

TELEFONICA BRASIL S.A.
Form 20-F
April 20, 2012

As filed with the Securities and Exchange Commission on April 20, 2012

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, 2011

OR

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

OR

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

Date of event requiring this shell company report _____
For the transition period from _____ to _____

Commission file number: 001-14475

TELEFÔNICA BRASIL S.A.
(Exact name of Registrant as specified in its charter)

TELEFÔNICA BRAZIL S.A.
(Translation of Registrant's name into English)

Federative Republic of Brazil
(Jurisdiction of incorporation or organization)

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01321-001 São Paulo, SP, Brazil
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(Name, Telephone, Email and/or Facsimile and Address of Company Contact Person)

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
Preferred Shares, without par value	New York Stock Exchange*
American Depositary Shares (as evidenced by American Depositary Receipts), each representing one share of Preferred Stock	New York Stock Exchange

* Not for trading purposes, but only in connection with the registration on the New York Stock Exchange of American Depositary Shares representing those Preferred Shares.

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.

The number of outstanding shares of each class as of December 31, 2011 was:

Title of Class	Number of Shares Outstanding
Shares of Common Stock	381,347,371
Shares of Preferred Stock	742,537,273

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

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

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 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

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

U.S. GAAP International Financial Reporting Standards as issued by the International Accounting Standards Board Other

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

Item 17 Item 18

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

Yes No

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INTRODUCTION

References in this annual report to “Telefônica Brasil,” “we,” “our,” “us,” “our company” and “the company” are to Telefônica Brasil S.A. and its consolidated subsidiaries (unless the context otherwise requires). All references in this annual report to:

- “ADRs” are to the American Depositary Receipts evidencing our ADSs;
- “ADSs” are to our American Depositary Shares, each representing one share of our nonvoting preferred stock;
- “ANATEL” are to Agência Nacional de Telecomunicações – ANATEL, the Brazilian telecommunication regulatory agency;
- “BM&FBOVESPA” are to the BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros, the São Paulo stock exchange;
- “BNDES” are to Banco Nacional de Desenvolvimento Econômico e Social, the Brazilian Development Bank;
- “Brazil” are to the Federative Republic of Brazil;
- “Brazilian Central Bank,” “BACEN,” “Central Bank of Brazil” or “Central Bank” are to the Banco Central do Brasil, the Brazilian Central Bank;
 - “Brazilian Corporate Law” are to Law No. 6,404 of December 15, 1976, as amended;
 - “CADE” are to Conselho Administrativo de Defesa Econômica, the Brazilian competition authority;
 - “CDI” are to Certificado de Depósito Interbancário, the Certificate for Interbank Deposits;
 - “Ceterp” are to Centrais Telefônicas de Ribeirão Preto;
- “Celular CRT” are to Celular CRT Participações S.A. and its consolidated subsidiary, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
 - “CMN” are to the Conselho Monetário Nacional, the Brazilian Monetary Council;
 - “Commission” or “SEC” are to the U.S. Securities and Exchange Commission;
- “Corporate Law Method” is the accounting practice to be followed in the preparation of our financial statements for regulatory and statutory purposes under Brazilian Corporate Law and accounting standards issued by the CVM;
 - “CTBC Telecom” are to Companhia de Telecomunicações do Brasil Central;
 - “CTBC Borda” are to Companhia Brasileira Borda do Campo – CTBC;
 - “CVM” are to the Comissão de Valores Mobiliários, the Brazilian Securities Commission;
 - “D.O.U.” are to the Diário Oficial da União, the Official Newspaper of the Brazilian Government;

- “Federal District” are to Distrito Federal, the federal district where Brasilia, the capital of Brazil, is located;
- “General Telecommunications Law” are to Lei Geral de Telecomunicações, as amended, the law which regulates the telecommunications industry in Brazil;

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- “Global Telecom” or “GT” are to Global Telecom S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;
 - “IASB” are to International Accounting Standards Board;
- “IBGE” are to Instituto Brasileiro de Geografia e Estatística, the Brazilian Institute of Geography and Statistics;
 - “IFRS” are to International Financial Reporting Standards, as issued by the IASB;
- “IOF” are to Imposto sobre Operações de Crédito, Câmbio e Seguros, or tax on credit, exchange and insurance;
- “IPCA” are to Índice Nacional de Preços ao Consumidor Amplo, the consumer price index, published by the Instituto Brasileiro de Geografia e Estatística;
 - “IST” are to Índice Setorial de Telecomunicações, the inflation index of the telecommunications sector;
- “Number Portability” are to Portabilidade Numérica, the service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers;
 - “NYSE” are to the New York Stock Exchange;
 - “Oi” are to Oi S.A., the mobile operator branch of Telemar;
- “PTAX” or “PTAX rate” are to the weighted average daily buy and sell exchange rates between the real and U.S. dollar that is calculated by the Central Bank;
 - “Real,” “reais” or R\$ are to the Brazilian real, the official currency of Brazil;
- “Speedy” are to broadband services provided by us through asymmetric digital subscriber lines, or ADSL;
- “TCO” are to Tele Centro Oeste Celular Participações, which includes TCO’s “B” band subsidiary and NBT, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
 - “TCP” are to TELESP Celular Participações S.A., Vivo’s predecessor company;
- “TLE” are to Tele Leste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
- “TSD” are to Tele Sudeste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
 - “Telebrás” are to Telecomunicações Brasileiras S.A.–Telebrás;
 - “Telemar” are to Telemar Norte Leste S.A. (controlled by Tele Norte Leste Participações S.A.);
 - “Telemig” or “Telemig Participações” are to Telemig Celular Participações S.A.;
 - “Telemig Celular” are to Telemig Celular S.A.;

- “Telenorte” or “Tele Norte” are to Tele Norte Celular Participações S.A.;
- “TELESP Celular” and “TC” are to TELESP Celular S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;
- “Telpart” are to Telpart Participações S.A.;

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- “TJLP” are to Taxa de Juros de Longo Prazo, or long-term interest rate;
- “UMBNDDES” are to a monetary unit of the BNDES, consisting of a currency basket of BNDES debt obligations in foreign currencies, which are mostly denominated in U.S. dollars;
 - “U.S. dollar,” “U.S. dollars” or “US\$” are to U.S. dollars, the official currency of the United States;
- “Vivo” are to Vivo S.A., a wholly owned subsidiary of Telefônica Brasil, that conducts cellular operations including SMP (as defined in the “Glossary of Telecommunication Terms”), in the following areas:
 - “Areas 1 and 2,” the state of São Paulo (operations previously provided by TELESP Celular S.A.);
 - “Area 3,” the states of Rio de Janeiro and Espírito Santo (operations previously provided by Telerj Celular S.A., or Telerj, and Telest Celular S.A., or Telest);
 - “Area 4,” the state of Minas Gerais;
 - “Area 5,” the states of Paraná and Santa Catarina (operations previously provided by Global Telecom);
 - “Area 6,” the state of Rio Grande do Sul (operations previously provided by Celular CRT);
 - “Areas 7 and 8,” the central western and northern regions, including the states of Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul, Rondônia, Acre, Amapá, Amazonas, Maranhão, Para and Roraima and in the Federal District (operations previously provided by Telegoias Celular S.A., or Telegoias, Telemat Celular S.A., or Telemat, Telems Celular S.A., or Telems, Teleron Celular S.A., or Teleron, Teleacre Celular S.A., or Teleacre, Norte Brasil Telecom S.A., or NBT and TCO);
 - “Area 9,” the states of Bahia and Sergipe (operations previously provided by Telebahia Celular S.A., or Telebahia, and Telergipe Celular S.A., or Telergipe); and
 - “Area 10,” the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.
 - “Vivo Participações” are to Vivo Participações S.A. (formerly TELESP Celular Participações S.A.) and its consolidated subsidiaries (unless the context otherwise requires); and
 - “Vivo brand” are to the brand used in Brazil in the operations of Vivo;

Unless otherwise specified, data relating to the Brazilian telecommunications industry included in this annual report were obtained from ANATEL.

The “Glossary of Telecommunications Terms” that begins on page 144 provides the definition of certain technical terms used in this annual report.

On October 3, 2011, our Extraordinary General Shareholders’ Meeting approved the merger, into the Company, of Vivo Participações S.A., with its subsequent extinguishment, as well as the modification of our corporate name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A.

As a result of such modification, the trade codes for our shares were also modified as of October 6, 2011 (inclusive), from TLPP3 (for the common shares) and TLPP4 (for the preferred shares) to VIVT3 and VIVT4, respectively, with

the subsequent change of trading name to TELEF BRAZIL. The trade code for the ADRs, VIV, on New York Stock Exchange was not changed.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENT

This Annual Report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “will,” “expect,” “aim,” “hope,” “anticipate,” “intend,” “believe” and similar language or the negative thereof or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3. Key Information—D. Risk Factors,” “Item 4. Information on the Company,” “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- statements concerning our operations and prospects;
- the size of the Brazilian telecommunications market;
 - estimated demand forecasts;
 - our capital expenditure plan;
- our ability to secure and maintain telecommunications infrastructure licenses, rights-of-way and other regulatory approvals;
 - our strategic initiatives and plans for business growth;
 - industry conditions;
 - our funding needs and financing sources;
 - network completion and product development schedules;
 - expected characteristics of competing networks, products and services;
 - the outcome of certain legal proceedings;
 - regulatory and legal developments;
 - quantitative and qualitative disclosures about market risk;
- other statements of management’s expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts; and
 - other factors identified or discussed under “Item 3. Key Information—D. Risk Factors.”

Forward-looking information involves risks and uncertainties that could significantly affect expected results. The risks and uncertainties include, but are not limited to:

-

the short history of our operations as an independent, private-sector entity and the ongoing introduction of greater competition to the Brazilian telecommunications sector;

- the cost and availability of financing;
- uncertainties relating to political and economic conditions in Brazil as well as those of other emerging markets;
 - inflation, interest rate and exchange rate risks;
 - the Brazilian government's telecommunications policy;

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- the Brazilian government's tax policy;
- the Brazilian government's political instability; and
- the adverse determination of disputes under litigation.

We undertake no obligation to publicly update or revise any forward-looking statements as a result of new information, future events or otherwise. Because of these risks and uncertainties, the forward-looking information, events and circumstances discussed in this annual report might not occur. Our actual results and performance could differ substantially from those anticipated in our forward-looking statements.

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PRESENTATION OF FINANCIAL INFORMATION

We maintain our books and records in reais. We prepared our consolidated financial statements included in this annual report in accordance with IFRS.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Those areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3 to our consolidated financial statements.

Our financial statements prepared in accordance with IFRS were those as of and for the years ended December 31, 2011 and December 31, 2010 which were filed with the CVM, the local securities regulator in Brazil and made publicly available. The selected financial information for the Company included in “Item 3. Key Information—A. Selected Financial Data” should be read in conjunction with, and is qualified in its entirety by, the IFRS financial statements of the Company and “Item 5. Operating and Financial Review and Prospects” appearing elsewhere in this annual report.

The consolidated financial statements as of December 31, 2011 and 2010 are in compliance with the IFRS, as issued by the International Accounting Standards Board (IASB) and also with the pronouncements, interpretations and guidance issued by Accounting Standards Committee (Comitê de Pronunciamentos Contábeis – “CPC”) in place on December 31, 2011, which include the new pronouncements, interpretations and amendments issued by the IASB and IFRIC (IFRS Interpretations Committee) which entered into force as of January 1, 2011.

Our first adoption of IFRS to consolidated financial statements was for the year ended on December 31, 2010. Our financial statements as of the transition date for applying IFRS as of January 1, 2009 and the comparative period as of and for the year ended December 31, 2009 have been restated to reflect adjustments made as a result of the adoption of IFRS. These consolidated financial statements have been audited by Ernst & Young Terco Auditores Independentes S.S. (“E&Y” or “Ernst & Young”).

We have made rounding adjustments to reach some of the figures included in this annual report. Accordingly, numerical figures shown as totals in some tables may not be an arithmetic aggregation of the figures that preceded them.

Vivo Participações S.A. and Vivo S.A. are included in our financial statements for only nine months in 2011, therefore our results of operations in 2010 and 2009 are not fully comparable with our results of operations in 2011.

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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

Our consolidated financial statements are prepared in accordance with IFRS.

We maintain our books and records in reais.

Our consolidated financial statements for the years ended December 31, 2011 and 2010 are prepared in accordance with IFRS. The date for our first adoption of IFRS to our consolidated financial statements was December 31, 2010. As a result the financial information for the year ended December 31, 2009 have been restated from Brazilian GAAP to reflect the first adoption of IFRS.

The selected financial data presented below should be read in conjunction with our consolidated financial statements, including the notes thereto. Our consolidated financial statements included herein as of and for the years ended December 31, 2011, 2010 and 2009 have been audited by Ernst Young Terco Auditores Independentes S.S. The report of Ernst Young Terco Auditores Independentes S.S. on the consolidated financial statements appears elsewhere in this annual report.

On March 25, 2011, the Boards of Directors of Vivo Participações, our former subsidiary, and Telefônica Brasil approved the terms and conditions of the corporate restructuring of both companies, which was approved unanimously by the general meetings of shareholders of the two companies held on April 27, 2011.

The transaction consisted of the unification of the share base of fixed and mobile operators of the Telefônica group in Brazil through the merger of all shares of Vivo Participações into Telefônica Brasil, with Telefônica Brasil as the surviving entity. Telefônica Brasil exchanged each share of Vivo Participações held by shareholders of Vivo Participações for shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. Upon closing of the merger and the share exchange, Vivo S.A. remained our wholly owned direct subsidiary. The Company assessed the fair value of the assets acquired and the liabilities assumed from Vivo Participações S.A. as of March 31, 2011 for purposes of applying the acquisition method to the transaction as a business combination, and we consolidated and included Vivo Participações S.A. in our results of operations as of April 1, 2011.

The Company acquired 100% of shares of Vivo Participações S.A., amounting to R\$31,222,630. See Note 1 and Note 4 to our consolidated financial statements. The Company's consolidated financial statements include Vivo Participações S.A. and Vivo S.A. as of April 1, 2011. Vivo Participações S.A. and Vivo S.A. were included in the Company's consolidated financial statements through the full consolidation method. Because Vivo Participações S.A. and Vivo S.A. are included in our financial statements for only nine months in 2011, our results of operations in 2010 and 2009 are not fully comparable with our results of operations in 2011.

In addition, Vivo Participações' Board of Directors meeting held on June 14, 2011 approved a proposal to group the authorizations for the provision of SMP services (at the time held by Vivo Participações in the state of Minas Gerais and by Vivo S.A. in the other states of Brazil), bringing together the operations and the Authorization Terms for SMP services at Vivo S.A.

This corporate restructuring took place on October 1, 2011 by the transfer of assets, rights and liabilities related to the operation of SMP services in Minas Gerais from Vivo Participações to Vivo S.A. Upon completion of this transfer, Vivo Participações became a holding company.

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In accordance with the provisions of Law No. 6,404/76, a specialized company was engaged to prepare a valuation study for the part of Vivo Participações' net assets corresponding to SMP operations in the state of Minas Gerais that were transferred to Vivo S.A., as well as for the net equity of Vivo Participações that was absorbed into the Company.

Accordingly, under the terms of article 226, paragraphs I and II of Law No. 6,404/76, shares held by the Company in Vivo Participações were cancelled. Upon conclusion of the corporate restructuring on October 3, 2011, Vivo Participações was merged into the Company and Vivo S.A. became the Company's full subsidiary, thus simplifying and rationalizing our corporate structure.

The following tables present a summary of our selected financial data at the dates and for each of the periods indicated. You should read the following information together with our audited consolidated financial statements and the notes thereto included elsewhere in this annual report and with "Item 5. Operating and Financial Review and Prospects."

Income Statement Data:	Year ended December 31,		
	2011	2010	2009
	(in millions of reais, except for share and per share data)		
IFRS			
Net operating revenue	29,129	15,798	15,852
Cost of goods and services	(14,728)	(8,845)	(9,236)
Gross profit	14,401	6,953	6,616
Operating expenses, net	(8,603)	(3,391)	(3,221)
Equity in earnings (losses) of associates	–	2.9	19.0
Operating income before financial expense, net	5,797	3,566	3,414
Financial expense, net	(140)	(121)	(189)
Income before tax and social contribution	5,658	3,445	3,225
Income tax and social contribution	(1,296)	(1,046)	(1,021)
Net Income	4,362	2,399	2,204
Attributable to:			
Controlling shareholders	4,355	2,398–	2,204
Non-controlling shareholders	7	–	–
Basic and diluted earnings per share:			
Common Shares	4.40	4.45	4.08
Preferred Shares	4.84	4.89	4.49
Cash Dividends per share in reais, net of withholding tax:			
Common Shares	4.78	3.62	2.56
Preferred Shares	5.26	3.98	2.81

Balance Sheet Data:	As of December 31,		
	2011	2010	2009
	(in millions of reais, except where indicated)		
IFRS			
Property, plant and equipment, net	17,154	10,201	9,672
Total assets	65,490	19,966	20,643
Loans and financing—current portion	988	420	1,768
Loans and financing—noncurrent portion	3,959	1,405	1,752
Shareholders' equity	43,331	11,667	11,300

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Attributable to:

Controlling shareholders	43,326	–	–
Noncontrolling shareholders	5	–	–
Capital stock	37,798	6,575	6,575
Number of shares outstanding (in thousands)	1,123,884	505,841	505,841

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Cash Flow Data:	Year ended December 31,		
	2011	2010	2009
	(in millions of reais, except where indicated)		
IFRS			
Operating activities:			
Net cash provided by operations	8,141	4,532	4,449
Investing activities:			
Net cash used in investing activities	(2,029)	(1,659)	(2,296)
Financing activities:			
Net cash used in financing activities	(4,729)	(3,594)	(1,618)
Increase (decrease) in cash and cash equivalents	1,383	(720)	536
Cash and cash equivalents at beginning of year	1,557	2,277	1,741
Cash and cash equivalents at end of year	2,940	1,557	2,277

Exchange Rates

The Brazilian Central Bank allows the real/U.S. dollar exchange rate to float freely and has intervened occasionally to control the exchange rate volatility. However, the exchange market may continue to be volatile, and the real may depreciate or appreciate substantially in relation to the U.S. dollar. The Brazilian Central Bank or the Brazilian government may intervene in the exchange rate market.

Since March 17, 2008, Brazilian exporters have been allowed to keep 100% of income from exports outside of Brazil. In addition, the foreign exchange mechanism was simplified to provide for the simultaneous purchase and sale of foreign currency through the same financial institution and using the same exchange rate.

In October 2009, the Brazilian government increased the tax rate related to foreign investments in the Brazilian financial and capital markets from 0% to 2%, including investments made pursuant the Brazilian Monetary Council (Conselho Monetário Nacional), or CMN, Resolution No. 2,689, dated January 26, 2000, as amended. The Tax on Financial Transactions (Imposto sobre Operações Financeiras), or IOF tax, applies upon conversion of foreign currency into Brazilian reais related to equity or debt investments by foreign investors in the Brazilian stock exchanges or the over-the-counter, or OTC, market, as well as private investment funds, Brazilian treasury notes and other fixed income securities.

On October 5, 2010, the Brazilian government announced measures to respond to the real appreciation by increasing the IOF tax rate to 4% on foreign exchange transactions related to foreign investments in the financial and capital markets, except for variable income investments traded on the stock exchange, which remained at 2%. However, the increase failed to achieve its intended goal of curbing the appreciation of the Brazilian currency in comparison to the U.S. dollar.

On October 18, 2010, new increases in the IOF tax rate were announced by the Brazilian government, which adopted a 6% tax rate for foreign exchange transactions and for the investments of foreign investors in accordance with the margin requirements for transactions with future instruments on the BM&FBOVESPA. The IOF tax rate remains at zero on exchange transactions for outflow of these funds as well as for proceeds received as a result of initial public offerings. The conversion of Brazilian currency into foreign currency for purposes of paying dividends for ADS programs is not subject to taxation.

On January 6, 2011, the Central Bank of Brazil published Circular 3,520, which imposes a 60% minimum reserve deposit for any financial operations exceeding US\$3 billion.

On July 26, 2011, the Brazilian government issued Decree 7,536, increasing the IOF tax rate to 1% on the acquisition, sale and maturity of derivative contracts that result in short positions in relation to the previous day, as a way to reduce short positions in foreign exchange rate.

The following tables set forth the exchange rate (rounded to the nearest tenth of a cent), expressed in reais per U.S. dollar (R\$/US\$) for the periods indicated, as reported by the Central Bank.

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Year ended December 31,	Exchange Rate of R\$ per US\$			
	Low	High	Average(1)	Period-End
2007	1.732	2.156	1.929	1.771
2008	1.559	2.500	1.833	2.337
2009	1.741	2.378	1.990	1.741
2010	1.655	1.880	1.759	1.665
2011	1.535	1.902	1.671	1.876

Source: Central Bank of Brazil, PTAX.

(1) Represents the average of the exchange rates (PTAX) on the last day of each month during the relevant period.

Month	Exchange Rate of R\$ per US\$			
	Low	High	Average(2)	Period-End
September 2011	1.604	1.902	1.729	1.854
October 2011	1.689	1.886	1.785	1.689
November 2011	1.727	1.894	1.781	1.811
December 2011	1.783	1.876	1.834	1.876
January 2012	1.739	1.868	1.804	1.739
February 2012	1.702	1.738	1.720	1.709
March 2012	1.715	1.833	1.774	1.822
April 2012 (through April 19)	1.826	1.887	1.856	1.887

Source: Central Bank of Brazil, PTAX.

(2) Represents the average of the exchange rates (PTAX) of the lowest and highest rates in the month.

On April 19, 2012, the exchange rate was R\$1.887 to US\$1.00. The real/dollar exchange rate fluctuates and, therefore, the exchange rate at April 19, 2012 may not be indicative of future exchange rates.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

This section is intended to be a summary of more detailed discussions contained elsewhere in this annual report. The risks described below are not the only ones we face. Additional risks that we do not presently consider material, or of which we are not currently aware, may also affect us. Our business, results of operations or financial condition could be impacted if any of these risks materializes and, as a result, the market price of our preferred shares and our ADSs could be affected.

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the trading price of our preferred shares and ADSs.

In the past, the Brazilian government has intervened in the Brazilian economy and made changes in policy and regulations. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, capital controls, and limits on imports, among other things. Our business, financial condition, results of operations and the market price of our preferred shares and ADSs may be

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adversely affected by changes in government policies, especially those related to our sector, such as changes in telephone fees and competitive conditions, as well as general economic factors, including:

- currency fluctuations;
- exchange control policies;
- internal economic growth;
 - inflation;
 - energy policy;
 - interest rates;
- liquidity of domestic capital and lending markets;
- tax policies; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over the possibility of the Brazilian government implementing changes in policy or regulation affecting these or other factors in the future may contribute to economic uncertainty in Brazil and heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian companies. In addition, possible political crises may affect the confidence of investors and the public in general, which may result in economic deceleration and affect the trading prices of shares issued by companies listed on the stock exchange, such as us.

Our business may be vulnerable to the current disruptions and volatility in the global financial markets.

The international economy remains subject to risks and adjustments arising from the international financial crisis. The international financial system remains susceptible to unfavorable credit and liquidity conditions. Foreign and national financial institutions, including some of the largest commercial banks, investment banks, mortgage lenders, guarantors and mortgage insurance companies, could continue to experience significant difficulties, including runs on their deposits and inadequate liquidity. Therefore, the prices of financial assets are likely to continue to reflect risk aversion, with increased volatility.

In an attempt to increase liquidity in the financial markets and prevent the failure of the financial system, various governments may continue to intervene in their financial systems, and perform tax adjustments. There is no assurance, however, that these measures will be successful in stabilizing conditions in international financial markets.

Despite the extent of the above-mentioned interventions, global investor confidence could remain low, the global financial markets could remain volatile and access to credit could still be lacking. The continuation or worsening of disruption and volatility in the global financial markets may have a material adverse effect on our ability to access the capital markets under appropriate financial conditions, which may adversely affect our operations. Furthermore, an environment of economic downturn may negatively affect the financial stability of our customers, which could result in a general reduction in Brazil's economic activity and the consequent loss of income for us.

Political instability may have an adverse impact on the Brazilian economy and on our business.

