment of Commercial papers and Bonds (less)	(225,844,067)	(122,595,127)	(188,404,582)	(353,885)
Repayment of other loans from related companies (less)	(23,608,290)	-	-	-
Other sources of financing	-	-	(687,110)	(1,291)
Net cash used in financing activities	**(901,214,853)**	**(205,394,443)**	**(181,661,451)**	**(341,220)**
NET CASH (USED IN) PROVIDED BY INVESTMENT ACTIVITIES				
Sales of property, plant and equipment	189,504	1,263,681	1,502,949	2,823
Sales of permanent investments	720,552,658	-	-	-
Sales of other investments	18,064,197	12,143,501	-	-
Collection of documented loans to related companies	179,865,476	-	-	-
Other investment income	-	26,866	-	-
Acquisition of property, plant and equipment (less)	(93,295,579)	(73,579,347)	(109,523,791)	(205,721)
Acquisition of intangibles	(7,262,498)	(7,946,870)	-	-
Investments in financial instruments (less)	(11,561,019)	(19,146,457)	-	-
Permanent investments (less)	-	(49,591)	-	-
Other investment activities (less)	(3,280,068)	(965,524)	-	-
Net cash (used in) provided by investment activities	**803,272,671**	**(88,253,741)**	**(108,020,842)**	**(202,898)**
NET CASH FLOWS FOR THE YEAR	**136,794,477**	**(67,381,471)**	**(55,051,462)**	**(103,404)**
EFFECT OF INFLATION ON CASH AND CASH EQUIVALENTS	**(6,713,663)**	**(1,574,386)**	**(863,534)**	**(1,622)**
NET (DECREASE) INCREASE OF CASH AND CASH EQUIVALENTS	**130,080,814**	**(68,955,857)**	**(55,914,996)**	**(105,026)**
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	**36,137,096**	**166,217,910**	**97,262,053**	**182,689**
CASH AND CASH EQUIVALENTS AT END OF YEAR	**166,217,910**	**97,262,053**	**41,347,057**	**77,663**

The accompanying notes 1 to 37 are an integral part of these consolidated financial statements

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements

Note 1. Composition of Consolidated Group and Registration with the Securities Registry:

Compañía de Telecomunicaciones de Chile S.A. and subsidiaries (Telefónica Chile S.A. or the Company) provides telecommunication services within Chile which consist of local and long distance telephone services and certain broadband services.

The Company is an open-stock corporation that is registered in the Securities Registry under No. 009 and is therefore subject to supervision by the Chilean Superintendency of Securities and Insurance (SVS) as well as by the United States Securities and Exchange Commission (SEC) since issuing American Depositary Receipts (ADRs) in 1990.

Subsidiary companies registered with the Securities Registry are:

Subsidiaries	Taxpayer Number	Registration Number	Participation (direct & indirect) as of December 31, 2004 %	2005 %	2006 %
Telefónica Larga Distancia S.A. (1)	96.551.670-0	456	99.16	99.16	99.31
Globus 120 S.A. (1)	96.887.420-9	694	99.99	99.99	-
Telefónica Asistencia y Seguridad S.A.	96.971.150-8	863	99.99	99.99	99.99

(1) On April 19, 2006, Telefónica Mundo S.A. changed its name to Telefónica Larga Distancia S.A. On May 1, 2006, Telefónica Larga Distancia S.A. absorbed Globus 120 S.A.

Note 2. Summary of Significant Accounting Policies:

a) Accounting period:

These consolidated financial statements (hereinafter the financial statements) are presented as of and for the years ended December 31, 2005 and 2006. (The following presentation of Form 20-F includes comparable disclosures and information of the income and cash flow statements for the year ended December 31, 2004. Originally this additional information was not presented in the local consolidated financial statements as of December 31, 2006).

b) Basis of preparation:

The consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in Chile (Chilean GAAP) and standards set forth by the Chilean Superintendency of Securities and Insurance. In the event of discrepancies between the generally accepted accounting principles in Chile issued by the Chilean Accountants Association and the standards set forth by the SVS, the standards set forth by the SVS shall prevail for the Company.

(c) Basis of presentation:

The comparative balances as of December 31, 2004 and 2005 have been price-level restated in order to allow comparison with the 2006 financial statements as detailed in Note 2e. For comparison purposes, certain reclassifications have been made to the 2004 and 2005 financial statements.

For the convenience of the reader, the financial statements have been translated from Spanish to English.

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (continued)

Note 2. Summary of Significant Accounting Policies, (continued):

(d) Basis of consolidation:

The financial statements include the assets, liabilities, income and cash flows of Compañía de Telecomunicaciones de Chile (the Parent Company) and subsidiaries. Significant intercompany transactions have been eliminated, and the participation of minority investors has been recognized as Minority Interest (see Note 24).