Political crisis in Brazil can affect the trust of investors and the public in general, as well as the development of the economy. Political crises may have an adverse impact on the Brazilian economy, our business, financial condition, results of operations and the market price of our preferred shares and ADSs.

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Inflation and government efforts to curb inflation may contribute to economic uncertainty in Brazil, adversely affecting our business and results of operations.

Brazil has historically experienced high rates of inflation. Inflation and certain of the government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2011, inflation measured by the Consumer Index (Índice de Preços ao Consumidor), or IPCA, reached 6.50%, in line with the upper limit established by the National Monetary Council, but above the central inflation target of 4.50%. In 2012, the Brazilian monetary policy will continue to use the IPCA for establishing the inflation target. The inflation target for 2012 is set at 4.50%, similar to 2011. If inflation rises beyond this target, the basic interest rates may rise, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2012, factors that may adversely affect consumer inflation are, among others, the international commodities prices, the impact of buoyant domestic economic activity on domestic prices and the indexation of prices and tariffs.

Since 2006, telephone fees for fixed line services have been indexed to the Index of Telecommunication Service, or IST, reduced by a productivity factor. The IST is a basket of national indexes that reflects the industry's operating costs. As a result, this index serves to reduce potential discrepancies between our industry's revenue and costs, and thus reduce the apparent adverse effects of inflation upon our operations.

The fee rate increase authorized by ANATEL, which references the IST, is reduced by a factor of productivity and applied cumulatively after a period of 12 months. This can cause increases in costs and salaries above and below that of our revenue, with adverse impacts on our profitability. Increases in interest rates may have a material adverse effect on our business.

The Monetary Policy Committee of the Brazilian Central Bank (Comitê de Política Monetária do Banco Central do Brasil), or COPOM, sets the target of the basic interest rate for the Brazilian financial system based on an expectation of convergence between the future inflation rate and the central inflation target. On December 31, 2011, the basic interest rate was 11.0% per year, compared to 10.75% per year on December 31, 2010. Further increases in the basic interest rate may occur throughout 2012 with adverse effects on our business. According to current market consensus, inflation measured by the IPCA will be higher than the established inflation target of 4.50% for 2012. As a result, the Central Bank may increase the SELIC rate (the Central Bank's overnight rate) in 2012 to align inflation with the inflation target, which may adversely effect our business.

Fluctuations in exchange rates may adversely affect our ability to meet liabilities denominated or linked to foreign currencies or reduce our income in foreign currency, and may have a material adverse effect on the market value of our preferred shares and ADSs.

The exchange rate between the U.S. dollar and the Brazilian real has experienced significant fluctuations in recent years. Between 2000 and 2003, the real was devalued 67% against the U.S. dollar and gained 40% between 2004 and 2010, considering the annual average exchange rates. Between 2001 and 2011, the real appreciated by 29% against the U.S. dollar.

As of December 31, 2011, 19.32% of our R\$6.20 billion total financial debt was denominated in U.S. dollars and UMBNDES. As of December 31, 2011, we had currency hedges in place to cover all of our financial foreign currency-denominated bank debt.

Part of the costs relating to our network infrastructure and services provided by outside vendors is payable or linked to payment by us in U.S. dollars. By contrast, our revenue is generated in reais, except income derived from hedging transactions, international long-distance interconnection and services to customers outside of Brazil.

To the extent that the value of the real decreases relative to the U.S. dollar or euro, our commitments linked to fluctuations in exchange rates or payable in foreign currencies becomes more expensive and in return our accounts receivable denominated in foreign currencies appreciate, which could adversely affect our revenue and expenses. However, 99.9% of the net balance of the transactions denominated in foreign currencies is covered by hedge transactions. Since May 2010, the Company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures generated by invoices issued or received in foreign currencies, substantially reducing the Company's risk to fluctuations in exchange rates. By periodically receiving invoices for the net balance

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coverage and determining the coverage of exposures, the Company's corporate market risk department monitors its foreign exchange exposure and commitments linked to foreign currencies so as not to achieve a significant amount of exposure.

It should be noted that the IST, the current index applicable to telecommunication fees for fixed-line services, does not adequately reflect the true effect of exchange rate fluctuations. Thus, since 2006, telecommunication revenue, when converted to U.S. dollars, does not adequately reflect the true effect of exchange rate fluctuations, so that our results of operations could be adversely affected. See "—A. Selected Financial Data—Exchange Rates" for more information on exchange rates.

Political, economic and social developments and the perception of risk in other developed and emerging countries may adversely affect the Brazilian economy, our business, and the market price of Brazilian securities, including our preferred shares and ADSs.

The market for securities issued by Brazilian companies may be influenced, to varying degrees, by economic conditions in both emerging and developed market countries. The reaction of investors to developments in other countries may have an adverse impact on the market value of securities of Brazilian companies. Crises in other emerging countries or the economic policies of other countries may reduce investor demand for securities of Brazilian companies, including our preferred shares. Any of the foregoing developments may adversely affect the market value of our preferred shares and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

Exchange controls and restrictions on remittances abroad may adversely affect holders of our preferred shares and ADSs.

Brazilian law allows that, whenever there is a significant imbalance in Brazil's balance of payments or a significant possibility that such imbalance will exist, the Brazilian government may impose temporary restrictions on capital outflows. Such restrictions could hinder or prevent the holders of our preferred shares or the custodian of our shares in Brazil, Banco Itaú Unibanco S.A. (acting as the agent for the depositary), from remitting dividends abroad. The Brazilian government imposed restrictions on capital outflows for a six-month period at the end of 1989. If similar restrictions are introduced in the future, they would likely have an adverse effect on the market price of our preferred shares and ADSs.

Risks Relating to the Brazilian Telecommunications Industry and Us

Extensive government regulation of the telecommunications industry and our concession may limit, in some cases, our flexibility in responding to market conditions, competition and changes in our cost structure or impact our fees.

Our business is subject to extensive government regulation, including any changes that may occur during the period of our authorization to provide telecommunication services. ANATEL, which is the main telecommunications industry regulator in Brazil, regulates, among other things:

- industry policies and regulations;
- licensing;
- fees and tariffs;
- competition, including, therefore, our ability to grow by acquiring other telecommunications businesses;

- telecommunications resource allocation;
 - service standards;
 - technical standards;
 - quality standards;

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- interconnection and settlement arrangements; and
- universal service obligations.

Brazil's telecommunications regulatory framework is continuously evolving. The interpretation and enforcement of regulations, the assessment of compliance with regulations and the flexibility of regulatory authorities are all marked by uncertainty. We operate under authorization from the Brazilian government, and our ability to retain this authorization is a precondition to our success. However, because of the regulatory framework, we cannot provide assurances that ANATEL will not adversely modify the terms of our authorization. Furthermore, according to the terms of our operating authorizations, we are obligated to meet certain requirements and to maintain minimum quality, coverage and service standards. Failure by us to comply with these requirements may result in the imposition of fines or other government actions, including the termination of our operating authorizations. Any partial or total revocation of any of our operating authorizations would have a material adverse effect on our business, financial condition, revenues, results of operations and prospects. In recent years, ANATEL has also been reviewing and introducing changes in the applicable regulation, especially regarding the interconnection fees among telecommunications service providers in Brazil. Interconnection fees, which are fees charged by telecommunications service providers to each other to interconnect to each others' networks, are an important part of our revenue base. To the extent that changes to the rules governing interconnection fees reduce the amount of interconnection fees we are able to collect, our businesses, financial conditions, revenues, results of operations and prospects could be materially adversely affected.

Therefore, our businesses, results of operations, revenues and financial conditions could be negatively affected by the actions of the Brazilian authorities, including, in particular, the following:

- the introduction of new or stricter operational and/or service requirements;
- the granting of operating licenses in our areas;
- delays in the granting of, or the failure to grant, approvals for rate increases; and
- antitrust limitations imposed by ANATEL and the CADE.

Brazilian antitrust regulation is based on Law No. 8,884 of June 11, 1994, which prohibits any practice or transactions aimed at restricting free competition, dominating the relevant market of goods or services, arbitrarily increasing profits, or abusively exercising a dominant market position. The Economic Law Office (Secretaria de Direito Econômico), or SDE, and the Secretariat for Economic Monitoring (Secretaria de Acompanhamento Econômico), or SEAE, also act towards promoting the principle of free, ample and fair competition among all providers, as well as toward correcting the effects of imperfect competition and repressing violations against economic order. We cannot continue to expand our growth through acquisition of other service providers given the antitrust objections of ANATEL along with the fact that we currently already render SMP service all over the country. Consolidation of other competitors in the telecommunications market will increase the competitive pressure on us due to the increase in their economies of scale and reduction of operational costs, and we may be unable to respond adequately to pricing pressures resulting from consolidation, which would adversely affect our business, financial condition and results of operations.

Our concession may be terminated by the Brazilian government under certain circumstances.

We operate our business under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other

things, expansion of our network to provide public pay-phone service for all locations with populations in excess of 100, expansion of our network to provide private individual telephone service for all locations with populations in excess of 300, and, with respect to quality of service, targets for the number of call completions. Our ability to satisfy these terms and conditions, as well as others, may be affected by factors beyond our control. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations. Moreover, the concession

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agreements establish that all assets owned by the Company and which are indispensable to the provision of the services described in such agreements are considered reversible assets and are deemed to be part of the concession assets. The assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time. On December 31, 2011, the net book value of reversible assets is estimated at R\$6.7 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

The expiration date of the original concession agreements was December 31, 2005, but it has since been renewed as of December 22, 2005 for an additional 20-year term. The current concession agreements contain a provision allowing ANATEL to review the concession terms in 2015 and 2020. This provision permits ANATEL to update the renewed concession agreements with respect to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions. On December 30, 2010, ANATEL amended the Company's concession agreements to allow further amendments on May 2, 2011, December 31, 2015 and December 31, 2020. These further amendments may establish new conditions and targets for universal access and quality, taking into consideration the conditions prevailing at the time, including complementary resources.

Important mergers and acquisitions in the market should increase competition in the upcoming years.

In 2011, we faced a strong growth in the Brazilian mobile telecommunication market, considering the number of costumers and revenue, due to new marketing strategies targeted at stimulating clients to use more voice (local and long-distance calls) and data services. In the fixed market, however, we experienced weak growth. Our competitors have also started to bundle services and integrate their fixed and mobile operations to sell complete service pack to their clients and improve operational efficiency.

Some of the most important telecommunication groups in Brazil experienced a degree of merger and acquisition (M&A) activity in 2011. These have included TIM, a subsidiary of Telecom Italia, and Oi, which acquired a medium-size company that provides Wi-Fi services in public indoor areas, and the largest shareholder of which is Portugal Telecom.

Mergers and acquisitions may change the market dynamic, cause competitive pressure and force small competitors to find partners and may impact our business, in terms of operations, financial condition, marketing strategies and offering of products and promotions.

We face increasing competition from telecom service providers.

The cellular industry is growing fast, mainly because of increased competition. Our competitors have been using aggressive promotions to increase their client base and, as a result, market share (in particular TIM, which reassumed the second position in the mobile market and is challenging our leadership in the prepaid market). New marketing strategies stimulate clients to use more voice (unlimited minutes within the provider's network, including long-distance calls) and mobile Internet (with the launch of prepaid and daily offers).

The increase in competition and the related potential loss in market share could have an adverse effect on our business, financial condition and results of operations.

Our results of operations may be negatively affected by the application of the SMP rules.

Under the SMP regime, our cellular subsidiaries receive payments for the use of their networks in accordance with a network usage payment plan, which includes outbound long-distance calls. Until June 30, 2004, SMP service

providers were able to opt to establish a price cap or freely negotiate our interconnection charges. In early 2005, ANATEL began permitting free negotiations for mobile interconnection, or VU-M, fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in mobile operators' fees). ANATEL approved that provisional agreement and, in March 2006, approved another provisional agreement of a 4.5% increase for VU-M fees for long-distance calls, or VC2, VC3, and international calls, among the same operators that had made the VC1 agreement in July 2005. The current rule is the free negotiation of fees, subject to ANATEL regulations. In July 2007, ANATEL approved a provisional agreement among us and the fixed-line operators Telemar, Brasil Telecom,

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CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of approximately 1.97% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of approximately 2.25% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

ANATEL also issued Regulation No. 460/2007 regarding Number Portability, implementing and developing fixed and wireless Number Portability in Brazil effective as of March 2009, with most costs being borne by the operators. For SMP, Number Portability is applied for wireless codes of access of the same registration area. As of December 2011, there were 242.2 million cell phones in Brazil. From the period beginning in September 2008, when Number Portability became effective, until December 31, 2011, 2,240,949 people changed out and 2,248,418 people changed into our subsidiaries as their mobile operator. For fixed operators, Number Portability is applied for fixed codes of access of the same local area. There can be no assurance that this new regulation will not have material adverse effects on the results of our operations.

We cannot predict whether the current regulatory regime will remain in place or whether any future regulatory change will have an adverse effect on our results of operations. We cannot assure you that the interconnection rates we negotiated will be upheld or that future negotiations will be as favorable as those that were previously set by ANATEL. If the readjustments that we negotiated are cancelled or if freely negotiated interconnection fees in the future are less favorable to us, our business, financial condition, revenues, results of operations and prospects will be adversely affected.

If the inflation adjustment index now applied to our prices is changed, the new index may not adequately reflect the true effect of inflation on our prices, which could adversely affect our results of operations.

The Brazilian government currently uses the General Price Index, or the IGP-DI (the Índice Geral de Preços Disponibilidade Interna), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, in connection with the prices charged in the wireless telecommunications industry. Starting in 2010, the Brazilian government began regulating the telecommunications industry based on an economic model (FAC, or "Fully Allocated Costs") that analyzes companies' total costs based on a theoretical company's costs and other factors. In connection with this model, the Brazilian government used a different inflation adjustment mechanism, the IST index. Under Resolution No. 438/2006, ANATEL will determine the reference cost of using mobile networks (RVU-M) for SMP providers who have significant market power, which will be used in the arbitration case by ANATEL to determine the VU-M fee. The inflation adjustment of the RVU-M value uses the IST index. In the auctions by SMP of new radio frequency bands, ANATEL has been using the IST index for determining the value of the installments to be paid for the licenses. If this new inflation adjustment mechanism, or any other mechanism chosen by the Brazilian government in the future, does not adequately reflect the true effect of inflation on our prices, our results of operations could be adversely affected.

ANATEL's new regulation regarding interconnection and network usage fees could have an adverse effect on our results.

Since the beginning of 2005, ANATEL published the following new regulations on interconnection and network usage fees of SMP providers, some of which could have an adverse effect on our results: (1) new General Regulation of Interconnection (Regulamento Geral de Interconexão—Resolution No. 410/2005, or RGI); (2) the Regulation of Separation and Allocation of Costs (Resolution No. 396/2005); (3) the Regulation for Network Usage Fees of SMP providers (Regulamento de Remuneração pelo Uso de Redes de Prestadoras do SMP—Resolution No. 438/2006 and Resolutions No. 480/2007, 483/2007, 503/2008 and 549/2010) and the Regulation on the Criteria for Adjustment of Tariffs for Calls from STFC involving SMP or SME No. 576/2011 (Resolution No. 576/2011); (4) the Regulation for Usage of Spectrum in the 800, 900, 1800, 1900 and 2100 MHz bands (Resolution No. 454/2006); (5) the Regulation

for Methodology of the Calculation of the WACC (Resolution No. 535/2009); (6) the Invitation Document No. 002/2007/SPV-ANATEL, relating to the auction organized by ANATEL of new 3G licenses, and stating that, in the maximum allowed period of eighteen months from April 30, 2008, the authorizations resulting from this auction must be combined with the existing SMP authorizations given to the bid winners when pertaining to the same region of the general authorization plan of SMP; and (7) the general plan for updating the Brazilian telecommunications regulation (Resolution No. 516/2008, or PGR). The following are some of the changes in the regulation that may adversely affect our results:

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- In the case of long-distance calls, two SMP providers controlled by the same economic group can receive only one instead of two interconnection charges (VU-M) for calls originated and terminated in their networks ((3) and (6) above).
- New negotiation rules for VU-M fees by which ANATEL will have a role in determining reference prices rather than the current free-market negotiation of prices. The reference prices will apply to SMP providers that have significant market power, which may be the case of Vivo (according to Resolution No. 549/2010, only the groups that include SMP operators with market share in mobile telephony lower than 20% combined in each one of the regions of the General Plan of Authorizations of SMP are considered groups without significant market power in the offer of mobile interconnection, in their respective areas of authorization) ((3) and (7) above (Resolution No. 549/2010 results of Public Consultation No. 5/2010).
- The free negotiation of the VU-M fee is the current rule. The reference price will only be used as a base in case of a conflict resolution related to the VU-M fee agreement. In the near future, ANATEL may issue a new regulation that will consider groups with significant market power those who have, among others: economies of scale and scope, market share within certain parameters and possibly for the providers that have integrated operation on the SMP and STFC.
- Reference prices were cost based commencing in 2008 in compliance with Resolution No. 483/2007. The prices are calculated according to the regulation on Costs Separation and Allocation (Resolution No. 396/2005) ((2) and (3) above).
- VU-M fees must follow the discounts granted to fixed telephony customers for out-of-business hours calls ((3) above).
- When receiving calls from public telephones, VU-M fees will adopt the same fee rules that apply to public telephones ((3) above).
- Creation of VU-M fee unification among SMP providers of the same economic group with significant market power ((3), (6) and (7) above).
- The interconnection payments between SMP operators for traffic in the same registration area may occur independently of the traffic balance between the operators (this regime is referred to as “full billing”) ((1) and (3) above). Before the adoption of the above-mentioned regulation, payments between SMP operators for traffic in the same area only occurred when the traffic balance between any two companies was either less than 45% or in excess of 55% (this regime is referred to as “partial bill and keep”).
- The Invitation Document 002/2007/SPV-ANATEL relates to the auction organized by ANATEL in December 2007 of new licenses (3G licenses) for the 1900-2100 MHz radio frequency bands denominated the “F,” “G,” “I” and “J” bands, and states that, in the maximum allowed period of eighteen months from the publication of the Terms of Authorization on April 30, 2008, the authorizations resulting from this auction will be combined with the existing SMP authorizations given to the bid winners when pertaining to the same region of the general authorization plan of SMP. Vivo and Vivo Participações acquired spectrum licenses for the “J” band in regions where we hold SMP licenses. In addition, the Invitation Document modifies the rule for the renewal of radio frequency licenses and includes in the calculation of operating profits the compensation received for the use of the SMP network together with the profits earned from the service plans. In accordance with this Invitation Document, in January 2010, ANATEL published an act determining the unification of our SMP authorizations in Regions II (states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with only one SMP authorization for each one of

these Regions (Terms of Authorization Nos. 005/2010 and 006/2010, signed in January 2010, for Region II and III, respectively). Moreover, ANATEL also determined that, from November 1, 2009 (eighteen months from April 30, 2008), in each Region of the PGA-SMP, the VU-M fee must be unified for that Region (two SMP providers controlled by the same economic group can receive only one instead of two interconnection charges (VU-M) for calls originated and terminated in their networks), and freely negotiated. Until such date, the mobile operators charged a VU-M fee for authorization of the SMP. In February 2010, ANATEL

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defined the VU-M fee to be paid for Oi (fixed and mobile operators) and for Brasil Telecom (fixed and mobile operators) to Claro, TIM, Vivo and Vivo Participações, for the region of the PGA-SMP, as a result of the unification of the SMP authorizations ((1), (3) and (6) above). In October 2010, the Oi signed an agreement with Vivo recognizing these VU-M fees as a unified region. Even though it paid the amounts defined by ANATEL, Oi had filed for arbitration against Vivo, which became moot after this agreement.

- In 2008, ANATEL published the general plan for updating the Brazilian telecommunications regulation (“Plano Geral de Atualização da Regulamentação das Telecomunicações no Brasil”–Resolution No. 516/2008, or “PGR”) ((7) above).
- In November 2010, ANATEL published Resolution No. 550/2010 for the Regulation on Exploration of Personal Mobile Services by means of a Virtual Network, making possible the creation of the “agent” and the Authorization of Mobile Virtual Network ((7) above). Resolution No. 550/2010 resulted from Public Consultation No. 50/2009. In accordance with this regulation approved by ANATEL, Mobile Virtual Network Operators may operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through the establishment of a representation agreement, which must be ratified by ANATEL. The agent’s activity is not defined as a “telecommunications service,” so this is of significant interest to companies that operate in other sectors such as large retailers, banks and football teams.

However, the activity of the virtual network licensee does fall within the definition of “telecommunications service” and is thus subject to all applicable rules:

- In October 2009, ANATEL published Resolution No. 535/2009 relating to the Methodology of the Calculation of the WACC ((5) above).
- In December 2008, Decree 6523/2008 became effective, relating to the general norms of customer interaction service by telephone, with the objective of improving the quality of services ((7) above).
- In December 2010, ANATEL organized auctions for the 1900-2100 MHz radio frequency band denominated the “H” band, for extension bands and for available frequencies at “A,” “D,” “E,” “M” and TDD bands, according the Invitation Document No. 002/2010/ANATEL. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and nine spectrum licenses in 900 MHz extension bands). In addition, the Invitation Document modifies the rule for the renewal of radio frequency licenses and includes in the calculation of operating profits the remuneration received for the use of the SMP network together with the profits earned from the service plans ((1) (3) (4) and (7) above); Invitation Document No. 002/2010/ANATEL results of Public Consultation No. 51/2009.
- In December 2010, ANATEL published Resolution No. 558/2010 transferring the bands of 451 MHz to 458 MHz and 461 MHz to 468 MHz to the SMP, STFC and SCM. These bands are currently assigned for access to the services of telephony and data in broad band, particularly in rural areas ((7) above); Resolution No. 558/2010 results of Public Consultation No. 24/2009.
- In August 2010, ANATEL published Resolution No. 544/2010 for the Regulation on Conditions of Use of Radio Frequencies in the Band of 2500 MHz to 2690 MHz. This band was assigned to the SMP Services and STFC in addition to SCM services and Pay Television by means of Multichannel Multipoint Distribution Service (MMDS) for which it was assigned previously ((7) above); Resolution No. 544/2010 results of Public Consultation No. 31/2009.
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In February 2010, ANATEL published Resolution No. 537/2010 relating to amending in the regulation of the 3400 MHz to 3600 MHz band, allowing it to apply additionally to mobile services ((7) above).

- In April 2009, ANATEL published Resolution No. 527/2009 relating to the regulation of the Broadband Power Line (BPL), allowing this service to apply to multimedia communication (SCM) ((7) above).
- In June 2010, ANATEL published Public Consultation No. 21/2010 with a proposal of altering the Regulation for Inspection (Resolution No. 441/2006) ((7) above).

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- In June 2010, ANATEL published Public Consultation No. 22/2010 with a proposal of altering the Regulation for Sanctions (Resolution No. 344/2003) ((7) above).
- In July of 2010, ANATEL published Public Consultation No. 27/2010 with the revision of the General Plan of Standards of Quality of the SMP (Resolutions 317/2002 and 335/2003) ((7) above).
- In November 2010, ANATEL published Resolution No. 548/2010 for the Regulation for Evaluation of the Efficiency of Use of the Radio Frequency Spectrum ((4) and (7) above).
- In December 2010, ANATEL published Resolution No. 553/2010 to allow the addition of the ninth digit in the numbers of the mobile telephones of area 11, raising the capacity of numeration in the metropolitan region of São Paulo and eliminating the problem of scarcity of numeration in this area ((7) above).
- In December 2010, ANATEL published Public Consultation No. 50/2010 with the Proposal for Revision of the Regulation of Industrial Exploration of Dedicated Lines (Resolution No. 402/2005) ((7) above).
- In August 2011, ANATEL published Public Consultation No. 46/2011, regarding compensation for the STFC, changes in the collection rate in the Local Network Usage (TU-RL) as regards reduced hours, changes in the interconnection regime and alterations in the compensation structure for the Interurban Network Use (TU-RIU).

Such new regulations could have an adverse effect on our results of operations because: (1) our interconnection charges could drop significantly, thereby reducing our revenues; (2) ANATEL may allow more favorable prices for economic groups without significant market power; (3) the prices we charge in some regions in which we operate are higher than those in certain other regions, and consolidation of those prices, competitive pressures and other factors would reduce our average prices and thereby reduce our revenues; (4) the granting of new licenses may increase competition in our area from other operators, which could adversely affect our market share, thereby reducing our revenues; (5) the inclusion in the calculation of operating profits the remuneration received for the use of the SMP network will increase the cost of renewing licenses; and (6) in ANATEL's general plan of updating the telecommunications regulation, ANATEL targets several areas of vital importance for the mobile telecommunications business, such as regulation to improve the quality of services that can cause the rise of operational costs, regulation of the virtual mobile operation (MVNO) that can cause an increase in competitive pressure, regulation against significant market power ("Poder de Mercado Significativo-PMS") arising from VU-M fee unification among SMP providers of the same economic group having significant market power, that can reduce our revenues, and regulation of multimedia communication (SCM), that can cause an increase in competitive pressure.

The industry in which we conduct our business is continually changing and evolving technologically.

The telecommunications industry is subject to rapid and significant technological changes. Our future success depends on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will be further developed.

The advent of new products and technologies could have a variety of consequences. These new products and technologies may reduce the price of our services by providing lower-cost alternatives, or they may also be superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring investment in new technology.

We are subject to certain risks related to conditions and obligations that could be imposed by ANATEL for the participation in the spectrum auction for LTE services.

In August 2010, ANATEL established a new policy regulating the 2.5 GHz spectrum which requires MMDS (Multichannel Multipoint Distribution Service) companies, including us, to return, until 2013, a significant portion of the spectrum they currently own and to offer cable TV on a primary basis. Through this initiative, ANATEL objects to providing more spectrum availability to mobile operators in Brazil, thus restricting them from increasing service penetration and superior data communication.

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On January 25, 2012, ANATEL issued Public Consultation No. 4/2012 for the call to bid for the 2.5 Ghz and 450 Mhz spectrum, for which the deadline to present proposals was March 5, 2012. According to ANATEL, the call to bid for those ranges should be published in April 2012 after the approval of ANATEL's directive council and the auction should be carried out in June 2012. On the draft call to bid proposed by ANATEL, several conditions and obligations were imposed for the acquisition of the 2.5 Ghz spectrum, such as the definition of a "spectrum cap" of 40Mhz for the first lots, which would also apply to the current holders of that spectrum that confirmed intentions to maintain portions of it. In this scenario, companies that already hold 10+10Mhz bands in 2.5 Ghz could only acquire the FDD (frequency division duplex) spectrum up to 40Mhz, which creates different bidding scenarios for current holders of portions of this spectrum and prospective new holders participating in this bid. However, ANATEL also imposed a spectrum cap of 80Mhz for the subsequent bidding rounds in case bidders show no interest in the first lots.

Additionally, the draft call to bid includes other specific conditions, such as the association of the 450Mhz ranges (destined for rural telephony) with the 2.5Ghz range, coverage targets for certain cities and for the 2014 FIFA World Cup, obligations to acquire national infrastructure and technology and, most importantly, rules regarding indemnification of the current MMDS providers, including us, to vacate the 2.5Ghz range to be auctioned by ANATEL, which should be based on criteria such as costs related to customer and equipment migration or investments made. Because such conditions were not entirely defined by ANATEL in the draft call to bid, the indemnification will be negotiated between the current holders of the range and the winning bidder and arbitrated by ANATEL in case of disputes, which could impact the indemnification amounts expected by MMDS providers.

Also, targets established by ANATEL associated with a fast paced implementation of networks could impact (i) the ability to obtain municipal licenses for the construction of new sites at the speed necessary to achieve the coverage targets, (ii) the capacity of suppliers to deliver the equipment necessary for this expansion, with possible impact on their prices, subject to targets to acquire national technology, and (iii) lack of workers to meet the expected implementation pace.

The creation of certain regulatory asymmetries arising from the General Plan of Competition (PGMC) could increase competition.

ANATEL is expected to issue in 2012 new rules relating to the General Plan of Competition (Plano Geral de Metas de Competicao), which is being created to organize a system for controlling the actions of economic agents in the telecommunications sector, imposing, removing or altering obligations of the service providers according to their market share, with a view to increasing competition. ANATEL is expected to issue rules relating, in particular, to the reservation of network capacity for sharing, and to the definition of "significant market power" in the offering of, interconnection services in mobile networks considering the integration between fixed and mobile services as one economic group. ANATEL is expected to also create a new supervising entity to resolve conflicts between companies with and without significant market power and to evaluate and certify the offering of wholesale services.

These new rules under the General Plan of Competition could increase competition in the markets where we operate.

Certain of our debt agreements contain financial covenants, and any default under such debt agreements may have a material adverse effect on our financial condition and cash flows.

Certain of our existing debt agreements contain restrictions and covenants and require the maintenance or satisfaction of specified financial ratios and tests. Failure to meet or satisfy any of these covenants, financial ratios or financial tests could result in an event of default under these agreements.

The telecom industry, including us, may be harmed by reports suggesting that radio frequency emissions cause health problems and interfere with medical devices.

Media and other reports have suggested that radio frequency emissions from base stations may cause health problems. These concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation. According to the World Health Organization (WHO), there is no evidence in the latest medical research that shows any relationship between radio frequency emissions of base stations and health concerns. However, expansion of our network may be affected by perceived risks if we

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experience problems in finding new sites, which in turn may delay expansion and may affect the quality of our services. On July 2, 2002, ANATEL published Resolution No. 303 that limits emission and exposure for fields with frequencies between 9 kHz and 300 GHz. In addition, the Brazilian government developed specific legislation for the deployment of radio frequency transmission stations that supersedes the existing state and municipal laws. In May 2009, the Brazilian government published Law No. 11934/2009 that limits the exposure for fields with frequencies up to 300 GHz. The new law uses the exposition limits determined by the International Commission on Non-Ionizing Radiation Protection (ICNIRP) and recommended by the World Health Organization (WHO).

In May 2011, the specialized body of the World Health Organization for research on cancer (IARC) classified electromagnetic fields of mobile telephony as “possibly carcinogenic,” a classification which also includes products such as coffee and pickled foods. The World Health Organization subsequently indicated, in fact sheet no. 193, published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health, although it also announced that in 2012 an official assessment of this risk will be conducted, taking into account all scientific evidence available.

New laws may create additional transmission regulations which, in turn, could have an adverse effect on our business. Also, health concerns may affect our ability to capture or retain customers, may discourage the use of the mobile telephone and may result in the adoption of new measures by governments or any other regulatory interventions, any of which could materially and adversely affect our business, results of operations and financial condition.

We face risks associated with litigation.

We are party to a number of lawsuits and other proceedings. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs to us. In addition, our senior management may be required to devote substantial time to these lawsuits, which they could otherwise devote to our business. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Matters.”

We may be required to record impairment charges relating to goodwill and long-lived assets in the future.

For IFRS purposes, we are required to test our goodwill for impairment at least annually. The excess of the book value of a company over its market value may indicate that impairment exists. This impairment test is described in Note 3 to our audited consolidated financial statements. The Company has substantial goodwill with a carrying value of R\$10.2 billion as of December 31, 2011. It is possible that we may be required to record impairment charges relating to our goodwill in future periods, and this would have an adverse effect on our results of operations. When we performed our last impairment test, our evaluation of our ability to recover the carrying value of our long-lived assets was based on projections of future operations that assumed a higher level of revenues and gross margin percentages than we have historically achieved as well as on assumptions that marketplace participants will make in valuing similar assets. We may not be successful in achieving these improvements in our revenues and gross margin percentages due to the competitive environment, changes in technology or other factors. If we are unable to achieve these improvements, we may be required to record impairment charges related to our long-lived assets, including goodwill, in future periods, and this could have an adverse effect on our operations.

In addition, we are required to record impairment charges on long-lived assets, including property, plant and equipment and finite-lived intangible assets (including licenses) if the carrying value of these assets exceeds the recoverable amount expected from their use. This impairment test is also described in Note 3 to our audited consolidated financial statements included in this annual report.

Risks Relating to the Preferred Shares and the ADSs

Holders of our ADSs may face difficulties in serving process on or enforcing judgments against us and other persons.

We are organized under the laws of Brazil, and all of our executive officers and our independent public accountants reside or are based in Brazil. Also, seven of our sixteen directors reside or are based in Brazil. Substantially all of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of the ADSs to effect service of process upon us or these other persons within the United States

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or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain conditions are met, holders may face greater difficulties in protecting their interests due to actions by us, our directors or executive officers than would shareholders of a U.S. corporation.

Holders of our Preferred Shares and ADSs generally do not have voting rights.

In accordance with Brazilian Corporate Law and our bylaws, holders of our preferred shares, and therefore of our ADSs, are not entitled to vote at meetings of our shareholders, except in limited circumstances set forth in “Item 10. Additional Information—B. Memorandum and Articles of Association.”

Holders of our Preferred Shares might be unable to exercise preemptive rights with respect to the preferred shares unless there is a current registration statement in effect which covers those rights or unless an exemption from registration applies.

Holders of our preferred shares will not be able to exercise the preemptive rights relating to the preferred shares underlying your ADSs unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to the shares underlying those rights, or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement. Unless we file a registration statement or an exemption from registration applies, holders of our preferred shares may receive only the net proceeds from the sale of their preemptive rights by the depository, or if the preemptive rights cannot be sold, they will lapse and you will not receive any value for them. For more information on the exercise of these rights, see “Item 10. Additional Information—B. Memorandum and Articles of Association—Preemptive Rights.”

An exchange of ADSs for preferred shares risks the loss of certain foreign currency remittance and Brazilian tax advantages.

The ADSs benefit from the certificate of foreign capital registration, which permits The Bank of New York, as depository, to convert dividends and other distributions with respect to preferred shares into foreign currency, and to remit the proceeds abroad. Holders of ADSs who exchange their ADSs for preferred shares will then be entitled to rely on the depository’s certificate of foreign capital registration for five business days from the date of exchange. Thereafter, they will not be able to remit non-Brazilian currency abroad unless they obtain their own certificate of foreign capital registration, or unless they qualify under Resolution No. 2,689 of the Central Bank of Brazil, dated January 26, 2000 and issued by BACEN, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration.

If holders of ADSs do not qualify under Resolution No. 2,689, they will generally be subject to less favorable tax treatment with respect to our preferred shares. There can be no assurance that the depository’s certificate of registration or any certificate of foreign capital registration obtained by holders of ADSs will not be affected by future legislative or regulatory changes, or that additional Brazilian law restrictions applicable to their investment in the ADSs may not be imposed in the future.

Holders of our preferred shares will be subject to, and holders of our ADSs could be subject to, Brazilian income tax on capital gains from sales of preferred shares or ADSs.

Brazilian Law No. 10,833 provides that gains on the disposition of assets located in Brazil by nonresidents of Brazil, whether to other nonresidents or to Brazilian residents, will be subject to Brazilian taxation. The preferred shares are expected to be treated as assets located in Brazil for purposes of the law, and gains on the disposition of preferred

shares, even by nonresidents of Brazil, are expected to be subject to Brazilian taxation.

Based on the fact that the ADSs are issued and registered abroad, we believe that gains on the disposition of ADSs made outside of Brazil by nonresidents of Brazil to another non-Brazilian resident would not be subject to Brazilian taxation, since they would not fall within the definition of assets located in Brazil for purposes of Law 10,833.

However, considering the general and unclear scope of Law No. 10,833 and the absence of judicial court rulings in respect thereto, we cannot be assured that such an interpretation of this law will prevail in the courts of Brazil. If the income tax is deemed to be due, the gains may be subject to income tax in Brazil at a rate of 15.0%

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(general taxation) or 25.0% (if the nonresident seller is located in a tax haven, a country which does not impose any income tax, which imposes it at a maximum rate lower than 20.0%, or in which the laws impose restrictions on the disclosure of ownership composition or securities ownership or the identification of the effective beneficiary of income attributed to nonresident holders). See “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations.”

Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

Telefónica Internacional S.A., or Telefónica Internacional, our principal shareholder, currently owns directly and indirectly approximately 91.76% of our voting shares and 73.81% of our total capital. See “Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders” and “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions.” As a result of its share ownership, Telefónica Internacional has the power to control us and our subsidiaries, including the power to elect our directors and officers and to determine the outcome of any action requiring shareholder approval, including corporate reorganizations and the timing and payment of our dividends. Given this degree of control over our company, circumstances could arise under which the interests of Telefónica Internacional could be deemed to be in conflict with the interests of our other shareholders.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

General

Following the restructuring and privatization of Telebrás, discussed below, we were incorporated on May 22, 1998, as a corporation (sociedade anônima) organized under the laws of the Federative Republic of Brazil. We are incorporated under the name Telefônica Brasil S.A. (and, before our merger with Vivo Participações S.A. on October 3, 2011, under the name Telecomunicações de São Paulo S.A. – TELESP)

We are registered with the CVM as a publicly held company and our stock is traded on BM&FBOVESPA. We are also registered with the SEC in the United States and our ADSs are traded on the New York Stock Exchange, or the NYSE. Our headquarters are located at Rua Martiniano de Carvalho, 851, 21st floor, 01321-001, São Paulo, SP, Brasil. Our telephone number is 55-11-7420-1172, our facsimile number is 55-11-7420-2247 and our website is www.telefonica.com.br/investidores. The information on our website is not part of this Form 20-F.

As of December 31, 2011, we had 381,347,371 outstanding common shares, with no par value per share, and 742,537,273 preferred shares, with no par value per share. Our shareholders’ equity was in the amount of R\$43.3 billion as presented under IFRS.

We provide fixed-line telecommunications services in the State of São Paulo under concession agreements granted in 1998 by the Brazilian government in connection with the restructuring and privatization of the Telebrás System, as described below. The concession, which was renewed in December 2005, authorizes us to provide fixed-line telecommunications services in a specific region, which includes all of the State of São Paulo except for a small area (Sector 33), where a previously existing fixed-line service provider, CTBC Telecom, which was not part of the Telebrás System, continues to operate independently.

In addition to the services that we provide under the concession agreements of 1998, we also provide international and interregional long-distance services, as permitted under Act No. 23,395 of March 1, 2002, under which ANATEL also

acknowledged the completion of our network expansion and achievement of universal service targets as of September 30, 2001.

We also provide multimedia communication services (“serviços de comunicação multimídia” or “SCM”) such as audio, data, voice and other sounds, images, texts and other information. ANATEL granted the SCM license with Act No. 33,791 of February 14, 2003, which authorized the rendering of the service in all of the State of São Paulo, except for a small area (Sector 33).

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On March 14, 2007, ANATEL conceded to A. TELECOM S.A., one of our wholly owned subsidiaries, the license to offer Pay TV services through DTH (“Direct to the Home,” a special type of service that uses satellites for the direct distribution of television and audio signals for subscribers). We began offering Pay TV services on August 12, 2007.

On October 31, 2007, the board of ANATEL approved, from a regulatory perspective, the association between Grupo Abril and the Company, which involved, among other transactions, the acquisition of all of the operations of Multichannel Multipoint Distribution Service (MMDS), a special license that allows us to offer Pay TV and broadband services through our subsidiary Telefonica Sistemas de Televisão S.A. The transaction continues to be analyzed by ANATEL, solely with respect to antitrust matters, and will be finally reviewed by CADE.

In 2008, the Company pioneered the launch of Internet access through fiber optic cables (“Fiber to the Home,” FTTH) for noncommercial customers. Aside from the offer of an Internet connection with high-speed capacities of 30 Mbps and 100 Mbps, various bundles have also been offered, including Wi-Fi, Digital TV, 2,000 minutes of local and intra-state calls, anti-virus protection, call identification, technical assistance and specific call center assistance.

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated with the MMDS in the cities of São Paulo, Curitiba, Rio de Janeiro and Porto Alegre.

According to data regarding market share published by ANATEL, we are among the leading providers of cellular telecommunications services in Brazil, with the help of our wholly owned direct subsidiary Vivo, the leading cellular operator in Brazil. Vivo is a cellular operator in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (also encompassing the area of Federal District), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São Paulo, Sergipe, Tocantins and Minas Gerais.

As of December 31, 2011, our telephone network included 10,981 thousand fixed-lines in service, 71,554 thousand mobile accesses, 3,631 thousand broadband clients and 699 thousand Pay TV clients.

Historical Background

The Restructuring and Privatization

After the incorporation of Telecomunicações Brasileiras S.A.–Telebrás in 1972, Telebrás and its operating subsidiaries (collectively, the “Telebrás System”) acquired almost all of the telephone companies in Brazil and monopolized the provision of public telecommunications services in virtually all areas of the country.

In May 1998, just before its privatization under the General Telecommunications Law, the Telebrás System was restructured to form, in addition to Telebrás, 12 new holding companies. Virtually all assets and liabilities of Telebrás were transferred to the new holding companies, or the “new holding companies.”

In July 1998, the federal government privatized the Telebrás System, selling substantially all its shares in the new holding companies, including TelesPar and its shares in TSP and CTBC Borda, to private sector buyers. As a result of a subsequent reorganization of SP Telecomunicações on January 10, 1999, one of its subsidiaries, SPT Participações S.A., or SPT, became the controlling shareholder of TelesPar.

The Reorganization of TelesPar

On November 30, 1999, the shareholders of TelesPar approved a reorganization involving a series of mergers, whereby Telespar became the telecommunications services company operating under our current name, Telefônica

Brasil S.A. (formerly Telecomunicações de São Paulo S.A. – TELESP prior to our merger with our direct subsidiary, Vivo Participações).

Ceterp's Acquisition

On December 20, 1999, we began the acquisition, through a public auction from the municipal government of the City of Ribeirão Preto, in the State of São Paulo, of 51.0% of the voting shares and 36.0% of the total share

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capital of Centrais Telefônicas de Ribeirão Preto S.A., or Ceterp. Ceterp provided fixed-line and cellular services in the State of São Paulo, outside the Telebrás System, and had been one of our minor competitors.

On December 27, 2000, Ceterp was merged with and into us.

The Spin-off of Certain Data Transmission Operations

On August 3, 2000, the wholly owned subsidiary, Telefônica Empresas S.A., was created with the corporate goal of providing Switched Package Network services, and, on January 30, 2001, the independent Brazilian corporation, Telefônica Data Brasil Holding S.A. (TDBH), was created through a shareholder-approved spin-off of the data transmission operations performed by Telefônica Empresas S.A. A merger of the company and TDBH was effective in July 2006. See “—The SCM Restructuring.”

Attainment of ANATEL Targets

Our business, services and tariffs have been regulated by ANATEL since June 16, 1997, in accordance with various decrees, decisions, plans and regulatory measures. We became the first operator to achieve ANATEL’s service targets. As a result, ANATEL granted us a license to offer domestic and international long-distance services to our customers. Accordingly, on May 7, 2002, we began providing international long-distance services and, on July 29, 2002, we began providing interregional long-distance service. See “—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies—Network Expansion and Quality of Service” for information relating to ANATEL’s network expansion and universal service targets.

The Board of Directors of ANATEL, at ANATEL’s meeting held on January 29, 2003, granted us the authorization to use the SCM nationwide. The Company may now offer voice and data services through various points of presence composed of networks and telecommunication circuits.

On July 6, 2003, mobile telephony operators started to implement a long-distance carrier selection (CSP) that enables the client to determine the long-distance carrier for each domestic long-distance call (VP2 and VP3) or international call, in accordance with the SMP rules. As a result, the Company, having acknowledgment of the revenue from these long-distance services, started to pay the mobile telephony operators for the use of their networks.

On September 4, 2004, the rules dictated by Resolution No. 373, dated as of June 3, 2004, were implemented to carry out the reconfiguration of the local areas for the STFC. As a consequence, all calls previously billed at domestic long-distance rates (DC level – Áreas Conurbadas) are now billed at lower rates as local calls. In São Paulo, this modification involved 53 municipalities, of which 39 are in Greater São Paulo (Grande São Paulo).

IP Network Asset Acquisition

On December 10, 2002, after receiving approval from ANATEL, our Board of Directors approved a proposal to acquire certain assets from Telefônica Data S.A. (formerly T-Empresas), one of the companies of the Telefônica group, including the following services: (i) an Internet service that allows our customers to access our network through remote dial-up connection and (ii) services that allow customers of Internet Service Providers, or ISPs, to have access to broadband Internet. The purpose of this asset acquisition was to capitalize on synergies that would assist in developing our network and provide a quick response to market competitors.

Acquisition and Reorganization of Atrium

On December 30, 2004, we acquired indirect control of Atrium Telecomunicações Ltda. from Launceston Partners CV. Atrium provided various types of telecommunications services in Brazil, including Internet and intranet services, telecommunications management services and the sale and rental of telecommunications systems and related equipment. The acquisition was carried out through the purchase of the total share capital of Santo Genovese Participações Ltda., which held 99.99% of the representative share capital of Atrium.

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On November 21, 2005, we approved the corporate reorganization of our wholly owned companies, A. TELECOM S.A. (formerly Assist Telefónica S.A.), Santo Genovese Participações Ltda., or Santo Genovese and Atrium Telecomunicações Ltda., or Atrium, which was implemented and became effective on March 1, 2006.

The SCM Restructuring

On March 9, 2006, our Board of Directors and the Boards of Directors of TDBH and Telefónica Empresas S.A., a wholly owned subsidiary of TDBH (“T-Empresas” and together with us and TDBH, the “Companies”), approved the restructuring of the Companies’ serviços de comunicação multimídia (“SCM”), or multimedia communications services, and data transmission activities (the “SCM Restructuring”).

The terms and conditions of the SCM Restructuring are set forth in an agreement executed by the Companies on March 9, 2006. The SCM Restructuring consisted of (i) the merger of TDBH into our company (the “Merger”); and (ii) the spin-off of all T-Empresas’ assets and activities except its SCM assets and activities outside Sectors 31, 32 and 34 of Region III of Annex II of the General Concession Plan (the “Spin-off”) and assets and activities related to the data center.

Following the approval of this restructuring: (i) TDBH was dissolved; (ii) its shareholders received shares of our common or preferred stock, or ADSs, as appropriate; (iii) we succeeded TDBH in all of its rights and obligations; and (iv) T-Empresas became our wholly owned subsidiary. The transfer to TELESP of the spun-off components of T-Empresas did not result in any increase or decrease in the net equity of TELESP, nor in the number of shares that comprise its capital stock.

With respect to TDBH’s Merger into us, certain minority shareholders tried to suspend our General Shareholders Meeting by contesting the appraisal of the share exchange ratio provided by NM Rothschild & Sons (Brasil) Ltda. by obtaining an injunction from the 14th civil chamber of the central forum of the district court of São Paulo. The injunction was lifted on July 28, 2006, and the merger became legally effective. The main action (Ação Ordinária No. 583.00.2006.156920-5) has not yet been resolved in the lower court.

On January 31, 2008, at the 22nd General Shareholders Meeting of Telefónica Empresas S.A., the only shareholder of which is the Company, it was resolved to change the corporate name of Telefónica Empresas S.A. to Telefónica Data S.A.

Agreement of Convergence, Purchase and Sale of Operations, Assets, Stock and Other Obligations with the Abril Group

On October 29, 2006, the Company entered into an agreement with Abril Comunicações S.A., TVA Sistema de Televisão S.A., Comercial Cabo TV São Paulo Ltda., TVA Sul Paraná Ltda., and TVA Radioenlaces Ltda. (the “Abril Group”), whereby we combined our telecommunications and broadband services with the broadband and cable services of Tevecap S.A., or TVA, the second largest Brazilian pay TV provider with operations in the states of Paraná, Rio Grande do Sul, São Paulo and Rio de Janeiro. Through this transaction, we broadened our services to meet our users’ increasing demand, combining the Abril Group’s expertise in content and media production and placement with the expertise of the Telefónica Group in the telecommunications segment.

On October 31, 2007, the board of ANATEL concluded the regulatory review of the association between Grupo Abril and the Company, approving the transaction, which involves (i) the acquisition of all of the operations of MMDS (Multichannel Multipoint Distribution Service) and broadband, and (ii) the acquisition of a significant stake, within the limit of the foreseen effective laws and regulations, in the cable television dealers controlled by Grupo Abril within and outside of the State of São Paulo. This decision was published in the D.O.U. of the Federal Executive on

November 19, 2007. Antitrust clearance is still pending from ANATEL and CADE competition authorities.

Our stockholders, in the extraordinary general meeting held on November 23, 2007, ratified the entering into of the Agreement, its amendments and annexes, and approved the implementation of the deal and the signature of all documents necessary for its complete formalization.