The Company consolidates the following companies:

		Ownership participation percentage				
		2004	2005	2006		
Taxpayer No.	Company name	Total	Total	Direct	Indirect	Total
96.551.670-0	Telefónica Larga Distancia S.A. (5)	99.16	99.16	99.31	-	99.31
96.961.230-5	Telefónica Gestión de Servicios Compartidos Chile S.A.	99.99	99.99	99.99	-	99.99
74.944.200-k	Fundación Telefónica Chile	50.00	50.00	50.00	-	50.00
96.971.150-8	Telefónica Asistencia y Seguridad S.A.	99.99	99.99	99.99	-	99.99
90.430.000-4	Telefónica Empresas CTC Chile S.A.	99.99	99.99	99.99	-	99.99
78.703.410-1	Telefónica Multimedia Chile S.A. (1)	99.99	99.99	99.99	-	99.99
96.834.320-3	Telefónica Internet Empresas S.A. (2)	99.99	99.99	99.99	-	99.99
96.811.570-7	Instituto Telefónica Chile S.A. (3)	79.99	79.99	-	99.99	99.99
96.545.500-0	CTC Equipos y Servicios de Telecomunicaciones S.A. (4)	99.99	99.99	-	-	-
96.887.420-9	Globus 120 S.A. (5)	99.99	99.99	-	-	-

(1) On January 26, 2006, Telefónica Internet Empresas S.A. sold 449,081 shares of Tecnonáutica S.A. to Telefónica Chile S.A. for ThCh$ 1,624,273 (historical) corresponding to its participation in that company. On that same date, CTC Equipos y Servicios de Telecomunicaciones S.A. sold 1 share to Telefónica Chile S.A. for ThCh$ 4 corresponding to its participation in that company. On April 19, 2006, Tecnonáutica S.A. changed its name to Telefónica Multimedia Chile S.A.

(2) On January 26, 2006, CTC Equipos y Servicios de Telecomunicaciones S.A. sold 16 shares of Telefónica Internet Empresas S.A. to Telefónica Chile S.A. for ThCh$ 132 (historical value) corresponding to its participation in that company.

On January 27, 2006, Telefónica Empresas CTC Chile S.A. sold 215,099 shares of Telefónica Internet Empresas S.A. to Telefónica Chile S.A. for ThCh$ 1,468,683 (historical) corresponding to its participation in that company.

(3) On October 3, 2006, the third party COASIN Chile S.A. sold to Telefónica Gestión de Servicios Compartidos de Chile S.A. its participation in Administradora de Telepeajes de Chile S.A. of 426,000 shares for a sum of ThCh$ 3,200 (historical value). On October 20, 2006, Telefónica Internet Empresas S.A. sold to Telefónica Gestión de Servicios Compartidos Chile S.A. 1,703,999 shares of Telepeajes de Chile S.A. for ThCh$ 12,800 (historical value). On that same date, Administradora de Telepeajes de Chile S.A. changed its name to Instituto Telefónica Chile S.A.

(4) On February 28, 2006, Telefónica Chile S.A. purchased one share of CTC Equipos y Servicios de Telecomunicaciones S.A. from third parties for ThCh$ 11 (historical value), and absorbed its subsidiary on March 1, 2006.

(5) On April 19, 2006, Telefónica Mundo S.A. changed its name to Telefónica Larga Distancia S.A. On May 1, 2006, Telefónica Larga Distancia S.A. absorbed Globus 120 S.A.

COMPAÑÍA DE TELECOMUNICACIONES DE CHILE S.A. AND SUBSIDIARIES

Notes to the Consolidated Financial Statements (continued)

Note 2. Summary of Significant Accounting Policies, (continued):

(e) Price-level restatement:

The cumulative inflation rate in Chile as measured by the Chilean Consumer Price Index (CPI) for the three-year period ended December 31, 2006 was approximately 8.9% .

Chilean GAAP requires that the financial statements be restated to reflect the full effects of changes in the purchasing power of the Chilean peso on the financial position and results of operations of reporting entities. The method is based on a model that enables calculation of net inflation gains or losses caused by monetary assets and liabilities exposed to changes in the purchasing power of the local currency. The historical costs of such accounts, equity accounts and the statement of operations are restated for general price-level changes between the initial date of recognition of each item and the year-end (see also Note 27).

The purchasing power gain or loss included in net income or loss reflects the effects of Chilean inflation on the monetary assets and liabilities held by the Company.

The restatements were calculated using the official consumer price index of the National Institute of Statistics and based on the prior month rule , in which the inflation adjustments are based on the CPI at the close of the month preceding the close of the respective period or transaction. This index is considered by the business community, the accounting profession and the Chilean government to be the index that most closely complies with the technical requirement to reflect the variation in the general level of prices in Chile, and consequently it is widely used for financial reporting purposes.

The values of the Chilean consumer price index used to reflect the effects