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As a result of this transaction, Navytree Participações S.A. (“Navytree”) became a wholly owned subsidiary of TELESP, and our provision of broadband services became centralized.

On June 10, 2008, at the General Shareholders Meeting of Navytree, the corporate name of Navytree was changed to Telefônica Televisão Participações S.A. (“TTP”).

Corporate Reorganization involving Ajato

On October 14, 2008, Telefonica Sistema de Televisão S.A. (“TST”) and TTP purchased from Abril Comunicações S.A. all shares of Mundial Voip Telecomunicações Ltda., EPP, which had its corporate name changed to Ajato Telecomunicação Ltda. (“Ajato”). Following the merger of TTP into the Company on November 11, 2008, Ajato’s shares are held by TST and us.

Corporate Reorganization involving DABR and TTP

On October 21, 2008, our Board of Directors and the shareholders of TTP and Telefônica Data Brasil Participações Ltda. (“DABR”) approved a corporate reorganization that consisted of the merger of TTP and DABR into us.

On November 11, 2008, the merger of TTP and DABR was approved by our Extraordinary Shareholders Meeting. As a result of this restructuring, TTP and DABR were dissolved and we assumed all the rights and obligations of TTP and DABR.

The reorganization allowed us to increase synergies, reduce managerial risk, simplify the corporate administrative structure and reduce costs, while also providing tax benefits expected to reduce TELESP’s income tax and other taxes assessed on revenue and income, thereby improving our cash flows. The reorganization and the goodwill amortization were structured so as to avoid any assumption of indebtedness by us and to minimize any negative impact on the future results of the Company.

Corporate Restructuring involving TS Tecnologia

On May 22, 2009, Telefônica Data S.A., our subsidiary, merged with its controlled subsidiary, TS Tecnologia da Informação Ltda., or TS Tecnologia, in accordance with the values recorded on the books and an appraisal report. This merger caused TS Tecnologia to be extinguished, and Telefônica Data S.A. became the successor to all of the assets and liabilities of TS Tecnologia.

Corporate Restructuring involving A.TELECOM S.A.

On December 9, 2009, our Board of Directors approved the submission to a shareholder vote of the corporate reorganization proposal consisting of the partial spin-off of A.TELECOM S.A. (“A.TELECOM”), and the subsequent merger into the Company of the spun-off part of A.TELECOM.

On December 30, 2009, A.TELECOM’s shareholders approved the spin-off of part of A.TELECOM and the subsequent merger of the spun-off part into the Company. On the same date, our shareholders approved the merger of the spun-off part into us.

This corporate restructuring created synergies for us and A.TELECOM providing both of us with better administrative, operating and regulatory efficiencies regarding telecommunication integrated services, thus benefiting both of us and our respective shareholders.

Corporate Restructuring involving Brasilcel

Acquisition of Brasilcel N.V. stocks by Telefónica S.A.

On July 28, 2010 Telefónica S.A. and Portugal Telecom SG SGPS, S.A. entered into an agreement for the acquisition by Telefónica of 50% of Brasilcel N.V.'s (Brasilcel) shares owned by Portugal Telecom. As a result, Telefónica indirectly acquired the shares of Vivo Participações held by Portugal Telecom. Prior to this agreement, Brasilcel's shares were held by Telefónica (50%) and by Portugal Telecom (50%) and, in 2002, it was used for the

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joint venture between both shareholders to jointly hold shares and control of Vivo Participações and other mobile phone companies which were later added under Vivo Participações and in Vivo S.A.

On December 21, 2010, Brasilcel was merged into Telefónica, which held direct and indirect stakes in Vivo Participações's capital stock representing approximately 60%.

Due to the acquisition of control of Vivo Participações and pursuant to the terms provided for in Article 254-A of Law 6,404/76 and the procedures established in article 29 of CVM Instruction 361 applicable to tender offers (OPA) by sale of control, as defined by item III of article 2 of CVM Instruction 361, on February 17, 2011 Telefónica through its subsidiary SP Telecomunicações Ltda ("SPTelecom") launched a Public Tender Offer for the shares with voting rights of Vivo Participações (ON shares) held by noncontrolling interests. Those shares were acquired at 80% of the value paid by Telefónica to Portugal Telecom SG SGPS S.A., for each common share with voting rights of Vivo Participações S.A. (ON) owned by Brasilcel.

On March 18, 2011, when the OPAs were made, SP Telecom acquired 10,634,722 common shares of Vivo Participações, representing 2.65% of its shares, resulting in the Telefonica group ownership of 62.1% of Vivo Participações.

Introduction of the Vivo Brand

In April 2003, Brasilcel launched in Brazil the brand name "Vivo," under which TCP, TCO, TLE, TSD and Celular CRT operate. The creation of the Vivo brand constituted a consolidation of the commercial models throughout the entire country into a common commercial strategy and replaced the different brands under which the different companies offered their services in their respective states. The commercial strategy of Vivo is to increase its customer base as well as revenues by retaining customers and maintaining their distribution channels. The launching of the Vivo brand was accompanied by customer loyalty programs and other measures designed to contribute to the success of the commercial strategy. Guided by a common management team, Vivo designs marketing, promotional and other initiatives common to all companies in the Vivo group and then tailors those activities to the particular markets of those companies.

Agreement with Telefónica and Telecom Itália

In October 2007, TELCO S.p.A. (a company in which Telefónica holds a corporate interest of 42.3%) acquired 23.6% of the capital stock of Telecom Itália. Telecom Itália also holds an interest in the capital stock of TIM. However, Telefónica did not acquire any right to directly participate in the operations of TIM as a result of the acquisition of the corporate interest in Telecom Itália by TELCO S.p.A.

As a result, any transaction involving us and TIM is considered an ordinary mobile network business transaction, which is regulated by ANATEL, as provided in the Act 68.276, dated October 31, 2007 and in the Act 3.804, dated July 7, 2009, both issued and published by ANATEL.

Corporate Restructuring involving Vivo Participações S.A.

In July 28, 2010, in accordance with the material fact disclosed to the public by Telefónica S.A., our controlling shareholder, Telefónica S.A. and Portugal Telecom SG SGPS, S.A. ("Portugal Telecom") executed a purchase agreement for the acquisition by Telefónica S.A. (directly or through any of the companies within its group) of 50% of the capital stock of Brasilcel, N.V. (a company jointly owned by Telefónica and Portugal Telecom, which owns shares representing approximately 60% of the capital stock of the Brazilian company Vivo Participações S.A.).

On December 27, 2010, the Company and Vivo Participações, jointly announced the approval by their respective Boards of Directors of a proposal for corporate restructuring involving the merger of shares of Vivo Participações into the Company, aiming for the consolidation of the shareholding positions of both companies.

Other than the concentration of the shareholding position herein mentioned, the corporate restructuring aimed to simplify the organizational structure of the companies, both of which were publicly held companies and listed on BM&FBOVESPA and with American Depositary Receipts traded in the United States of America. The restructuring allowed their respective shareholders to participate in one unified company with greater liquidity and with shares

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traded on Brazilian and foreign stock exchanges. Moreover, the corporate restructuring provided for the rationalization of the cost structure of the two companies and facilitated the integration of businesses and the generation of synergies, thus positively impacting both companies.

The simplified organization chart below demonstrates the corporate structure of the companies before and after the implementation of this reorganization.

The corporate structure before the merger of shares is as follows:

Upon completion of this corporate restructuring, Telefónica, S.A. holds the shares of the Brazilian holding companies that currently are held indirectly by Telefónica, S.A., through the holding of Brasilcel, N.V., as a result of a transaction implemented abroad. The merger of shares did not change the composition of the ultimate control of the companies involved.

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The corporate structure after the merger is as follows:

The totality of shares of Vivo Participações was merged into the Company, and the holders of the merged shares of Vivo Participações received new shares to which they were entitled in the Company. In accordance with Brazilian Corporate Law, as well as the bylaws of the two companies, financial advisors and specialized companies were retained for the preparation of studies regarding the transaction and the subsequent preparation of valuation reports of the companies that were used as reference for the determination of the exchange ratio of shares and the increase in capital stock resulting from the merger of shares, as well as for the purposes of article 264 of Law No. 6,404/76 regarding the exchange ratio between the shares.

In addition to the notice of material fact to be published reflecting more details on the terms and conditions of the corporate restructuring that were agreed upon as mentioned above, the meeting notice of the respective extraordinary shareholders' meetings of the companies for voting on the restructuring were timely published.

The corporate restructuring was approved by ANATEL on March 24, 2011. Before the corporate restructuring, the Brazilian entities, TBS Celular Participações Ltda., Portelcom Participações S.A. and PTelecom Brasil S.A. (jointly, the "Holdings BR"), were merged into Vivo Participações. The Holdings BR had as its main asset the shares of Vivo Participações and were controlled by Brasilcel, N.V. The merger of Holdings BR did not result in any change in the number and the composition of classes of shares of Vivo Part, and did not affect the participation of the shareholders of Vivo Participações.

Acquisition of Vivo Participações by Telefônica Brasil and corporate restructuring

In order to unify the shareholder's base of the companies in our group, simplify the organizational structure, rationalize costs, integrate businesses and, consequently, generate synergies provided for in the strategy of Telefônica, on December 27, 2010, the Boards of Directors of Vivo Participações and Telefônica Brasil approved the terms and conditions for restructuring, which provided for the merger of 100% of the shares of Vivo Participações into Telefônica Brasil. Following recommendations of the Guiding Opinion No. 35 of CVM, independent special committees were created to negotiate the exchange ratio of shares and determine the other conditions of the Corporate Restructuring proposal in order to submit later its recommendations to the Board of Directors of both companies.

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The proposal was submitted to ANATEL's authorization and approved at a meeting of the Board of this agency held on March 24, 2011.

On March 25, 2011, the Boards of Directors of Vivo Participações and Telefônica Brasil approved the terms and conditions of the corporate restructuring, which were approved unanimously by the general meetings of shareholders of the Companies held on April 27, 2011.

Before the corporate restructuring commenced, the Holdings (composed of TBS Celular Participações Ltda., Portelcom Participações S.A. and Brazil PTelecom S.A.), controlled by Telefônica S.A. and whose main purpose was to hold shares of Vivo Participações, were merged into Vivo Participações as a preliminary phase for the first stage of restructuring.

The first stage of the transaction consisted of the unification of the share base of fixed and mobile operators of the Telefonica group in Brazil, through the merger of shares of Vivo Participações into Telefônica Brasil. Telefônica Brasil merged Vivo Participações in its entirety, attributing directly to the holders of shares of Vivo Participações the new shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange share ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. This followed the recommendations of the independent special committees.

Due to this merger of shares of Vivo Participações, Telefônica Brasil's capital was increased by R\$31,222,630, reflecting the economic value of the incorporated shares, based on an economic value appraisal of Vivo Participações prepared by Planconsult Consultoria Ltda. ("Planconsult").

Telefônica's strategy in the first stage of the corporate restructuring was to maximize the potential of its operations in Brazil. Therefore, Telefônica Brasil became the direct shareholder of Vivo Participações, and indirectly of Vivo S.A. Through the creation of this "umbrella investment structure", the noncontrolling shareholders of both companies were equally benefited by the added values generated by the combination of the telecommunications business. This is a basic movement in business so as to improve its converging market strategy, including combined mobile and fixed-line offers. This reorganization created the conditions for the beginning of the process to obtain operational and financial synergies.

Additionally, as a consequence of this merger, on July 6, 2011, Vivo Participações filed a statement with the SEC in order to cancel its registration for the program of American Depositary Shares (ADSs), since all its ADSs were converted into ADSs of Telefônica Brasil, plus payment currency in lieu of fractional Telefônica Brasil ADSs, which was approved on July 7, 2011.

The second and third stages of the corporate restructuring, disclosed to the market on June 15, 2011, sought to continue the simplification process of the organizational structure of the Companies, so as: (i) to focus all authorizations for the rendering of SMP (personal mobile service) services (originally held by Vivo Participações and Vivo S.A.), and (ii) simplify the current corporate structure, eliminating the structure of Vivo Participações, which due to the concentration of commitments became a holding company.

In the second stage, held on October 1, 2011, assets, rights and obligations of Vivo Participações related to mobile operations in Minas Gerais were awarded to Vivo S.A., a subsidiary of Vivo Participações. As a result, Vivo S.A. became the only mobile operator in the group.

After ANATEL's approval of the third stage of corporate restructuring, on August 16, 2011, Telefônica Brasil absorbed Vivo Participações's equity, extinguishing Vivo Participações on October 3, 2011, which simplified and rationalized the Company's cost structures.

SMP Authorizations and Corporate Restructuring

On June 14, 2011, the Board of Directors of Vivo Participações S.A. approved a proposal for the merger of licenses to provide SMP services (then owned by Vivo Participações S.A. in the State of Minas Gerais and Vivo in other Brazilian States). As a result, the operations and authorizations for the provision of SMP services were unified under Vivo. On the same date, the proposal for merger of SMP authorizations as well as for simplifying the corporate structure was filed with ANATEL. The form proposed for this simplified corporate structure was the transfer of

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businesses, including property, rights and obligations related to provision of SMP services, as well as the authorizations for the provision of SMP in the State of Minas Gerais held by Vivo Participações, to Vivo, which would result in Vivo S.A. being a wholly owned direct subsidiary of the Company and the mobile operator group that owns the SMP authorizations in other Brazilian states. After the transfer, Vivo Participações was to become a holding company and immediately merge with the Company, thus simplifying and rationalizing the cost structure of the companies involved and subsequently extinguish its corporate existence. On August 16, 2011, ANATEL approved the corporate restructuring pursuant to Act. No. 5,703, published in the D.O.U. on August 18, 2011.

On September 12, 2011, in compliance with Brazilian Corporate Law, an independent firm prepared a valuation report of Vivo Participações S.A.'s net assets based on its book value as of August 31, 2011 containing part of Vivo Participações S.A.'s assets relating to the operations of SMP in the State of Minas Gerais that were transferred to Vivo and the assets of Vivo Participações merged into the Company. Vivo Participações' valuation as of August 31, 2011 was R\$10.3 billion.

On September 13, 2011, the Board of Directors of Vivo Participações S.A. approved, ad referendum of the shareholders: (i) the valuation report of Vivo Participações S.A., containing part of the assets corresponding to the SMP operations in the State of Minas Gerais, which led to a capital increase in Vivo in the amount of R\$833.0 million, through the subscription of shares of Vivo Participações S.A.; and (ii) the Protocol of Merger and Instrument of Justification of Vivo Participações S.A. into Telecomunicações de São Paulo S.A. – TELESP (“Protocol”) for the merger of Vivo Participações S.A. into the Company, preceded by the transfer of commercial establishments, including the assets, rights and obligations related to provision of SMP, as well as authorizations for the provision of SMP in the State of Minas Gerais held by Vivo Participações S.A.

On October 1, 2011, the Extraordinary General Shareholders Meeting approved the valuation report of Vivo Participações S.A.. The net assets of Vivo Participações in Minas Gerais transferred to Vivo S.A. amounted to R\$833.0 million, which were used for the capital increase in Vivo through the subscription of shares by Vivo Participações S.A., paid via the transfer of assets.

On October 3, 2011, the Extraordinary General Meeting of the Company approved the merger of Vivo Participações S.A. into the Company. On the same date, the Company changed its name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A., to reflect its nationwide operations.

On October 18, 2011, the Extract of the Authorization Term No. 46/2011/PVCP/SPV-ANATEL was published in the D.O.U. as a result of Act No. 5703 of October, 16 2011, which authorizes the transfer to Vivo of the authorization to render SMP services in the State of Minas Gerais.

Provision of STFC outside the State of São Paulo by Vivo

On August 18, 2011, ANATEL's Act No. 7012 was published in the D.O.U. authorizing Vivo to provide STFC services for the general public. On October 7, 2011, Vivo began providing fixed services through mobile technology (FWT) outside of the State of São Paulo.

ANATEL granted on August 18, 2011 consent to the Company to transfer to Vivo its authorizations for STFC service in local mode, domestic long-distance and international long-distance in Regions I and II of the General Plan of Grants (outside of São Paulo). On September 8, 2011, the Extract of the Authorization Term was published in the D.O.U. with the transfer of the STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer STFC across its area, except for the State of São Paulo, using basically the network elements and some radio frequencies that support the provision of SMP.

Plan for the purchase of shares issued by the Company.

On August 11 and 15, 2011, the Company informed its shareholders and the market in general, respectively, of approval by the Board of Directors, of the acquisition of preferred and common shares issued by the Company for subsequent cancellation, disposal or maintenance in treasury, without capital reduction, in order to add value for shareholders. For this repurchase, there was use of part of the capital reserve existing as of June 30, 2011, excepting the reserves mentioned in article 7, letter (a) to (d) of CVM Rule No. 10/80.

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The repurchase started on the date of the resolution, and remained effective until October 20, 2011, and acquisitions were on BM&FBOVESPA, at market prices. The Executive Board was responsible for establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, as well as the definition of the parameters to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 2,700,000 preferred shares and 2,900,000 common shares.

On November 7, 2011, the Company announced approval by the Board of Directors of a new plan for the purchase of common and preferred shares issued by the Company for the same purpose and using the aforementioned reserve.

This new repurchase started on the date of the resolution, remaining effective until November 6, 2012, and acquisitions were made on BM&FBOVESPA, at market prices, observing legal limits and the established maximum number of 2,912,734 common shares and 25,207,477 preferred shares.

By December 31, 2011, the Company acquired 29,000 common shares and 1,292,300 preferred shares (inclusive of the shares purchased on August 11, August 15 and November 7, 2011).

Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

ON: common shares.

PN: preferred shares.

Restructuring Telefônica Brasil's subsidiaries

On March 15, 2012, our Board of Directors approved, based on Law No. 12.485/11, a corporate restructuring involving the Company's wholly owned subsidiaries to rationalize the provision of services rendered by these subsidiaries and the concentration of the provision of telecommunication services into a single company.

The restructuring will be implemented by a process of partial division and merger, first involving only the Company's wholly owned subsidiaries—A. TELECOM, TData, TST, Ajato and Vivo. As a result of the restructuring, Value Added Services ("VAS") provided by several wholly owned subsidiaries of the Company will be unified under Telefonica Data S.A. and other telecommunications services will be unified under the Company, which, as a final step to the corporate restructuring, will merge these subsidiaries. Following the merger, VAS will be provided by Telefonica Data S.A. and the Company will provide other telecom services.

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In addition to streamlining the rendering of services, the corporate restructuring (now possible because of legislative changes applicable to STFC providers) aims to simplify the current organizational structure of the Company, as well as assist the integration of business and the generation of synergies arising therefrom.

This corporate restructuring can only be implemented after the consent of ANATEL. As of the date of this annual report, there is no expected date for ANATEL's consent.

Capital Expenditures

Year ended December 31, 2011

In 2011, we invested in projects that support our current results and prepare the Company for the competitive landscape in the medium-term. A significant proportion of resources was allocated to enable growth associated with the services we provide.

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of data customers, whether fixed and mobile data services or dedicated high-speed services to the corporate market, as well as the increase in capillarity of our fiber optics network in São Paulo. We also invested in the expansion of the national data transmission backbone to meet increasing demand for mobile data traffic nationwide. In 2011, we invested an amount exceeding R\$1 billion to support the full range of data services we offer to our customers.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2011.

Telefônica Brasil	Year ended December 31,		
	2011(1)	2010	2009
	(in millions of reais)		
Network	3,381.0	2,039.7	1,779.8
Technology / Information Systems	612.5	266.1	262.0
Others(2)	1,408.0	135.6	179.3
<u>Total capital expenditures</u>	<u>5,401.5</u>	<u>2,441.4</u>	<u>2,221.1</u>

(1) The financial information presented for 2011 represents information from Telefônica Brasil's consolidated financial statements.

(2) Consists primarily of free handset rentals, network construction, furniture and fixtures, office equipment and store layouts and a value of R\$811.8 million related to the acquisition of licenses.

We anticipate that our capital expenditures for 2012 will be similar to 2011. We expect to fund these expenditures with funds internally generated from our operations and through debt.

Year ended December 31, 2010

In 2010, we were focused in voice services in order to comply with ANATEL's targets and to provide quality service for clients. Also, in order to achieve a consolidated position in the broadband market, during 2010 the focus of our capital expenditure were expanding, modernizing and upgrading our ADSL network and improving our systems and processes of customers relations, marketing and sales.

Year ended December 31, 2009

In 2009, we were focused in voice services in order to comply with ANATEL's targets and to provide quality service for clients. Also, in order to achieve a consolidated position in the broadband and Pay TV market, during 2009 the focus of our capital expenditure were expanding, modernizing and upgrading our ADSL network, increasing the base of Pay TV and improving our systems and processes of customers relations, marketing and sales.

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B. Business Overview

The concessions granted by the Brazilian government in 1998 and renewed in 2005, with the effective date starting in January 2006, allow us to provide fixed-line telecommunications services to a region that includes most—approximately 95%—of the State of São Paulo. The portion of the State of São Paulo that is excluded from our concession region represents approximately 1.5% of total lines in service and 2.2% of the population in the State. This concession is operated by CTBC Telecom.

Our concession region is Region III, which comprises 622 municipalities, including the City of São Paulo, with an aggregate population of approximately 41.3 million. Of the municipalities in Region III, 72 have a population in excess of 100,000. The City of São Paulo has a population of approximately 11 million. According to the plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the State of São Paulo was divided into four sectors, including Sectors 31 (our predecessor company's area before the reorganization), 32 (the area corresponding to Ceterp before our acquisition), 33 (corresponding to the portion of the State of São Paulo that we do not service) and 34 (CTBC Borda do Campo area before the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. According to the Presidential Decree regarding the new General Plan of Grants, published in the D.O.U. on November 21, 2008, the three sectors for which we act as a concessionaire (sectors 31, 32 and 34) were unified into a single sector (sector 31).

On May 7, 2002, we began offering international long-distance services and on July 29, 2002, we started offering interregional service. The conditions for the provision of interregional and international long-distance services outside the concession area contemplate that providers already operating services under a selection code (a two-digit code to be input by the caller as a prefix to the number dialed) shall keep such code under the new licenses authorizing operation outside the applicable concession area. Accordingly, we continue using the provider selection code "15" that permits our callers to originate calls using our services even though they are outside our concession area. All interregional and international cellular calls, whether in our concession area or that of another provider, need to dial a carrier selection code using Personal Mobile Service—SMP, through which mobile services users choose the provider for interregional and international long-distance calls, and which requires dialing our code "15" to use our services. See "—Network Services."

Since our merger with Vivo Participações, we provide mobile telecommunications services in all of the Brazilian states in addition to the Distrito Federal, the Federal district, representing a total of approximately 8.5 million square kilometers and a population of approximately 190.7 million people. Our wholly owned subsidiary Vivo became a national operator when, on September, 2007, it acquired a license of 1.9 GHz ("L" band) to operate within 6 states located in the Northeast region (Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte), combined with the acquisition of Telemig.

According to data regarding market share published by ANATEL, we are among the leading providers of cellular telecommunications services in Brazil, with the help of our subsidiary Vivo, the leading cellular operator in Brazil. Vivo is a cellular operator in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (also encompassing the area of Federal District), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São Paulo, Sergipe, Tocantins and Minas Gerais.

In Areas 1 and 2, Vivo uses a frequency range known as "A," "L" and "J" band that covers 100% of the municipalities in its authorized areas in the state of São Paulo. On December 31, 2011, Vivo had 19.6 million cellular lines in service in these areas, which represented a 14.0% net increase from December 31, 2010, and a market share of approximately

33.0% in São Paulo.

In Area 3, Vivo uses the band “A,” “L” and “J” frequency range that covers 100% of the municipalities and 100% of the population in the states of Rio de Janeiro and Espírito Santo. On December 31, 2011, Vivo had 10.1 million cellular lines in service in this area, which represented a 17.1% net increase from December 31, 2010, and a market share of approximately 38.8% in those states.

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In Area 4, Vivo uses a frequency range known as “A,” “E” and “J” band that covers 71.6% of the municipalities and 92.4% of the population in the state of Minas Gerais. On December 31, 2011, Vivo had 7.9 million cellular lines in service in this area, which represented a 16.0% net increase from December 31, 2010, and a market share of approximately 33.3% in Minas Gerais.

In Area 5, Vivo uses a frequency range known as “B” band that covers 67.2% of the municipalities in the states of Paraná and Santa Catarina and 93.9% of the population of Paraná and Santa Catarina. On December 31, 2011, Vivo had 4.5 million cellular lines in service in this area, which represented a 14.1% net increase from December 31, 2010, and a market share of approximately 21.7% in those states.

In Area 6, Vivo uses the band “A,” “L” and “J” frequency range that covers 82.1% of the municipalities and 97.7% of the population in the state of Rio Grande do Sul. On December 31, 2011, Vivo had 6.0 million cellular lines in service in this area, which represented a 14.0% net increase from December 31, 2010, and a market share of approximately 42.6% in that state.

In Areas 7 and 8, Vivo is the leading cellular operator, by number of customers, in its authorization area and uses a frequency range known as “A,” “B,” “L” and “J” band that covers 60.2% of the municipalities in the states of Acre, Federal District, Goiás, Mato Grosso, Mato Grosso do Sul, Rondônia, Tocantins, Amazonas, Amapá, Maranhão, Pará and Roraima which covers 83.0% of the population in these states. On December 31, 2011, Vivo had 15.4 million cellular lines in service in these areas, which represented a 26.2% net increase from December 31, 2010, and a market share of approximately 34.8% in those states.

In Area 9, Vivo uses the band “A,” “L” and “J” frequency range that covers 63.8% of the municipalities and 87.2% of the population in the States of Bahia and Sergipe. On December 31, 2011, Vivo had 5.5 million cellular lines in service in this area, which represented a 23.3% net increase from December 31, 2010, and a market share of approximately 29.8% in those states.

In Area 10, Vivo uses the band “L” and “J” frequency range that covers 37.6% of the municipalities and 73.2% of the population in the States of Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte. On December 31, 2011, Vivo had 2.5 million cellular lines in service in this area, which represented a 43.0% net increase from December 31, 2010 and a market share of approximately 7.1% in those states.

On September 18, 2007, with ANATEL’s approval, Vivo acquired the band “L” lots, except for lot 16 (area of Londrina, Paraná, in region 5) and lot 20 (area of Northern Brazil in region 8). Band “L” comprises lots in frequency ranges 1895 to 1900 MHz and 1975 to 1980 MHz, with 5 + 5 MHz band width. As a result, Vivo managed to complete its last coverage gap and will soon be operating in the entire Brazilian territory. On December 20, 2007, with ANATEL’s approval, Vivo acquired the band “J” lots with 10 + 10 MHz band width, with the exception of the lots in the state of Minas Gerais then acquired by Telemig Celular and now by Vivo.

On December 14 and 15, 2010, Vivo acquired 23 lots in the SMP remaining band auction. Vivo acquired lots in almost all regions of the country, which allowed it to reach spectrum capacity of 70 Mhz or higher in all regions where it operates (excluding 23 municipalities in the region of Franca, State of São Paulo, where the spectrum is 50 Mhz).

In the auction of frequencies of H Band and other remaining bands by ANATEL in December 14 and 15, 2010, in compliance with the call notice No 002/2010/PVCP/SPV, Vivo was the winner in 23 of the blocks auctioned.

As a result, Vivo improved its capacity of rendering of services throughout the national territory and now operates in the 900 MHz and 1,800 MHz frequencies in a broad way.

The table below lists the 23 blocks in which Vivo had the winning offer:

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Blocks	Frequency Range (MHz)	Width	Service Areas
41	1800	10 + 10	States of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul, Rondonia, Acre and the Federal District
42	1800	10 + 10	State of São Paulo
44	1800	15 + 15	Pelotas, Morro Redondo, Capão do Leão and Turuçu municipalities in State of Rio Grande do Sul
45	1800	15 + 15	States of Alagoas, Ceará, Paraíba, Piauí and Rio Grande do Norte
76	900	2.5 + 2.5	State of Rio de Janeiro
77	900	2.5 + 2.5	State of Espírito Santo
78	900	2.5 + 2.5	States of Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondonia, Acre and the Federal District (3)
79	900	2.5 + 2.5	State of Rio Grande do Sul except Pelotas, Morro Redondo, Capão do Leão and Turuçu municipalities
80	900	2.5 + 2.5	Municipalities of CN 43(2), in the State of Paraná, except Londrina and Tamarana municipalities
81	900	2.5 + 2.5	States of Paraná and Santa Catarina, except CN 43(2) and Londrina and Tamarana municipalities, in the State of Paraná
82	900	2.5 + 2.5	State of Bahia
83	900	2.5 + 2.5	State of Sergipe
84	900	2.5 + 2.5	State of Amazonas, Amapá, Maranhão, Pará and Roraima
92	1800	2.5 + 2.5	State of São Paulo except the São Paulo Metropolitan Area (Grande São Paulo) and nearby area and Sector 33(1) General Plan of Grants in the State of São Paulo
101	1800	2.5 + 2.5	State of Amazonas, Amapá, Maranhão, Pará and Roraima
105	1800	2.5 + 2.5	Paranaíba municipality, in the State of Mato Grosso do Sul
107	1800	2.5 + 2.5	Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão municipalities, in the State of Goiás
115	1800	2.5 + 2.5	Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão municipalities, in the State of Goiás
119	1800	10 + 10	States of Rio de Janeiro, Espírito Santo, Bahia and Sergipe
122	1800	10 + 10	State of Amazonas, Amapá, Maranhão, Pará and Roraima
124	1800	10 + 10	States of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte
128	1800	10 + 10	Paranaíba municipality, in the State of Mato Grosso do Sul and Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão municipalities, in the State of Goiás
163	1800	5 + 5	Londrina and Tamarana municipalities in the State of Paraná

(1) Municipalities: Altinópolis, Aramina, Batatais, Brodowsqui, Buritzal, Cajuru, Cássia dos Coqueiros, Colômbia, Franca, Guaíra, Guará, Ipuã, Ituverava, Jardinópolis, Miguelópolis, Morro Agudo, Nuporanga, Orlandia, Ribeirão Corrente, Sales de Oliveira, Santa Cruz da Esperança, Santo Antônio da Alegria and São Joaquim da Barra, in the State of São Paulo.

(2) CN = Municipalities with the National Select Code.

(3) Except Paranaíba municipality, in the State of Mato Grosso do Sul, and Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão municipalities, in the State of Goiás.

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On April 28, 2011, ANATEL decided, with regard to the auction of the “H” band and remaining bands (Notice of No Bid. 002/2010/PVCP/SPV-ANATEL), to grant lots 41, 42, 44, 45, 76–84, 92, 101, 105, 107, 115, 119, 122, 124, 128 and 163 to Vivo and other operators of the winning lots in that auction. The lots assigned solely to Vivo are specified on the table above.

On May 30, 2011, ANATEL’s decision was published in the D.O.U. and the Authorization Terms were signed by ANATEL. On June 1, 2011, the Extracts of the Authorization Terms were published on the D.O.U. As a result, Vivo increased its spectrum, beginning to operate at frequencies of 900 MHz and 1800 MHz in a comprehensive manner.

The following table sets forth population, gross domestic product (GDP), and per capita income statistics for each state in Vivo’s service regions at the dates and for the years indicated:

Area	Frequency Range (MHz)	On December 31, 2011			Last available IBGE data from 2009		
		Population (in thousands)(1)	Percent of Brazil’s population(1)		GDP (in millions of reais)(2)	Percent of Brazil’s GDP(2)	Per capita income (in reais)(2)
São Paulo State	850, 900, 1800, 1900 and 2100	41,252	21.63 %		1,084,353	33.47 %	26,202
Paraná State	850, 900, 1800, 1900 and 2100	10,440	5.47 %		189,992	5.87 %	17,780
Santa Catarina State	850, 900, 1800, 1900 and 2100	6,250	3.28 %		129,806	4.01 %	21,214
Goiás State	850, 900, 1800, 1900 and 2100	6,004	3.15 %		85,615	2.64 %	14,447
Tocantins State	850, 900, 1800, 1900 and 2100	1,383	0.73 %		14,571	0.45 %	11,278
Mato Grosso State	850, 900, 1800, 1900 and 2100	3,034	1.59 %		57,294	1.77 %	19,085
Mato Grosso do Sul State	850, 900, 1800, 1900 and 2100	2,449	1.28 %		36,368	1.12 %	15,410
Rondônia State	850, 900, 1800, 1900 and 2100	1,561	0.82 %		20,236	0.62 %	13,455
Acre State	850, 900, 1800, 1900 and 2100	733	0.38 %		7,386	0.23 %	10,689
Amapá State	850, 900, 1800 and 2100	669	0.35 %		7,404	0.23 %	11,809
Amazonas State	850, 900, 1800 and 2100	3,481	1.83 %		49,614	1.53 %	14,622
Maranhão State	850, 900, 1800 and 2100	6,570	3.44 %		39,855	1.23 %	6,260
Pará State	850, 900, 1800 and 2100	7,588	3.98 %		58,402	1.80 %	7,859
Roraima State	850, 900, 1800 and 2100	451	0.24 %		5,593	0.17 %	13,285
Federal District	850, 900, 1800, 1900 and 2100	2,563	1.34 %		131,487	4.06 %	50,436
Bahia State	850, 900, 1800, 1900 and 2100	14,021	7.35 %		137,075	4.23 %	9,365
Sergipe State	850, 900, 1800, 1900 and 2100	2,068	1.08 %		19,767	0.61 %	9,786

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	850, 900, 1800, 1900 and 2100							
Rio de Janeiro State	850, 900, 1800, 1900 and 2100	15,994	8.39	%	353,878	10.92	%	22,104
Espírito Santo State	850, 900, 1800, 1900 and 2100	3,513	1.84	%	66,763	2.06	%	19,146
Rio Grande do Sul State	850, 900, 1800, 1900 and 2100	10,696	5.61	%	215,864	6.66	%	19,779
Alagoas State	900, 1800, 1900 and 2100	3,121	1.64	%	21,235	0.66	%	6,728
Ceará State	900, 1800, 1900 and 2100	8,448	4.43	%	65,704	2.03	%	7,686
Pernambuco State	900, 1800, 1900 and 2100	8,796	4.61	%	78,428	2.42	%	8,902
Piauí State	900, 1800, 1900 and 2100	3,119	1.64	%	19,033	0.59	%	6,052
Paraíba State	900, 1800, 1900 and 2100	3,767	1.97	%	28,719	0.89	%	7,618
Rio Grande do Norte State	900, 1800, 1900 and 2100	3,168	1.66	%	27,905	0.86	%	8,893
Minas Gerais State	850, 900, 1800 and 2100	19,595	10.27	%	287,055	8.86	%	14,328
Vivo		190,733	100.00	%	3,239,402	100.00	%	16,984

(1) According to the last revision published by IBGE in 2009 (latest data available).

(2) According to the most recent IBGE data (2009). Nominal Brazilian GDP was R\$3,239,402 million as of December 2009 calculated by IBGE, subject to revision.

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On December 31, 2011, Vivo had 324 sales outlets (85 in the state of São Paulo, 43 in the states of Rio de Janeiro and Espírito Santo, 35 in the state of Rio Grande do Sul, 37 in the states of Paraná and Santa Catarina, 21 in the states of Bahia and Sergipe, 29 in the states of Minas Gerais, seven in the states that make up the northwest regions of Brasil and 44 in the states that make up the Midwestern and 21 northern regions of Brazil). It also has an efficient network of 11,337 authorized retail and resales dealerships. Consequently, Vivo has maintained its market leadership position, with a total of 11,661 points of sale.

Prepaid telephone card recharging was available at more than 600,000 locations, including our own stores, dealers, lottery shops, physical and online card distributors, and at smaller shops, drugstores, newspaper stands, bookstores, bakeries, gas stations, bars and restaurants. Recharging is also provided online by several banks' websites, by credit card's machines, by telephone and accredited websites.

Overview

Our services consist of:

- voice services, including activation, monthly subscription, measured service and public telephones;
- interconnection charges (or network usage charges), which are amounts we charge other cellular and fixed-line service providers for the use of our network;
 - intraregional, interregional and international long-distance voice services;
 - data services, (including broadband services) and mobile value added services;
- Pay TV services through DTH (direct to home), satellite technology and land based wireless technology MMDS (multichannel multipoint distribution service);
 - the sale of wireless devices and accessories;
 - network services, including rental of facilities, as well as other services.

In March 2002, ANATEL certified our compliance with the 2003 universal service targets and authorized us in April 2002 to start providing local and intraregional services in certain regions in which we were not operational and interregional and international long-distance services throughout Brazil. See “—Competition” and “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

We provide interconnection services to cellular service providers and other fixed telecommunications companies through the use of our network. In April 1999, we also began to sell handsets and other telephone equipment through A. TELECOM S.A. (formerly Assist Telefónica S.A.), our wholly owned subsidiary. Until January 2001, we provided data transmission services, but spun-off our data transmission operations into TDBH. In March 2006, we began the restructuring of our multimedia communications services (serviços de comunicação multimídia) and data transmission activities. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

The monthly and usage fees for our fixed services (local and long-distance) were initially determined in our concession agreements. From March 2007 until July 31, 2007, the billing system was converted to a minute basis and the former measurement based on pulses was discontinued for all customers. Our concession agreements also

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set forth criteria for annual fee adjustments. We derive a substantial portion of our revenue from services subject to this price adjustment. The method of price adjustment is essentially a price cap. ANATEL annually applies a price index correction that reflects the inflation index of the period and a productivity factor to our local and long-distance fees. Since 2006, the inflation index has been replaced by the IST, which reflects variations in telecommunications companies' costs and expenses. ANATEL has complied with the fee range set by the concession agreements.

We also provide mobile services for voice, internet and value-added services, including voicemail, voice mail translation in a speech-to-text service ("Vivo Torpedo Recado"), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones ("Vivo Som de Chamada"), data services through WAP protocol and 3G (with a pre-paid data plan special to smartphones), and innovative services such as multi-media backup and cloud based services to save the short messages ("Vivo Torpedo Center"). We also offer direct Internet through data plans for Smartphones, Tablets and other data enabled devices. We developed a new interface—Vivo Services Store ("Loja de Serviços Vivo") to sell all the services provided by Vivo, from bundles of SMS to content download such as music, video and games.

We offer wireless roaming services through agreements with local mobile service providers throughout Brazil and other countries, allowing our subscribers to make and receive calls while outside of our concession areas. We provide reciprocal roaming rights to the customers of the mobile service providers with which we have such agreements.

Local Service

Fixed local service includes activation, monthly subscription, measured service and public telephones. Measured service includes all calls that originate and terminate within the same local area or municipality of our concession region, which we refer to as "local calls." Excluding the portion of our region that was serviced by Ceterp before its acquisition in December 1999, we were the only supplier of local fixed-line and intraregional long-distance telecommunications services in our region until July 1999. At that time, licenses were auctioned to permit a competitor to provide local fixed-line and intraregional long-distance telecommunications services in our region, including the area formerly served by Ceterp. Vésper São Paulo S.A. received authorization and began operations in December 1999. Embratel, GVT, Oi and Tim also provide local services in our concession region. See "—Competition."

We became the first telephone service concessionaire in Brazil to offer fixed local services outside its concession region (the State of São Paulo). In May 2003, we achieved the network expansion and universal service targets established by ANATEL, and began providing fixed local services to six other states in Brazil, including Sergipe, Espírito Santo, Rio Grande do Sul, Paraná, Santa Catarina and certain areas in Rio de Janeiro. In May 2004, we began providing local fixed telephone services in seven other states in Brazil, including those in the capitals of Pará, Roraima, Amapá, Rondônia, Maranhão, Tocantins and Acre. In May 2005, we also began to provide fixed local telephone services in the capitals of the following states: Ceará, Amazonas, Pernambuco, Rio de Janeiro, Bahia, Mato Grosso do Sul and Mato Grosso. Since May 2006, we have also been providing fixed local telephone services in Brasília (Federal District) and Goiânia, the capital of the State of Goiás. Currently, our main markets outside our concession region are Rio de Janeiro, Espírito Santo, Minas Gerais, Bahia, Pernambuco, Ceará, Federal District, Goiás, Rio Grande do Sul, Paraná and Santa Catarina.

Intraregional Long-Distance Service

Intraregional long-distance services consists of all calls that originate in one local area or municipality and terminate in another local area or municipality of our concession region. We were the sole provider of intraregional long-distance services in our region until July 3, 1999, when the federal government also authorized Embratel and Intelig to provide intraregional long-distance services. Currently, our main competitors in this service are Embratel, Tim, Oi and GVT.

Interregional and International Long-Distance Fixed Service

On March 1, 2002, ANATEL acknowledged that we had satisfied its network expansion and universal service targets two years before the scheduled date. As a result, on April 25, 2002, ANATEL published an order that allowed us to be the first fixed-line telephone company to provide the full range of STFC and granted us a

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concession to develop interregional long-distance services in Region III and an authorization to develop services in the local, intraregional, interregional and international markets throughout Brazil.

We began operating international long-distance services in May 2002 and interregional long-distance services in July 2002. Interregional long-distance services consists of state-to-state calls within Brazil. International long-distance services consists of calls between a point in Brazil and a point outside Brazil.

Data Services—Fixed Broadband

The fixed broadband service was launched in 1999 with the Speedy brand, initially with ADSL technology, which uses the same copper pair that is used in the provision of voice services, to provide fast Internet service. Currently, the product portfolio of broadband speeds on ADSL range from 256 Kbps (kilobytes per second) up to 8 Mbps (mega bits per second). In 2011, Telefonica has 100% coverage of the municipalities in its concession area and is the first operator in Brazil to reach this mark. In addition, throughout 2011, Speedy reached the milestone of 3.6 million subscribers.

In 2010, Telefonica began selling the product Popular Broadband (Banda Larga Popular), which is an initiative in the State of São Paulo to deliver affordable broadband for low-income populations. This product has a speed of 1 Mbps.

In 2011, the Company and the Ministry of Communications signed the National Broadband Plan (Plano Nacional de Banda Larga) commitment which defines conditions for the provision of broadband retail and wholesale, as well as the conditions of communication, quality and supervision.

Broadband services provided under the National Broadband Plan can be provided starting with 90 days after it becomes effective. However, the Company voluntarily launched its services under the National Broadband Plan in July 2011 in municipalities where Vivo's 3G network was already available. On September 28, 2011, the Company began providing fixed broadband services for retail and wholesale customers. The Company also agreed to offer retail broadband for a price of up to R\$35.00 to the consumer or a broadband and fixed telephony package for a price of up to R\$65.00 to the consumer. Broadband services offered under the National Broadband Plan for retail customers have a minimum speed of 1 Mbps and may have limits on the amount of downloads available. Wholesale services were available in 350 municipalities and can be used by local governments and companies registered under the tax system called "SIMPLES." Broadband services offered under the National Broadband Plan for wholesale customers are available in multiples of 2 Mbps, limited to 8 Mbps for local governments and 20 Mbps for corporate users.

We also provide fixed broadband services using coaxial cable at speeds ranging from 8 Mbps to 30 Mbps through Ajato (allowing for speeds from 2 Mbps to 16 Mbps) and optical fiber (FTTx). Optical fiber is the most advanced technology currently available and it allows for speeds of up to 100 Mbps.

Pay TV Services

On March 14, 2007, ANATEL has granted A. TELECOM S.A., one of our wholly owned subsidiaries, the license to offer pay TV services via DTH. We began offering pay TV services on August 12, 2007.

On October 31, 2007, ANATEL's council approved, from a regulatory perspective, the agreement between Grupo Abril and the Company, which involved, among other transactions, the acquisition by the Company of all of Grupo Abril's Multichannel Multipoint Distribution Service (MMDS) operations (a special license that allows us to offer pay TV through our subsidiary, Telefonica Sistemas de Televisão S.A). The transaction remains under consideration by ANATEL only with respect to antitrust factors, and will ultimately be reviewed by CADE. On December 31, 2011, we reached 699 thousand pay TV users, including both DTH and MMDS technologies. We currently offer DTH to the

whole State of São Paulo, and MMDS in the cities of São Paulo, Rio de Janeiro, Curitiba and Porto Alegre.

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Network Services

Brazil is divided into four regions in relation to fixed telecommunication services with the following incumbent service providers (which initially received concessions from ANATEL): (i) Region I, that encompasses the North, Northeast and Southeast regions of Brazil, except the State of São Paulo, where concessions are granted to Oi (Telemar) and CTBC Telecom; (ii) Region II, that encompasses the South and Center-West regions of Brazil, where concessions are granted to Oi (Brasil Telecom), CTBC Telecom and Sercomtel; (iii) Region III, that encompasses the State of São Paulo, where concessions are granted to us and CTBC Telecom; and (iv) Region IV, that encompasses the whole country and in which the concession for long-distance calls is granted to Embratel.

In 2005, after meeting the targets imposed in the concession agreement two years before the expected date, Telefonica started to operate long-distance services in every municipality in Brazil. For the operation of local services in Regions I and II, the Company expanded its network to the main Brazilian cities, providing services in these markets with infrastructure based on new-generation platforms.

In 2007, the Company developed solutions and invested significant resources to adapt its network to the requirements of Number Portability determined by ANATEL. Number Portability is a service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers. The implementation of Number Portability in the State of São Paulo was effectively initiated in September 2008 and fully implemented in March 2009.

By the end of 2011, for local services, we were present in the main cities of Regions I and II, namely: Porto Alegre, Curitiba, Brasília, Rio de Janeiro, Vitória, Belo Horizonte, Salvador, Florianópolis, Fortaleza, Recife, Goiânia and Uberlândia. For the provision of data services, we had networks in fourteen cities in these regions.

We have continuously adapted and expanded our network topology aiming to develop new business opportunities in the State of São Paulo through offering services to other telecommunications companies. The result was a significant increase in the number of providers that use our wholesale services.

Other important adaptations have been implemented in the network topology to meet the regulatory requirements and to integrate several calling areas in the State of São Paulo, thus allowing customers to make local calls that had previously been categorized as long-distance calls. The integration of new cities into local areas is annually determined by ANATEL and we are fully complying with ANATEL's determinations.

Competition for long-distance services has continuously increased and by the end of 2011 there were a total of 38 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora—CSP). Satellite services for providing circuits in remote areas for wholesale and large customers have been also implemented.

Other Services

Currently, we provide a variety of other telecommunications services that extend beyond basic telephone service, including extended maintenance, caller identification, voicemail, cell phone blockers, computer support, antivirus software for our Internet service subscribers, and posto informático (a solution with a fixed monthly fee consisting of a computer, broadband access and technical support twenty-four hours, seven days a week), among others.

Interconnection

In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to publish on the Internet an interconnection public offer for all types of interconnection services, in addition to the interconnection between fixed-line service providers and mobile service providers; (ii) offers of interconnection for Backbone Internet Providers; (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which new interconnection solicitations are answered. These reforms have facilitated market entry for new operators.

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The interconnection public offer (OPI) had been amended following negotiations with providers and changes in the services rendered and regulatory requirements. We have adopted procedures to reduce the time necessary to answer customers' interconnection requests, as well as to monitor and comply with quality levels set by ANATEL for interconnection services with a current availability level of 99.8%.

In 2006, the Company completed the implementation of the interconnection with mobile service providers in the most intensive traffic areas, assuring the proper billing for such calls and reducing interconnection costs.

In 2007, ANATEL published the new version of the Regulation of Fixed Network Compensation Rates, which primarily modified the rules for interconnection rates and calculation methods. Local and long-distance tariffs that were flat at all times became variable according to the rules for public service tariffs. A 20% increase was applied to tariffs of nonincumbents.

In addition to the necessary adaptations in its network concerning the Number Portability, the Company, in conjunction with other operators, implemented a systematic solution including several interoperable processes which enables the correct forwarding of calls.

According to SMP regulations, the VU-M price is subject to free negotiation between parties and once an agreement is reached it must be homologated by ANATEL to take effect. The agreement currently in effect was executed in 2009.

Starting in November 2009, the licenses of each mobile operator were consolidated by region, resulting in the consolidation of tariffs and in the reduction of interconnection fees for long-distance traffic within its network.

At the end of 2011, Telefonica had 106 local and long-distance interconnection agreements and 87 agreements for provision of local traffic and long-distance.

I-Telefónica

I-Telefónica is a free Internet access service provider launched in September 2002 by our subsidiary A. TELECOM S.A. (formerly Assist Telefónica). The product is available in 622 cities in the State of São Paulo and over 1,500 cities in all of Brazil. The service delivers high-quality, stable Internet access that is structured to ensure that our clients do not encounter a busy signal when connecting to the Internet. I-Telefónica permits us to increase the range of our services and better supply our customers by offering an entry-level option to the Internet market.

I-Telefónica also represents a strategic tool to protect us against the possible traffic imbalance that may be generated by Internet access service providers that do not use our network. Traffic imbalance (sumidouro) occurs when a certain telecommunications operator has a higher volume of incoming than outgoing traffic (with another operator). When the incoming/outgoing traffic relationship falls outside the 45% to 55% range, the operator with higher outgoing traffic must pay to the other the interconnection fees corresponding to the traffic that exceeds the range. Telecommunications operators that house Internet service providers tend to have more incoming than outgoing traffic, and thus receive interconnection revenue from other operators. I-Telefónica helps us keep our dial-up traffic on our own network, and thus reduce unfavorable traffic imbalance, thereby lowering our interconnection expenses.

Authorization to Provide Multimedia Services

On January 29, 2003, ANATEL granted our SCM license nationwide, allowing A. TELECOM S.A. (formerly Assist Telefónica), our wholly owned subsidiary, to provide voice and data services through points-of-presence (POPs), which are comprised of private telecommunications networks and circuits. In addition to A. TELECOM S.A., ANATEL granted SCM licenses to T-Data (formerly T-Empresas) and Emergia.

Authorizations for pay TV via satellite

On March 14, 2007, ANATEL granted A. TELECOM S.A. authorization to provide services of pay TV via satellite (Direct to Home – DTH). DTH is one of the special types of subscription TV services that utilize satellites

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for the direct distribution of television and audio signals for subscribers. The launching of the commercial transaction occurred on August 12, 2007.

Authorization for Multichannel Multipoint Distribution Service (MMDS)

On October 31, 2007, the board of ANATEL concluded its regulatory review of the agreement between Grupo Abril and the Company, approving the transaction from a regulatory perspective, which involved, among other transactions, the acquisition of all of the operations of MMDS.

This decision was published in the D.O.U. on November 19, 2007. The transaction continues to be analyzed by ANATEL, solely with respect to antitrust matters, and will ultimately also be reviewed by CADE.

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated with the MMDS in São Paulo, Curitiba, Rio de Janeiro and Porto Alegre. ANATEL is currently analyzing the price to be paid for the spectrum usage.

The STFC Concession Agreement

The Company is authorized to provide STFC to render local and domestic long-distance call services originated in Region III, which comprises the State of São Paulo, except for Sector 31, established in the General Plan of Grants.

The current concession agreement, dated December 22, 2005, was renewed on January 1, 2006, and will be valid until December 31, 2025. On December 15, 2010, ANATEL released a public consultation proposing the amendment of clause 3.2 of the concession agreement which resulted in the approval of Resolution No. 559 published on December 27, 2010. Resolution No. 559 establishes that the current concession agreement can be reviewed by ANATEL on May 2, 2011, December 31, 2015, and December 31, 2020. Based on the amended clause 3.2, ANATEL may establish new requirements and targets for universal and high-quality telecommunication services, according to the conditions present at the time of review.

On June 30, 2011, the Company renewed its concession agreement and entered into new contracts for local and long-distance services with ANATEL pursuant to the concession agreement, with new conditions imposed on the Company to change the basis of calculation of the biannual concession costs. The most relevant modifications discussed by ANATEL's board include: (i) suppression of clause 14.1 which prohibits service providers from controlling cable TV operators within their concession area; (ii) amendment of clause 3.2, which provides for a biennial concession fee, to include interconnection revenue in its calculation basis; (iii) broadening of ANATEL's supervisory powers; (iv) the possibility of off-setting cost of universalization in the calculation of the concession burden; (v) the inclusion of the AICE tariff adjustment formulas; (v) the possibility of remote monitoring of services; (vi) limiting the price of AICE subscription to 60% of the basic subscription; and (vii) free price determination.

The concession agreement establishes that all assets owned by the Company and which are indispensable to the provision of the services described in such agreement are considered reversible assets and are deemed to be part of the concession assets. These assets will be automatically returned to ANATEL upon expiration of the concession agreement.

Every two years, during the agreement's new 20-year period, publicly held companies will have to pay a renewal fee which will correspond to 2% of the revenue resulting from the application of basic service plans and alternative STFC, net of taxes and social contributions. The first payment of this biennial fee occurred on April 30, 2007, based on 2006 revenue, and the second payment occurred on April 30, 2009, based on 2008 revenue. The next payment is scheduled for 2012 based on 2011 revenue. See Note 1 to our Consolidated Financial Statements.

On April 8, 2008, we signed an amendment to the concession contracts to substitute the obligation to install telecommunications service posts with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires.

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ANATEL granted on August 18, 2011 consent to the transfer from the Company to Vivo of the concessions for the provision of local STFC services, domestic long-distance and international long-distance services in Regions I and II of the General Plan of Grants (outside São Paulo). On September 8, 2011, the extract of the authorization term was published on the D.O.U. for the transfer of STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC through the GSM technology across its area, except for the State of São Paulo.

In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, which are authorizations to provide wireless communication services through SMP, personal mobile service, to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunication services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands which were denominated as the “C” band (which was later transformed into extension bands), the “D” band, “E” band and “M” band. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002, in September 2004, in March 2006, in September 2007, in December 2007 and in December 2010.

Services for Corporate Customers

We offer our corporate clients comprehensive telecommunications solutions and IT support designed to address specific needs and requirements of companies operating in all types of industry (retail, manufacturing, services, financial institutions, government, etc.).

Our clients are assisted by our highly qualified professionals who are capable of meeting the specific needs of each company with voice, data, broadband and computer services solutions. We work to consistently achieve greater quality and efficiency in our services and increase our level of competitiveness in the market.

Rates and Taxes

Rates

Overview

We generate revenue from (i) activation and monthly subscription charges, (ii) usage charges, which include measured service charges, and (iii) network usage charges and other additional services.

Rates for telecommunications services are subject to comprehensive regulation by ANATEL. See “—Regulation of the Brazilian Telecommunications Industry.” Since the relative stabilization of the Brazilian economy in mid-1994, two major changes in rates for local and long-distance services have occurred: in 1996 to compensate for accumulated effects of inflation and in 1997 to eliminate the cross-subsidy between local and long-distance services.

Concession agreements, which were valid from 1998 until December 31, 2005, and subsequently renewed under a new contract for an additional 20 years until 2025 (all of our relevant concession agreements were renewed), establish a price cap for annual rate adjustments.

According to the new contract, we readjust charges based on a service basket of fees, as follows:

- Local services, where rates are established pursuant to a service basket of fees that includes rates for the measured traffic and subscription fees. In the case of a price adjustment, each one of the items within the local fee basket has a different weight and, as long as the total local fee price adjustment does not exceed the rate of increase in the

Telecommunication General Price Index, or IST, minus a productivity factor as established in the concession agreements, each individual fee within the basket can exceed the IST variation by up to 5%.

- Installation of residential and commercial lines and public telephone services, with adjustments limited to the rate of increase in the IST minus a productivity factor as established in the concession agreements.

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- Domestic long-distance services, with rate adjustments divided into intraregional and interregional long-distance services, which are calculated based on the weighted average of the traffic, and taking into account time and distance. For these categories, each fee may individually exceed the rate of increase in the IST by up to 5%; however, the total adjustments in the basket of fees cannot exceed the rate of increase in the IST minus a productivity factor as established in the concession agreements. See “—Regulation of the Brazilian Telecommunications Industry.”

Our rates for international services are not subject to regulation and are not required to follow the price cap for annual rate adjustment described above for other services. Therefore, we are free to negotiate our fees for international calls based on the international telecommunications market, where our main competitor is Embratel.

Local Rates

As of March 2007, the billing system for local calls was converted to a per-minute system and the previous pulse system was discontinued. The conversion of pulses to minutes occurred gradually, between the months of March and July of 2007. As of August 1, 2007, all of the customers of the Company had their local calls billed in minutes.

Our revenue from local service consists principally of activation charges, monthly subscription charges, measured traffic charges and public telephone charges. Users of measured traffic, both residential and non-residential, paid for local calls depending on usage, which until July 2007 was measured in pulses and from then on has been measured in minutes. The first minute is accounted for at the moment a call is connected to its destination.

Under current ANATEL regulations, residential customers who sign up for the basic plan monthly fee receive an allowance of 200 minutes per month.

Our local concession contracts set forth two mandatory plans for local fixed service, and allow for the concession company to design other alternative pricing plans of its own. Customers will have a choice between the two mandatory plans, any other alternative plan or a combination of basic and alternative plans. The main differences between the two main mandatory plans are as follows:

- Local Basic Plan: for clients that make mostly short-duration calls (up to three minutes), during regular hours; and
- Mandatory Alternative Plan (PASOO): for clients that make mostly longer-duration calls (above three minutes), during regular hours and/or that use the line for dial-up service to the Internet.

The following table outlines the basic billing requirements and rates for the local Basic Plan and the Mandatory Alternative Plan:

Characteristics of Plan	Basic Plan	Mandatory Alternative Plan
Monthly Basic Assignment		
Allowance (minutes included in the Residential Assignment)	200 minutes	400 minutes
Commercial Assignment Allowance (minutes included in the Commercial Assignment)	150 minutes	360 minutes
Local Call Charges		
Regular Hours		
Completing the call (minutes deducted from the allotment)		– 4 minutes
Completing the call after the terms of the allotment Sector 31		– R\$0.15980
Local Minutes—charges in excess use of the allotment Sector 31	R\$0.10224	R\$0.03994

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Minimum time billing	30 seconds	–
Reduced Hours		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R\$0.20448	R\$0.15980

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The fees for Local Basic Plan Service were approved by ANATEL's Act No. 5,834 of August 24, 2011. The Alternative Plan under Mandatory Service Provisions (Oferta Obrigatória) (PASOO) was approved by Resolution No. 450, on December 7, 2006, being that the readjustment of the tariffs follows the same rule established for the local basic plan.

In addition, Resolution No. 547, published on November 29, 2010, established that the Company's fees for both the Local Basic Plan and Mandatory Alternative Plan (PASOO) will be unified following the unification of sectors 31, 32 and 34 into one single sector (sector 31), as defined by the Presidential Decree regarding the new General Plan of Grants published in the D.O.U. on November 21, 2008. Before this unification, ANATEL must publish an Act with the calculated fees taking into consideration the methodology in Resolution No. 547. This unification also applies to Basic Plan tariffs of fixed-to-mobile calls and long-distance calls and presumes the preservation of revenue earned on each item of the Basic Plan.

Besides the Basic Service Plans, the Company may offer alternative plans with any pricing design it chooses. However, ANATEL must be notified of these alternative plans before the publication and implementation of any such plan.

Clause 12.1 of the STFC concession agreement provides that the Local Basic Plan can be readjusted for periods of not less than 12 months taking into consideration the inflation index "IST" reduced by a fraction of the Company's productivity (named "Fator X," which is calculated by ANATEL based on Resolution No. 507/08). The Mandatory Alternative Plan (PASOO) follows the same readjustment formula as the Local Basic Plan. Other alternative service plans are readjusted based on the IST.

On August 24, 2011, ANATEL's Act No. 5,834 approved new local tariffs for our areas of concession, effective as of December 24, 2011. The average readjustment in the local service basket was 0.66%. The tariffs were applied to customers as demonstrated below:

- Residential customers were charged a monthly subscription fee for the provision of service of R\$41.38;
- Commercial clients and nonresidential customers (PBX) were charged a monthly subscription fee for the provision of service of R\$69.67 in Sector 31, R\$67.82 in Sector 34 and R\$64.72 in Sector 32;
 - Local minute tariffs were charged at R\$0.10423 per minute in Sector 31; and
 - Activation fees of R\$113.81 were charged in Sector 31.

Intraregional and Interregional Long-Distance Rates

Intraregional long-distance services consists of all calls that originate in one local area or municipality of our concession region and terminate in another local area or municipality of our concession region. All other calls are denominated interregional long-distance calls. Rates for intraregional and interregional long-distance calls are computed on the basis of the time of day, day of the week, duration and distance of the call, and also may vary depending on whether special services, including operator assistance, are used.

On July 29, 2002, after we received the concession from ANATEL to provide interregional long-distance services in Region III and authorization to provide interregional long-distance services throughout Brazil, we launched several new options of interregional calling plans relating to consumer "Code 15," which is the selection code dialed by customers who may choose a long-distance provider with each call and may result in different prices based upon frequency of use and customer calling patterns.

International Long-Distance Rates

On May 7, 2002, we began operating international long-distance services. International long-distance call charges are computed on the basis of the time of day, day of the week, duration and destination of the call, and also may vary depending on whether special services are used or not, including operator assistance.

We have developed alternative rate plans for our residential and corporate customers.

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Network Usage Charges

We earn revenue from any fixed-line or mobile service provider that either originates or terminates a call within our network. We also pay interconnection fees to other service providers when we use their network to place or receive a call. Under the General Telecommunications Law, all fixed-line telecommunications service providers must provide interconnection upon the request of any other fixed-line or mobile telecommunications service provider. The interconnection agreements are freely negotiated among the service providers, subject to a price cap and in compliance with the regulations established by ANATEL, which includes not only the interconnection basic principles covering commercial, technical and legal aspects, but also the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers to any party an interconnection fee below the price cap, it must offer the same fee to any other requesting party on a non-discriminatory basis. If the parties cannot reach an agreement on the terms of interconnection, including the interconnection fee, ANATEL can establish the terms of the interconnection. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

In accordance with ANATEL regulations, we must charge interconnection fees to the other telephone service providers based on the following:

- Fee for the use of our local network—we charge long-distance services providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network. We charge local service providers a fee for traffic that exceeds 55% of the total local traffic between the two service providers.
- Fee for the use of our long-distance network—we charge the service providers a network usage charge on a per-minute basis only when the interconnection access to our long-distance network is in use.
 - Fee for the rental of certain transmission facilities used by another service provider to place a call.

Beginning in 2006, with the 20-year renewal of the concession contracts, the rules in respect of local network fees, or TU-RL, were changed. Beginning on January 1, 2008, local network fees were supposed to be calculated based on a long-term cost model (LRIC—Long Run Incremental Costs).

Through Resolution No. 464, published on April 27, 2007, ANATEL postponed the adoption of the LRIC model to April 30, 2009. Nevertheless, ANATEL is still working on the necessary studies to implement this cost model, as this model is part of its General Plan for Updating the Telecommunications Regulations in Brazil, published on November 12, 2008.

On February 8, 2007, ANATEL published Resolution No. 458, which approved the regulation of payment for interconnection for STFC. Through this regulation, ANATEL established, as the transition rule until the LRIC model becomes effective, that the value TU-RL stays limited to 40% of the local minute value.

In the same way, Resolution No. 458 established that the transition rule for the inter-city network tariff TU-RIU will remain in effect until the LRIC model becomes effective, and further determined that the value of TU-RIU is limited to 30% of the long-distance minute value of Class 4, which is the class of calls of the longest distance established by ANATEL.

Cellular telecommunications services in Brazil, unlike those in the United States, are offered on a “calling party pays” basis, under which the subscriber pays only for calls that he or she originates. Additionally, a subscriber pays roaming charges on calls originated and terminated outside his or her home registration area. Calls received by a subscriber are paid for by the party that places the call in accordance with a rate based on per-minute charges. For example, a

fixed-line service customer pays a rate based on per-minute charges for calls made to a cellular service subscriber. The lowest base rate per minute, or “VC1,” applies to calls made by a subscriber in a registration area to persons in the same registration area. Calls to mobiles outside the registration area, but within the mobile authorization area, are charged at a higher rate, “VC2.” Calls to mobiles outside the mobile authorization area are billed at the highest rate, “VC3.” When a fixed-line service customer calls a mobile subscriber, we charge the fixed-line service customer per-minute charges based on VC1, VC2 or VC3 rates. In turn, we pay the cellular service provider the cellular network usage charge.

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Our revenue from network services also includes payments by other telecommunications service providers for the use of part of our network arranged on a contractual basis. Other telecommunications service providers, including providers of trucking and paging services, may use our network to connect a central switching office to our network. Some cellular service providers use our network to connect cellular central switching offices to the cellular radio-based stations. We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

Data Transmission Rates

We receive revenue from charges for data transmission, which includes our broadband service “Speedy,” the rental of dedicated analog and digital lines for privately leased circuits to corporations and others that were provided by us and Telefonica Data. See “—A. History and Development of the Company—Historical Background—The Spin-off of Certain Data Transmission Operations” and “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

Taxes

The cost of telecommunications services to each customer includes a variety of taxes. The principal tax is a state value-added tax, the Imposto sobre Circulação de Mercadorias e Serviços, or “ICMS,” which the Brazilian states impose at varying rates from 7% to 35% on certain revenues from the sale of goods and services, including telecommunication services.

- Federal Social Contributions: Contribuição para o Programa de Integração Social or “PIS,” and Contribuição para o Financiamento da Seguridade Social or “COFINS,” are imposed on gross operating revenue at a combined rate of 3.65% for telecommunications services (consisting of the COFINS amounts of 3.0% and PIS amount of 0.65%) and 9.25% for other services (consisting of the COFINS amounts of 7.6% and PIS amount of 1.65%). PIS is a tax designed to share business profits with employees through a mandatory national savings program, and is financed by monthly deposits collected as a percentage of gross operating revenue. COFINS is a tax designed to finance special social programs created and administered by the Brazilian government. Revenue related, among other things, to investments, dividends and sales of fixed assets are not subject to PIS and COFINS.
- Contribution for the Fund for Universal Access to Telecommunications Services—“FUST.” FUST was established in 2000 to cover the cost exclusively attributed to fulfilling obligations (including free access to telecommunications services by governmental institutions) of universal access to telecommunications services that cannot be recovered with efficient service exploration or that are not the responsibility of the concessionaire. Contribution to FUST are due at the tax rate of 1% of gross operating telecommunications services revenue (except for interconnection revenue), and it may not be passed on to customers.
- Contribution to the Fund of Telecommunications Technological Development—“FUNTTEL.” FUNTTEL is a federal social contribution and was established in 2000, to stimulate, among others, technological innovation and to enhance human resources development so as to increase the competitiveness of the Brazilian telecommunications industry. Contribution to FUNTTEL is due at the tax rate of 0.5% of gross operating telecommunications services revenue (except interconnection revenue), and it may not be passed on to customers.
- Contribution to the Fund for Telecommunications Regulation—“FISTEL.” FISTEL is a federal tax applicable to telecommunications transmission equipment which serves to provide funds to cover the expenses incurred by the Federal Government in performing inspections of telecommunication services and in developing the means and improving the techniques necessary for carrying out these inspections. The fees owed to FISTEL, known as the FISTEL Taxes, are: (i) an installation inspection fee assessed on telecommunications central offices upon the

issuance of their authorization certificates and (ii) an annual operations inspection fee that is based on the number of authorized central offices in operation at the end of the previous calendar year.

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Billing

We send each customer a monthly bill covering all of the services provided during the prior period. Telephone service providers are required under Brazilian law to offer their customers the choice of at least six different payment dates for each month. In our case, customers are divided into 47 different groups, and each group receives a bill according to a specific billing date within the monthly billing cycle.

We have a billing and collection system with respect to local, national and international long-distance voice, subscriptions, broadband, data, IT services, outsourcing, television and third-party services. Payments of bills are effected under agreements with various banks and other collection agencies (including lottery-playing facilities, drugstores and supermarkets) either by debiting the customer's checking account, direct payment to a bank or through the Internet. We aim to avoid losses in the implementation of new processes and the roll-out of new products through the monitoring of billing, collection and recovery controls. The billing process is audited by the Associação Brasileira de Normas Técnicas (Brazilian Association of Technical Standards), or ABNT, under the applicable rules of the Sarbanes Oxley Act. The actions are followed closely by our Revenue Assurance Team, which measures every risk of loss of revenue detected along the billing and collection chain. These risks are managed to minimize revenue losses.

Our subsidiary Vivo uses Atlys, a billing solution that combines software and hardware resources, from the supplier company Convergys as the billing system for centralized billed invoicing in the city of São Paulo. The billing system operates via a batch processing concept using Vivo customers' voice and data traffic. This system functions by segregating voice and data traffic on a daily basis, according to which of seven total billing preferences a customer elects. Each cycle has a specific due date for each of the consumer and corporate segments.

For prepaid services, Vivo uses the Next Generation Intelligence Network (NGIN) platform, a prepaid platform, from the supplier company PTI, which also works in a centralized way in the city of São Paulo. In order for the NGIN platform to process correctly, the same system for billed invoicing is used. This system separates the module for customer information, called Care, which is a services platform, from the Voice and Data traffic processing module used, called Core, which is a tariff platform.

During 2006, the RJ/ES and CO/N centralization billing (billed and prepaid) were completed. The BA/SE centralization process was completed in April 1, 2007.

In July 2009, Telemig Celular concluded its centralization process to conform its billing practices to Vivo's prepaid platform (NGIN). The billing system for postpaid customers was centralized in August 2010 when Telemig Celular completed its process to conform all the billing practices.

In November 2011, Vivo began developing a project to optimize its operational processes and reduce the period between the cut and due date of bills. At the end of this project, expected for April 2012, Vivo will reduce its billing cycles to six month cycles.

Co-billing

In accordance with the Brazilian telecommunications regulations, we use a billing method called "co-billing" to both segments, fixed and mobile. This method allows billing from other phone service providers to be included within our own invoice. Our customers can receive and subsequently pay all of their bills (including the fees for the use of services of another telephone service provider) by using one invoice. To allow for this method of billing, we provide billing and collection services to other phone service companies. We have co-billing agreements ("co-billing in") with national and international long-distance phone service providers. Similarly, we use the same method of co-billing to bill our services on the invoices of other fixed and mobile providers. We use direct billing through the national

registry of clients for customers who use our long-distance services through operators that have no joint billing agreement with us.

Value Added Services (VAS)

Entertainment, information and online interactivity services are available to all Vivo customers through agreements with content suppliers. These agreements are based on a revenue-sharing model through the processes of

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billed and prepaid categories, with all divergences between these categories being demonstrated to the content suppliers.

Third-party Services

In fixed as well as mobile billing process is made inclusion third-party services into the bill, collection and transfer. This service is charged to the contractor.

Collection

We have policies dealing with accounts of defaulting customers according to each ANATEL regulation. For mobile service, we apply the SMP regulation and for fixed service we apply the STFC.

For mobile customers, as a general rule, if the payment is late for more than 15, service can be partially suspended. If payment is late for more than 45 days after the partial suspension, the service can be fully suspended until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 90 days, the contract can be cancelled and reported to credit protection agencies.

For fixed customer, as a general rule, if the payment is late for more than 30 days, service can be partially suspended. If payment is late for more than 60 days after the partial suspension, service can be fully suspended until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 90 days, the contract can be cancelled and reported to credit protection agencies.

After the cancellation of the contract, for mobile and fixed services, the accounts are directed to independent collection agencies.

The amounts receivable overdue by 105 days, except for accounts receivables from interconnection fees and government and corporate customers, are considered provisions for doubtful accounts. The write-offs are made in accordance with Brazilian regulations, which permits a bad debt write-off for late payments of R\$0 to R\$5,000 if they are over 180 days late or R\$5,001 to R\$30,000 if they are over 365 days late. Write-offs of late payments of over R\$30,001 that are open for more than 365 days require the commencement of a lawsuit.

During 2011, the monthly average of partial suspensions, for both mobile and fixed services, was 2,050,000 lines and the monthly average of total suspensions was 379,000 lines. The provision for doubtful accounts in 2011 was 1.18% of the total gross revenue.

Network and Facilities

Our network consists of an access layer that connects our clients through our metal or optical networks, which are connected to voice and data centers. These centers are interconnected locally or remotely through transmission equipment connected predominantly with fiber optics and occasionally through a microwave network, which together form a network layer that enables connectivity between the various central aggregate services platforms as well as interconnection with other carriers. Our network strategy is based on the expansion of the Access Network (fiber optics) to allow greater coverage and broadband (high-speed) services for our customers, as well as to develop an integrated multiservice network and multimedia applications. As a telecommunication service provider, we do not manufacture equipment for the construction of our networks and facilities. We buy the equipment from qualified suppliers and through this equipment we implement our networks and facilities through which we supply our services. The following table sets forth selected information about our network in aggregate:

At and for the year ended December 31,

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Wireline access lines	2011	2010	2009	2008	2007
Installed access lines (millions)	14.7	14.6	14.5	14.7	14.6
Access lines in service (millions) (1)	11.0	11.3	11.3	11.7	12.0
Average access lines in service (millions)	11.1	11.3	11.5	11.8	12.0
Access lines in service per 100 inhabitants	26.5	27.5	27.1	28.7	29.1
Percentage of installed access lines connected to digital switches	100.0	100.0	100.0	100.0	100.0

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	At and for the year ended December 31,				
	2011	2010	2009	2008	2007
Wireline access lines					
Number of public telephones (thousands)	215.8	250.7	250.5	250.3	250.3
Broadband access lines (millions)	3.6	3.3	2.6	2.5	2.0
		Year ended December 31,			
	2011	2010	2009	2008	2007
Mobile access lines					
Cellular lines in service at year-end (in millions)	71.5	60.3	51.7	44.9	37.4
Contract customers (in millions)	16.1	12.6	9.8	8.6	7.1
Prepaid customers (in millions)	55.4	47.7	42.0	36.4	30.3
Growth in cellular lines in service during year	18.7 %	16.5 %	15.1 %	20.2 %	11.6 %
Churn(2)	34.2 %	32.0 %	30.5 %	31.3 %	28.8 %
Estimated covered population (in millions)(3)	190.7	191.5	191.5	190.4	135.3
Penetration at year-end(4)	123.9 %	104.6 %	90.5 %	79.1 %	63.5 %
Market share(5)	29.5 %	29.7 %	29.78 %	29.8 %	30.9 %

(1)Data includes public telephone lines.

(2)Churn is the number of customers that leave us during the year, calculated as a percentage of the simple average

(3)Number of people within our region that can access our cellular telecommunications signal.

(4)Number of cellular lines in service in our region, including those of our competitors, divided by the population of our Region.

(5)Percentage based on all lines in service in our region at year-end.

Technology

In order to offer a greater quantity of integrated services, we have incorporated a series of new technologies in our voice and data networks, the most prominent being IP/MPLS Multiservices networks supported by the IP/MPLS platform. Following the evolution of the Internet, we are also adding the IP/MPLS to the IPv6 technology, and installing a platform for traffic analysis (DPI – Deep Packet Inspection) to optimize the network evolution and delivery of products and services.

The IP/MPLS platform allows us to offer Internet connection solutions to residential clients (Speedy) and business clients, and for the later, at speeds that vary from 64 Kbps to 10 Gbps.

This platform is connected to the main Brazilian Internet providers and telecommunication companies through the network of Telefonica International Wholesale Services, or TIWS, which has redundancy connections. In addition to this connectivity, we installed distributed “mirrors” of the main content providers, using innovative resources from the CDN solution (Content Delivery Network). These characteristics provide our clients with high-quality services and short delays in their Internet connections.

Additionally, we have solution centers named DNS (Domain Name System) strategically positioned in the network which were extended by 25% in 2010 and which guarantee a quick name resolution to our Internet services clients. These centers transform the Internet addresses typed by residential and business clients into IP addresses guaranteeing

the correct transmission of data. There were no extensions in 2011, but we plan a 15% increase in 2012 and another 15% in 2013.

We provide the IP/MPLS network to our business clients offering advanced connection solutions to small, medium and large companies (Virtual Private Networks – VPN). This network has mechanisms of quality assurance for all applications (QoS – Quality of Service) as well as applications for voice, video and data convergence. We also offer connectivity solutions to business clients through a network based on Frame-Relay, X25, ATM and Metro Ethernet technologies.

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In the residential segment, since 1999, we have been heavily investing in offering broadband access through an asymmetric digital subscriber line, or ADSL, technology under the brand “Speedy.” This technology provides high-speed Internet access through regular telephone lines. In 2007, we initiated the implementation of the FTTx network (available through fiber optic cables running to the subscriber’s home – GPON technology) with a coverage of 1,042K Home Passed, offering in 2011 a range of different speeds up to 10 Mbps, and IPTV high definition service (HDTV). In December 2011, we surpassed the mark of 3.6 million broadband clients connected in service, 45% of which had speeds equal to or greater than 2Mbps. To reach this number of clients, we constantly search for market differentials such as new integrated services, speed upgrades and servicing of new localities, among others.

We offer the IPTV service through a partnership with TVA through the FTTx network and the Telefônica Brasil Platform. We made several improvements in the platform, such as the inclusion of Fast Channel Change (FCC) and installing a new version of the software with more interactive navigation, with the aim of providing a better user experience. In 2012, we will continue the improvements started in Telefônica Brasil’s Platform aiming to increase competitiveness in the ITS market. This platform consists of pay TV with video broadcast offered through the use of the IP protocol. The offering of such technologically advanced services is only made possible due to our partnership with TVA, a recognized provider of pay TV services. Additional services, such as pay-per-view and video on demand (VOD), are also available. New high definition channels (HD) will be included to increase the quality and option for our customers. Furthermore, Telefônica Brasil’s network contains space for the recording of programs or local recordings in the Set Top Box (STB), and in the future, third-party content providers will be able to offer games, interactive and connectivity services.

We also offer digital television service via satellite (DTH) to the subscribers in the State of São Paulo (and in the future, all of Brazil) that receive broadcast/PPV content through a Ku band antenna and standard Set Top Box (with Smart Card), also available with a Personal Video Record (PVR) service. As of December 31, 2011, we surpassed the mark of 428 thousand subscribers in service. We finished the implementation of the Content Protection system in 2010, aiming to reduce the possibility of undesired access to the distributed content. In 2011, we began offering plans with new channels in high definition (HD)—up to 11 paid channels in HD, offering premium content to our customers and new local channels to increase service penetration in some areas of coverage.

Our development plan contemplates the use of the most advanced technology available, focusing on integration with the Internet and an increase in the number of multimedia transmission services, with an emphasis on ADSL, FTTx (GPON), NGN, DWDM, ROADM and retransmittal technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

Before November 1998, our subsidiary Vivo network used only AMPS analog technology. After privatization, we began to use CDMA digital and TDMA digital technologies. In 2006, we began to implement a GSM Network. In 2007, we began to implement a WCDMA Network. In 2011, we launched the HSPA+ technology, commercially known as 3GPlus, working across our 3G network. This technology was commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11), allowing customers who have compatible terminals to achieve even higher transmission rates, reaching up to three times the value of traditional 3G’s rate. Digitalization offers certain advantages, such as greater network capacity and additional revenue through the sale of value-added services. We continue to increase network capacity and coverage to improve our quality of service and to meet customer demand.

Our advanced network management technology ensures global management and supervision of all our network processes and network performance. The network management centers are located in São Paulo, Brasília and Minas Gerais. The network management center of São Paulo monitors the critical network operational parameters of the countrywide transmission backbone, third parties’ networks, IP networks and service platforms. The network management center in Brasília monitors the critical network operational parameters in the Midwestern Region (CO),

Rio de Janeiro, Espírito Santo, Rio Grande do Sul and Paraná/Santa Catarina. The network management center in Minas Gerais monitors the critical network operational parameters in the Northeastern region (NE), the Northern region (NO), Bahia, Sergipe, São Paulo and Minas Gerais. These centers are able to identify abnormalities in both our network and in third parties' networks, using failure and signaling monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with maintenance and operations teams that maintain and operate cellular network elements, as well as cellular infrastructure and

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transmission, in addition to the radio network elements and computing bases, service platforms and communications backbones.

Currently, 100% of our network is digital.

Competition

In 2011, the competition continued to increase in the market for small/medium enterprises and in the residential market due to an expansion of the coverage area of the main competitors, improvements on their portfolios, and also due to an increase in their commercial activity and offers for both fixed and mobile services, adding downward pressure to prices and pushing for higher discounts.

We face intense competition in all the areas in which we operate, principally from other cellular service providers and also from fixed-line operators. Many of these competitors are part of a large, national or multinational group and therefore have access to financing, new technologies and other benefits that are derived from being a part of such a group.

The principal cellular competitor in the state of São Paulo is Claro and in the states of Paraná and Santa Catarina is TIM Celular or TIM. The main fixed-line operator in this area is Brasil Telecom S.A. (in 2008, the Brazilian Government published Decree No. 6654/2008 of revision of the fixed-line general concession plan (Plano Geral de Outorgas, or PGO), allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A. to buy Brasil Telecom.

In the Central, Western and Northern region the principal competitors are: Claro, in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District, and TIM, in the region encompassing the states of Amazonas, Roraima, Pará, Amapá and Maranhão. The main fixed-line operators in this area are: Brasil Telecom S.A., in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District, and Telemar Norte Leste S.A.—Telemar, in the region encompassing the states of Amazonas, Roraima, Pará, Amapá and Maranhão. Other competitors are Oi (Telemar mobile operator) and TIM.

In the Bahia and Sergipe service areas, the principal cellular competitor is Claro. Other cellular competitors are Oi and TIM Celular or TIM, which also operate in the state of Minas Gerais. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In the Ceará, Pernambuco, Paraíba, Alagoas, Rio Grande do Norte and Piauí service areas, the principal cellular competitor is TIM. Other cellular competitors are Oi and Claro. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In the Rio de Janeiro and Espírito Santo service areas, the principal cellular competitor is Claro, which operates in the states of Rio de Janeiro and Espírito Santo. Claro is controlled by a consortium led by the Telecom Américas Ltd. (controlled by América Móvil S.A. de C.V.). Claro began providing cellular telecommunications services in this Region at the end of 1998. The principal fixed-line operator in this area is Telemar Norte Leste S.A. Oi is the third competitor and is integrated with Telemar (a fixed-line operator) and TIM is the fourth competitor.

In Rio Grande do Sul, the principal cellular competitor is Claro, which operates in several regions in Brazil, including Vivo-Rio Grande do Sul's region. Other cellular competitors are Brasil Telecom S.A. and TIM. The main fixed-line competitor in this area is Brasil Telecom.

In Minas Gerais, currently, there are four other wireless service providers operating within the authorization area of Vivo S.A. Our subsidiary Vivo faces competition from the following operators: (a) TIM, the “B” band frequency range operator that launched its services in December, 1998 (TIM is primarily owned by Telecom Italia and operates in the entire State of Minas Gerais using GSM and WCDMA technologies); (b) Oi, the “D” band operator that launched its services in June 2002 (Oi is a subsidiary of Tele Norte Leste Participações S.A. (Telemar) and operates in the entire State of Minas Gerais using GSM and WCDMA technology); (c) Claro, the “E” band operator that launched its services in the fourth quarter of 2005 (Claro is controlled by América Móvil and operates

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a GSM and WCDMA technology network); and, (d) CTBC Celular, an “A” band and 3G band operator (CTBC Celular is controlled by CTBC, a fixed-line operator and uses GSM and WCDMA technologies).

Our subsidiary Vivo S.A. also compete with certain other wireless telecommunications services in specific segments, such as mobile radio (including digital trunking technology, offered by Nextel), paging and beeper services, which are used by some operators in the areas of Vivo S.A. as a substitute for cellular telecommunications services. These competing wireless telecommunications services are generally less expensive than mobile telecommunications services. In December 2010, through the auction 002/2010/ANATEL, NEXTEL was awarded 12 SMP licenses (11 spectrum licenses in “H” band (3G band) and 1 spectrum license in “M” band (1800 MHz band)).

Satellite-operated services which provide nationwide coverage, are also available in Brazil. Although these services have the advantage of covering much larger areas than those covered by the cellular telecommunications services, they are considerably more expensive than the cellular telecommunications services we offer and do not provide competitive coverage inside buildings.

Our main competitors for the provision of fixed services are: America Móvil / Telmex group (which includes NET, Claro and Embratel), TIM (which includes Intelig and Tim Fiber) and GVT. Our competitors employ varied strategies to gain market share. For instance, GVT expanded its operations to other major cities in the State of São Paulo, with a strategy based on ultra-broadband services, low price, high-quality customer service, and a new TV product, targeting high-income residential clients and small and medium businesses. NET improved its TV portfolio with a new on-demand video product (NOW) and continued its strategy of aggressive broadband prices, offering promotionally 10 Mb for the price of 1 Mb, which increased our churn up to 7% in some regions, against an average of 2.3%. TIM acquired a large optical-fiber network from AES (Atimus), and constituted a new company called TIM Fiber, which is expected to begin to offer high-speed fixed broadband in the city of São Paulo and other 11 cities nearby, making this market even more competitive. In the segment of low-income customers, we face competition from Embratel in TV services and NET in both TV and broadband services.

At Telefonica, we continue to develop and expand our product offerings, particularly those with great potential for future growth, such as broadband Internet services, pay-TV, and information technology services. Speedy maintained its position as market leader in the State of São Paulo with more than 3.5 million customers as of December 31, 2011 and over 9% growth compared with the same date in 2010. Additionally, our broadband service over high-speed optical fiber reached over 50 thousands households, a growth over 300%, contributing to lower churn with a high trend of bundling.

The strategy of low cost long-distance calls initiated by TIM for on-net calls on a “billing per call” basis continued the success already observed in 2010, and led Claro and our subsidiary Vivo to start making similar offers. These low-cost mobile long-distance rates contribute to the losses of fixed-lines of the incumbents. Nevertheless, the total market of fixed-lines grew 2% compared to the previous year, supported by FWT offers in locations not covered by copper networks and by the growth of fixed-lines provided by non-incumbent companies sometimes bundled for free.

Our subsidiary Vivo has also launched a FWT service which offers fixed-phones using the wireless network. With Vivo’s FWT service, we aim to leverage the fixed-phones sales, mainly outside the state of São Paulo, where we have reduced fixed network capacity. This solution can also reduce the cost of providing this service to enterprises located nationwide, such as banks, which we already have in our portfolio of clients.

We continue with our strategy in the corporate market as a provider of complete infrastructure solutions for information technology customers, integrating hardware packages, voice, data, Internet and network services. Additionally, we launched the service “OnVideo,” a product that allows the client to watch movies directly from a TV with digital video technology on demand. The service “At Home,” which provides home automation (a solution that

integrates home electrical devices, thus offering improved convenience, comfort, energy efficiency and security), completed its second year in 2011.

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position as market leader in the State of São Paulo with more than 3.5 million customers as of December 31, 2011 and over 9% growth compared with the same date in 2010. Additionally, our broadband service over high-speed optical fiber reached over 50 thousands households, a growth over 300%, contributing to lower our churn with a high trend of bundling.

Seasonality

Our business and results of operations are not materially affected by seasonal fluctuations in the consumption of our services.

Regulation of the Brazilian Telecommunications Industry

General

Our business, including the services we provide and the rates we charge, is materially affected by comprehensive regulation under the General Telecommunications Law and various administrative rules thereunder. Our companies that operate under a concession are authorized to provide specified services and have certain obligations, according to the Plano Geral de Metas de Universalização, or General Plan on Universal Service Targets and the Plano Geral de Metas de Qualidade, or General Plan on Quality Targets.

ANATEL is the regulatory agency established by the General Telecommunications Law. ANATEL is administratively and financially independent from the Brazilian government. Any proposed regulation by ANATEL is subject to a period of public comment and, occasionally, public hearings, and its decisions may be challenged in the Brazilian courts.

Concessions and Authorizations

Concessions are licenses to provide telecommunications services that are granted under the public regime, while authorizations are licenses to provide telecommunications services granted under the private regime.

Companies that provide services under the public regime, known as the concessionary companies, are subject to certain obligations as to quality of service, continuity of service, universality of service, network expansion and modernization.

Companies that provide services under the private regime, known as the authorized companies, are generally not subject to the same requirements regarding continuity or universality of service; however, they may be subject to certain network expansion and quality of service obligations set forth in their authorizations.

Companies that operate under the public regime include us, Embratel, Oi, CTBC Telecom and Sercomtel. The primary public regime companies provide fixed-line telecommunications services in Brazil that include local, intraregional, interregional and international long-distance services. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in our concession region, operate under the private regime.

Public regime companies, including us, can also offer certain telecommunications services in the private regime, of which the most significant are data transmission services.

Fixed-line Services—Public Regime. Our current concession agreements for the local, intraregional and interregional long-distance services were extended on December 22, 2005, for an additional period of 20 years.

Our current concession agreements contain a provision, amended by ANATEL on June 30, 2011, providing that they may be amended on December 31, 2015, and December 31, 2020 to establish new conditions and new targets for universal access and quality, taking into consideration the conditions prevailing at the time, and defining, in the case of universal access targets, complementary resources, as provided by article 81 of Law No. 9,472 of 1997.

Under the renewed concession agreements and during the 20-year renewal period, we are required to pay a biennial fee equal to 2% of the gross revenue of the previous year, net of taxes and social contributions, arising from the rendering of basic service plans and alternative STFC in our concession area . See “—Obligations of

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Telecommunications Companies.” Each of the foregoing regulatory terms and conditions affecting (or potentially affecting) the current concession agreements, as well as current obligations under the existing concession agreements, may impact our business plan and results of operations.

Fixed-line Services—Private Regime. The Brazilian telecommunications regulation delegates to ANATEL the power to authorize private regime companies to provide local and intraregional long-distance services in each of the three fixed-line regions and to provide intraregional, interregional and international long-distance services throughout Brazil. ANATEL has already granted authorizations to private regime operators to operate in Region III, our concession region. ANATEL also granted other private regime companies authorizations to operate in other fixed-line regions and authorizations to provide intraregional, interregional and international long-distance services throughout Brazil in competition with Embratel. Several companies have already applied for authorization, and ANATEL may authorize additional private regime companies to provide intraregional, interregional and international long-distance services. See “—Competition.”

Since 2002 we provide local and interregional services in Regions I and II and Sector 33 of Region III, and international long-distance services in Regions I, II and III.

Before January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under “A” band and “B” band. “A” band and “B” band mobile service providers were granted concessions pursuant to the Lei Mínima, or the Minimum Law. Each concession was a specific grant of authority to supply cellular telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications services other than those authorized by its authorized concession, it may apply to ANATEL for an authorization to offer such other services.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are included in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. In addition, ANATEL is empowered to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain certain economic and financial standards. The concession is granted for a fixed period of time and is generally renewable only once.

An authorization is a permission granted by the public administration under the private regime, which may or may not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the rendering of the relevant type of telecommunication service in the private regime. The authorization is granted for an indeterminate period of time. Under an authorization, the government does not guarantee to the authorized company the economic-financial equilibrium, as is the case under concessions.

SMP Licenses

In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, which are authorizations to provide wireless communication services through SMP, personal mobile service, to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunication services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands which were denominated as the “C” band (which was later transformed

into extension bands), the “D” band, “E” band and “M” band. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002, in September 2004, in March 2006, in September 2007, in December 2007 and in December 2010. In September 2007, ANATEL organized auctions for 15 new licenses in the 1900 MHz radio frequency bands which were denominated Band “L.” Vivo acquired 13 spectrum licenses in band “L.” In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses) which were denominated bands “F,” “G,” “I”

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and “J.” Vivo acquired seven spectrum licenses in Band “J” and Vivo Participações acquired two spectrum licenses in Band “J.” In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands).

On December 1, 2011 ANATEL carried out the bidding of frequency blocks (Notice No. 001/2011/PVCP/SPV-ANATEL), divided into 54 lots, in the bands: 800 MHz (Band A in the North), 1800 MHz (subbands extension in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (national coverage), totaling approximately R\$592 million, considered the minimum bidding price. This auction offered remaining lots from Notice No. 002/2010/SPV-ANATEL, held in December 2010, in which Vivo was one of the largest winners in the auction by acquiring radio frequency bands 900 MHz and 1,800 MHz.

Of the 54 lots under auction, 15 were sold, totaling revenue of R\$237 million to the government, representing a premium of 0.69%.

Our subsidiary Vivo was unable to participate in this auction because it has already reached maximum spectral capacity in most concession areas. As a result, if Vivo had purchased any lot in these areas, it would have exceeded its spectrum cap as established by applicable regulations. Under these new licenses:

- services are to be provided using the 1800 MHz frequency bands (“D” band, “E” band and “M” band), 1900 MHz frequency bands (“L” band), 1900–2100 MHz frequency bands (“F” band, “G” band, “H” band, “I” band and “J” band) and extension bands;
 - each operator may optionally provide domestic and international long-distance services in its licensed area;
- existing cellular service providers as well as new entrants into the Brazilian telecommunications market can bid for “D” band, “E” band, “M” band, “L” band, “F” band, “G” band, “I” band and “J” band licenses;
- according to the Invitation Document 002/2010/ANATEL, a single SMP operator in one geographic area will only be authorized to have radio frequency bands up to the total maximum limit of 80 MHz or 85 MHz, depending on the circumstances, while observing the following limits for each band:

I – (12.5 + 12.5) MHz, for the 800 MHz bands;

II – (2.5 + 2.5) MHz, for the 900 MHz bands;

III – (25 + 25) MHz, for the 1800 MHz bands;

IV – (15 + 15) MHz, for the 1900 MHz and 2100 MHz bands;

V – 5 MHz, for the TDD extensions of 1900 MHz band;

- as a result, Nextel and other new 3G operators were given preferential status in the “H” band ((10 + 10) MHz) segment of the auction. Vivo, TIM and Claro were eligible to enter bids for the remaining SMP frequencies. Oi acquired the band “H” lot 8 (for the cities in the states of Mato Grosso do Sul and Goiás). CTBC acquired the band “H” lot 5 (for the cities in the state of Minas Gerais) and Nextel acquired the other band “H” lots; and
- a cellular operator, or its respective controlling shareholders, may not have geographical overlap between licenses.

According to the Invitation Document 002/2010/ANATEL, a single SMP operator in one geographic area will only be authorized to have radio frequency bands until the total maximum limit of 80 MHz or 85 MHz, regardless of the type of frequency band. Pursuant to the SMP services regulation each of the three main regions is divided into registration areas, or tariff areas.

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On February 3, 2003, TCO replaced its SMC Concession Contracts for Personal Mobile Service Agreements (Termos de Autorização do Serviço Móvel Pessoal) in Regions I (subrange of “B” frequencies) and II (subrange of “A” frequencies) of the General Plan of Grants. On December 10, 2002, Telerj Celular, Telest Celular, Telebahia Celular, Telergipe Celular, Celular CRT, Global Telecom and TELESP Celular replaced its SMC Concession Contracts for Personal Mobile Service Agreements, or SMP, in Regions I (subrange of “A” frequencies), II (subrange of “A” and “B” frequencies) and III (subrange of “A” frequencies) of the General Granting Plan. On July 27, 2006, ANATEL published Act 59867 authorizing the incorporation of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC by GT, as well as the transfer of the respective SMP service authorization titles and of the SMP radio-frequency rights-of-use titles. Act 59867 also provides for the automatic termination of the authorizations for Multimedia Communication Services (Serviços de Comunicação Multimídia, or SCM) of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC, upon each of their respective incorporations.

In order to transfer our services to SMP, we were required to comply with several technical and operational conditions, including, among other things, the adoption of a carrier selection code for long-distance calls originating from our network.

Our authorizations consist of two licenses—one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for another 15-year period upon the payment of an additional license fee.

Our new SMP licenses include the right to provide cellular services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the old licenses (Vivo-Rio Grande do Sul (“A” band) until 2022 (renewed in 2006); Vivo-Rio de Janeiro (“A” band) until 2020 (renewed in 2005); Vivo-Espírito Santo (“A” band) until 2023 (renewed in 2008); Vivo-Bahia (“A” band) and Vivo-Sergipe (“A” band) until 2023 (renewed in 2008); Vivo-São Paulo (“A” band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2008); Vivo-Paraná/Santa Catarina (“B” band) until 2013; Vivo-Federal District (“A” band) until 2021, (renewed in 2006); Vivo-Acre (“A” band), Vivo-Rondnia (“A” band), Vivo-Mato Grosso (“A” band) and Vivo-Mato Grosso do Sul (“A” band) until 2024 (renewed in 2008); Vivo-Gois/Tocantins (“A” band) until 2023 (renewed in 2008); Vivo-Amazonas/Roraima/Amap/Par/Maranho (“B” band) until 2013; Vivo (Minas Gerais) (“A” band) until 2023 (renewed in 2007) and Vivo (for the cities where CTBC Telecom operates in the state of Minas Gerais) (“E” band) until 2020). Spectrum rights may be renewed only once over a 15-year period.

In September 2007, ANATEL organized auctions of new SMP licenses in the remaining radio frequency bands “D” and “E,” in the 1.8 GHz frequency band “M,” and fifteen licenses in the 1.9 GHz frequency band “L,” previously allocated to fixed operators. Vivo acquired 13 spectrum licenses in band “L.” The following Terms of Authorization for band “L” have been signed: Vivo-Rio Grande do Sul (“L” band) until 2022 (renewed in 2006) or 2022 for the cities of the metropolitan area of Pelotas; Vivo-Rio de Janeiro (“L” band) until 2020 (renewed in 2005); Vivo-Esprito Santo (“L” band) until 2023 (renewed in 2008); Vivo-Bahia (“L” band) and Vivo-Sergipe (“L” band) until 2023 (renewed in 2008); Vivo-So Paulo (“L” band) until 2023 or 2024, for the cities of Ribeiro Preto and Guatapar (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of So Paulo; Vivo-Paran (excluding the cities of Londrina and Tamarana)/Santa Catarina (“L” band) until 2013; Vivo-Federal District (“L” band) until 2021, (renewed in 2006); Vivo-Acre (“L” band), Vivo-Rondnia (“L” band), Vivo-Mato Grosso (“L” band) and Vivo-Mato Grosso do Sul (“L” band) until 2024 (renewed in 2008) or 2022 for the city of Paranaba of Mato Grosso do Sul; Vivo-Gois/Tocantins (“L” band) until 2023 (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of Gois and Vivo-Alagoas/Cear/Paraba/Piaui/Pernambuco/Rio Grande do Norte (“L” band), until 2022. Spectrum rights may be renewed only once over a 15-year period.

In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated as bands F, G, I and J. Vivo was awarded seven spectrum licenses in band “J” and Vivo Participações was awarded two licenses. The following Terms of Authorization for “J” band have been signed: Vivo-Rio Grande do Sul (including the cities of the metropolitan area of Pelotas) (“J” band) until 2023; Vivo-Rio de Janeiro (“J” band) until 2023; Vivo-Espírito Santo (“J” band) until 2023; Vivo-Bahia (“J” band) and Vivo-Sergipe (“J” band) until 2023; Vivo-São Paulo (including the cities of Ribeirão Preto and Guatapar and the cities where CTBC Telecom operates in the state of So Paulo) (“J” band) until 2023; Vivo-Paran (including the cities of Londrina and Tamarana)/Santa Catarina (“J” band) until 2023; Vivo-Federal District (“J” band) until 2023; Vivo-

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Acre (“J” band), Vivo-Rondônia (“J” band), Vivo-Mato Grosso (“J” band) and Vivo-Mato Grosso do Sul (including the city of Paranaíba) (“J” band) until 2023; Vivo-Goiás (including the cities where CTBC Telecom operates in the state of Goiás)/Tocantins (“J” band) until 2023; Vivo-Alagoas/Ceará/Paraíba/Piauí/Pernambuco/Rio Grande do Norte (“J” band), until 2023; Vivo-Amazonas/Roraima/Amapá/Pará/Maranhão (“J” band) until 2023; Vivo (including the cities where CTBC Telecom operates in the state of Minas Gerais) (“J” band) until 2023. Spectrum rights may be renewed only once over a 15-year period.

In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands):

- “M” band (1800 MHz) of the Federal District and the states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia and Acre;
 - 1800 MHz extension band of the state of São Paulo;
- “D” band (1800 MHz) of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu in the state of Rio Grande do Sul;
 - “E” band (1800 MHz) of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
 - 900 MHz extension band of the state of Rio de Janeiro;
 - 900 MHz extension band of the state of Espírito Santo;
- 900 MHz extension band of the states of Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District, with the exception of the cities of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- 900 MHz extension band of the state of Rio Grande do Sul, with the exception of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu;
- 900 MHz extension band of the cities of the registration area number 43 of the state of Paraná, with exception of the cities of Londrina and Tamarana;
- 900 MHz extension band of the states of Paraná and Santa Catarina, with exception of the cities of the registration area number 43 of the state of Paraná and the cities of Londrina and Tamarana;
 - 900 MHz extension band of the state of Bahia;
 - 900 MHz extension band of the state of Sergipe;
- 900 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the state of São Paulo, with exception of the cities of the metropolitan region of São Paulo and the cities where CTBC Telecom operates in the state of São Paulo;
 - 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;

- 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul;
- 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- other 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;

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- 1800 MHz extension band of the states of Rio de Janeiro, Esp rito Santo, Bahia and Sergipe;
- 1800 MHz extension band of the states of Amazonas, Amap , Maranh o, Par  and Roraima;
- 1800 MHz extension band of the states of Alagoas, Cear , Para ba, Piau , Pernambuco and Rio Grande do Norte;
- 1800 MHz extension band of the city of Parana ba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciol ndia, Itumbiara, Paranaiguara and S o Sim o, in the state of Goi s;
- 1800 MHz extension band of the cities of Londrina and Tamarana, in the state of Paran ; and
- 800 MHz (Band A in the North), 1800 MHz (extension subbands in Region II, within the states of S o Paulo and Esp rito Santo, Cear  and Pernambuco) and TDD (National coverage).

Obligations of Telecommunications Companies

We and other telecommunications service providers are subject to obligations concerning quality of service, network expansion and modernization. The concession telecommunication companies are also subject to a set of special restrictions regarding the services they may offer, which are listed in the Plano Geral de Outorgas (PGO), or General Plan of Grants, and special obligations regarding network expansion and modernization contained in the General Plan on Universal Service Targets.

In 2008, the presidential decree published with the General Plan of Grants increased the flexibility of telecommunications provider groups as STFC concessionaires by allowing such providers to provide services in up to two General Plan of Grants regions. Before this decree, telecommunications provider groups holding STFC concessions could offer STFC services in only one region under the public regime.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R\$50 million.

The mobile service authorizations of our subsidiary Vivo involve obligations to meet quality of service standards the system's ability to make and receive calls, call failure rates, the network's capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL published the method for collecting these quality service standards data on April 23, 2003 (ANATEL Resolution No. 335/03 and 317/02). In July 2010, ANATEL published Public Consultation No. 27/2010, revising the General Plan of Standards of Quality of the SMP.

To restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to check the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ).

The new Regulation provides for the assessment of the network connection and their respective data transmission rate, assessing aspects of availability, stability and connection speed for the data network. In addition, the rule established the formation of GIPAQ (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the "Instant Transmission Rate Guarantee" and "Average Transmission Rate Guarantee."

The methodology and procedures regarding the collection of data connection indicators will be defined by a group composed of providers, ANATEL Aferidora and Quality Authority (EAq), which shall be responsible for implementing these processes and which will be hired by the mobile operators, as a group, starting with February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be borne by the providers of SMP services. The impacts of the regulations are still being evaluated, particularly its financial aspects.

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Restrictions on Companies to Provide STFC in the Public Regime

Public regime companies are also subject to certain restrictions on alliances, joint ventures, mergers and acquisitions, including:

- a prohibition on holding more than 20% of the voting shares in any other public regime company, unless previously approved by ANATEL, according to ANATEL's Resolution No. 101/99; and
- a prohibition on public regime companies to provide similar services through related companies.

Network Expansion and Quality of Service

We are subject to the General Plan for Universal Service Targets (Plano Geral de Metas para a Universalização) and the General Plan of Quality Targets (Plano Geral de Metas de Qualidade), each of which respectively requires that we undertake certain network expansion activities with respect to our fixed-line services and meet specified quality of service targets. The timing for network expansion and benchmarks for quality of service are revised by ANATEL from time to time. After two public consultations, ANATEL and the Federal Government are still discussing the new General Plan for Universal Service Targets to be in effect for the period from 2011 to 2015, which became part of the amended concession agreement on June 30, 2011.

The decree altering the General Plan for Universal Service Targets rescinded in 2008 the obligation of telecommunications concessionaires to install telecommunications service centers (providing calling and data access to walk-in customers) and substituted such obligation with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires. In compliance with the decree, in 2011, all municipalities in Brazil had infrastructure for broadband networking. This obligation made us implement an additional network infrastructure in 257 of the 622 municipalities in our concession region.

Moreover, we have, as have other telecommunications concessionaires, committed to provide free Internet access to public schools during the term of our concession grant (until 2025). In 2011, we started offering plans with new channels in high definition (HD)—up to 11 paid channels in HD, offering premium content to our customers and new local channels to increase penetration of service in some areas of coverage.

If a public regime company does not fulfill its obligations under the General Plan for Universal Services and the General Plan for Quality Targets, there are various monetary penalties that may be imposed by ANATEL. A company may lose its license if ANATEL considers it incapable of providing basic services under the two General Plans.

General Plan for the Universalization of the Fixed Switched Service (PGMU III)

On June 30, 2011 the Brazilian government published Decree No. 7,512 related to the General Plan for the PGMU III. The PGMU III sets new targets for Telefone de Uso Público (public phones) density in rural and poor areas and goals related to AICE and bidding for the 450 MHz and 2500 MHz spectrum ranges (to, respectively, meet the needs of rural regions and develop fourth generation mobile telephony). Also according to the new PGMU, the backhaul used to meet the commitments of universalization was characterized as a reversible asset.

ANATEL approved other resolutions and consents in 2011:

- STFC Local Areas Rules: On February 9, Resolution No. 560/2011 was published approving the STFC Local Area Rules. This regulation establishes guidelines and criteria for setting Local Areas for Fixed STFC for the use of the general public.

- Resolution No. 573/2011: On October 10, ANATEL authorized the free establishment of prices for Long-distance International calls (LDI). The resolution sets out the implementation of the new regime from January 1, 2016 and before that, providers must demonstrate compliance with standards set forth in the resolution.

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- Prior Consent for transfer of STFC licenses outside the State of São Paulo for Vivo: ANATEL granted on August 18 prior consent to the transfer from the Company to Vivo of the concessions for the provision of local STFC services, domestic long-distance and international long-distance services in Regions I and II of the General Plan of Grants (outside São Paulo). On September 8, 2011, the extract of the authorization term was published on the D.O.U. for the transfer of STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC through the GSM technology across its area, except for the State of São Paulo.

The following Public Consultations held by ANATEL in 2011 were not adopted as resolutions:

- Regulation of the Special Class Individual Access (AICE): Public Consultation No. 11/2011 is related to the proposal for AICE, which regulates the provision of compulsory service plans for low-income families. The consultation seeks to amend Resolution No. 427/2005 by modifying the offer of phones with a monthly fee for about R\$9.50 (without tax) for low-income clients registered in the social program “Bolsa Família.” The main purpose of the consultation is the progressive universalization of access to the STFC through individualized specific conditions for use, special rates and methods of payment.
- Standard Calculation for the Transfer Factor X: ANATEL, as provided in the General Telecommunications Law and in specific legislation, proposed through Public Consultation No. 39 the review of the STFC productivity factor, known as Factor X, which acts as a mechanism to encourage greater production efficiency by transferring to the client part of the economic gains resulting from the modernization, expansion or rationalization of services, as well as new alternative revenues to STFC providers. The main proposed changes are: (i) the Factor X calculation method by type of service and company; (ii) the Recomposition Factor (Fator de Recomposição) of the margin applied to local mode considers the net additions of AICE and other plans related to regulatory requirements, and the concept of Economic Value Added (EVA) that considers the cost of capital of the company in calculating the Factor X, and a model based on future projections (forward looking).
- General Plan of Competition (PGMC): another important action of ANATEL to maintain competition in the telecommunications industry, and in line with the framework of the “General Plan for the Update of Telecommunications Regulation in Brazil” (PGR), consisted of publication of a public consultation with the aim of establishing a General Plan of Competition (PGMC). Responses to this consultation were originally accepted until October 8, 2011 and extended until October 23, 2011. The PGMC was proposed by ANATEL to organize a control scheme for the actions of economic agents in the telecommunications industry, imposing, removing or altering obligations on providers, according to their market power, with a view to increasing competition. The consultation highlighted the reservation of network capacity for sharing and provided criteria for determination of significant market power in the provision of interconnection services on mobile networks.

The consultation also provides sets of regulatory measures applicable to groups with significant market power: structural measures (applicable to all markets) and specific measures (applicable only to specific markets). The consultation also contained provisions for the creation of three entities: the “Representative” (responsible for gathering the groups without SMP and represent them in case of conflict), the “Supervisor” (responsible for resolving conflicts between groups with and without SMP and assess or certify wholesale offers) and the “Comparer” (responsible for receiving and comparing offers retail).

- Review of Regulation of Multimedia Communication Service (SCM): A revision of the SCM was discussed by Public Consultation No. 45/2011. The proposal deals with the supply of the SCM and issues related to network neutrality, storage of subscriber data and other obligations for the provision of service.

Below is a summary of Public Consultations issued by ANATEL in 2011 which have not yet become regulation, but may be later issued by ANATEL:

- Public Consultation No. 11: Regulation of the Special Class of Individual Access (AICE), which regulates the provision of compulsory service plan for low-income families. The deadline for submissions was April 30, 2011.

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- Public Consultation No. 16: Proposal for a regulation aimed at managing the quality of fixed-line service (RGQ STFC). The deadline for submissions was May 6, 2011.
- Public Consultation No. 23: Proposal for Public Bidding for the Issuance of Authorizations for the Use of Radio in Sub-band segments of 3,400 MHz to 3,600 MHz for the SCM, the STFC for the General Public and SMP. The deadline for submissions was July 27, 2011.
- Public Consultation No. 26: Proposal for the new General Plan of Quality for Subscription Television Services, to be called the Quality Management Regulation for Providers of Subscription Television Services. The deadline for submissions was July 7, 2011.
- Public Consultation No. 31: Regulation of Cable TV Service. The deadline for submissions was July 26, 2011.
- Public Consultation No. 32: Proposal for a term of authorization to operate the cable TV service (current concessions). The deadline for submissions was July 26, 2011.
 - Public Consultation No. 33: Proposal for a term of authorization to operate the service Cable TV (new grants). The deadline for submissions was July 26, 2011.
- Public Consultation No. 39: Standard methodology for the calculation of transfer factor “X,” applied tariff adjustments in the STFC. The deadline for submissions was September 2, 2011.
- Public Consultation No. 41: Proposed General Plan of Competition (PGMC). The deadline for submissions was October 23, 2011.
- Public Consultation No. 45: Proposed Amendment to Regulation of the Communication Services and Annexes I and III of the Rules of Price Collection for the Right of Public Telecommunications Services Exploration and Exploitation of the Satellite Rights. The deadline for submissions was September 16, 2011.

Summary of Public Consultations in 2011

During 2011, ANATEL issued two public consultations directly and indirectly affecting the SMP:

- Public Consultation No. 23: Proposal for Bidding for Shipment Authorization for Use of Radio in Sub-band segments of 3,400 MHz to 3,600 MHz for the SCM, the STFC and SMP. This Public Consultation’s period was extended until July 25, 2011. The corresponding rule was not yet published by ANATEL.
- Public Consultation No. 39: Standard methodology for the calculation of transfer factor “X,” applied tariff adjustments in the STFC. This Public Consultation’s period ended February 9, 2011. The corresponding rule was not yet published by ANATEL.
- Public Consultation No. 45: Proposal to Amend the Regulation of Communication Services and Annexes I and III of the Rules of Price Collection of the Right to Public Telecommunications Services Exploration and Exploitation of the Right to Satellite. This Public Consultation’s period ended September 16, 2011. The corresponding rule was not yet published by ANATEL.

Other Regulatory Issues

On November 21, 2008, the Brazil Government published the 6,654/2008 Decree, dated November 20, 2008, for the revision of the fixed-line General Plan of Grants, allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A.—Telemar or Oi— to acquire Brasil Telecom.

In 2007, ANATEL published Resolution No. 477/2007, effective on February 13, 2008, relating to alterations in the regulation of SMP, which has contributed to an increase in our operating costs. In the new regulation, ANATEL notes areas of vital importance for mobile business, such as the necessity for retail stores in the cities within an operator's coverage areas, increases in the validity periods of prepaid cards and places limits on the period of time

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during which customers may not leave service plans. These new regulations may have an adverse effect on our revenues and results of operations. To minimize the impacts resulting from these regulatory changes, we had already prepared ourselves during the last quarter of 2007, to meet and comply with the terms set forth by the new regulation, mainly those related to the customer service which affect procedures and required significant changes to our systems. In 2009, we continued establishing retail stores in the cities within our coverage areas, pursuant to the provisions of Resolution No. 477/2007. In 2009, we also established mediation centers to attend to users with hearing and speech impediments, pursuant to the provisions of Resolution No. 477/2007. Our plans for achieving the goals set by this new regulation was extend to August 13, 2011 and all goals relating to Resolution No. 477/2007 were achieved by the Company and certified by ANATEL. Because ANATEL considers Vivo to be affiliated with Telefônica Brasil, which already provides wire line long-distance services in the state of São Paulo and was awarded a license to provide these services nationwide, ANATEL will not award a wire line long-distance license to Vivo. Though we and other mobile operators have requested that ANATEL revise the current SMP regime, there can be no assurance it will do so.

ANATEL granted on August 18, 2011 prior consent to the Company to transfer to Vivo its authorizations for STFC service in local mode, domestic long-distance and international long-distance in Regions I and II of the General Plan of Grants (outside of São Paulo). On September 8, 2011 the Extract of the Authorization Term was published in the D.O.U. with the transfer of the STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC across its area, except for the State of São Paulo, using basically the network elements and some radio frequencies that support the provision of the SMP.

Under the SMP regime, we receive revenues from interconnection fees paid to us by wire line long-distance operators due to long-distance traffic originating and terminating on our network. While Vivo is not obligated to use Telefônica Brasil's fixed-line network due to the affiliation relationship, it also cannot receive its own fixed-line license in the event of disagreements with Telefônica Brasil since Telefônica Brasil has the fixed nationwide license and an affiliate cannot have the same type of license in the same area. Since Vivo is not permitted to have a fixed license, Vivo is only able to receive interconnection fees from wire line carriers that have traffic originating or terminating on their network but not from wireless carriers using their fixed-line network. Some of our wireless competitors are also unable to earn such a fixed license due to their affiliations. For example, Oi cannot have a fixed license because it is affiliated with Telemar and Claro cannot have a fixed license because it is affiliated with Embratel. Tim has a fixed license because is not affiliated with any fixed operator, but in July 2009, ANATEL published Act No. 3804/2009 determining the conditions to be followed to guarantee total separation between Tim (Telecom Italia) and our subsidiaries.

On March 24, 2011, ANATEL approved the corporate restructuring of Vivo Participações S.A. and Vivo, which are now controlled by the Company and not by Brasilcel. The operation resulted in the final merger of shares of Vivo Participações into the Company. See "Item 4. History and Development of the Company—A. Historical Background—Corporate Restructuring Involving Vivo Participações S.A."

On August 18, 2011, through Act 5,703/2011, dated August 16, 2011, ANATEL approved the merger of Vivo Participações S.A. into the Company, with the transfer of the SMP authorizations and respective authorizations terms held by Vivo Participações to Vivo, as well as the resignation by Vivo of its SCM authorization.

New Regulations for Restricted Access Services— SeAC

On September 12, 2011, the Brazilian Congress adopted Law 12,485/2011 as a result of Bill 116, which establishes a new legal framework for audiovisual communication with restricted access. This law opens the Pay TV market by enabling telecom operators to offer audiovisual content to subscribers through their networks, creating a new service called Restricted Access Services (Serviço de Acesso Condicionado, or SeAC). The absence of restrictions on foreign capital to be invested in SeAC providers, as well as the elimination of restrictions for the provision of other telecommunications services through STFC, allow us to provide Pay TV services, as well as other telecommunication

services previously limited under the General Telecommunications Law.

According to Law 12,485/2011, the SeAC service will replace current cable subscription TV services, subscription TV, MMDS and DTH and will be regulated by ANATEL. As a result of this law, ANATEL introduced

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in December 2011 the proposed regulations for Pay TV services through Public Consultation No. 65/2011, including license grants, installation and licensing of stations and mandatory distribution programming channels. The Public Consultation was finalized on February 2, 2012 and resulted in Resolution No. 581, issued by ANATEL on March 28, 2012, as well as the new Authorization Terms of the SeAC (which were subject to Public Consultation No. 5/12 and were available for comments until the first week of February).

Law No. 12,485/2011 also established an annual payment to Condecine (Contribuição para o Desenvolvimento da Indústria Cinematográfica) to be made by providers of telecommunication services and amended Law No. 5,070/1966 by revising the amount due as Inspection Fee (Taxa de Fiscalização de Funcionamento) for telecommunication stations from 45% to 33% of the Installation Fee (Taxa de Fiscalização de Instalação). The amount due to Condecine is approximately 12% of the Installation Fee for telecommunication services and must be paid yearly by March 31 of each year.

As a result of Law No. 12,485/2011, the National Cinema Agency (Agência Nacional do Cinema, or Ancine) issued one public consultation by the end of 2011 and one public consultation in 2012 to regulate the registration of economic agents before Ancine. Both public consultations remain under Ancine's review and are expected to be issued in 2012, as they will become the regulatory framework for the SeAC.

Interconnection Regulation

Under the General Telecommunications Law, all mobile telecommunications service providers must provide interconnection upon the request of any other mobile or fixed-line telecommunications service provider. More specifically, telecommunications service providers are classified as providers of either collective or restricted services. All cellular operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service provider. Since 2005, telecommunications service providers have been permitted to freely negotiate the terms and conditions upon which interconnection will be provided, subject to price caps and other rules established by ANATEL. For example, providers must enter into agreements regarding, among other things, tariffs, commercial conditions and technical issues with all parties on a nondiscriminatory basis and starting in 2005, to have a more homogeneous system and to accelerate the negotiation of interconnection contracts, ANATEL has required a standard interconnection network from STFC and SMP Operators through an offer made publicly and equitably.

If parties to an interconnection agreement cannot agree upon the terms and conditions of interconnection, ANATEL may determine those terms and conditions by arbitration. Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations. ANATEL has adopted, from time to time, various regulations governing interconnection rules. The following are the material regulations currently applicable to our business:

- the new General Regulation of Interconnection (“Regulamento Geral de Interconexão”—Resolution No. 410/2005, or “RGI”);
 - the Regulation of Separation and Allocation of Costs (Resolution No. 396/2005);
- the Regulation of Industrial Exploration of Dedicated Lines (“Exploração Industrial de Linha Dedicada”—Resolution No. 402/2005, or “EILD”). In December 2010, ANATEL published Public Consultation No. 50/2010, with the Proposal for Revision of the Resolution No. 402/2005;
- the Regulation of Remuneration of Use of SMP Providers Networks (Resolution No. 438/2006). In November 2010, ANATEL published Resolution No. 549/2010 modifying Resolution No. 438/2006 and providing that the groups

that include SMP operators with participation rates lower than 20% in the market of mobile telephony combined in each one of the regions of the General Plan of Authorizations of SMP (PGA-SMP), are considered groups who lack significant market power in the offer of mobile interconnection, in their respective areas of authorization;

- the Regulation of Fixed and Wireless Number Portability (Resolution No. 460/2007, effective March 2009);

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- the new Regulation of SMP (Resolution No. 477/2007, effective February 13, 2008);
- the Regulation of Terms of Separation and Allocation of Costs (Resolutions No. 480/2007, 483/2007 and 503/2008);
- the general plan of update of the regulation of the telecommunications in Brazil (“Plano Geral de Atualização da Regulamentação das Telecomunicações do Brasil” – Resolution No. 516/2008, or “PGR”);
- the general norms of customer interaction service by telephone, with the objective of improving the quality of services (Decree No. 6523/2008);
- the Methodology of the Calculation of the WACC (Resolution No. 535/2009);
- amendment of the regulation of the 3400 MHz to 3600 MHz band, allowing it to apply additionally to mobile services (Resolution No. 537/2010);
- the regulation of the Broadband Power Line (BPL), allowing this service to apply to multimedia communication (SCM) (Resolution No. 527/2009);
- related Invitation Document No. 002/2007/SPV-ANATEL regarding the auction organized in December 2007 of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses), denominated bands “F,” “G,” “I” and “J,” which stated that, within a maximum allowed period of eighteen months from the publication of the Terms of Authorization (it occurred on April 30, 2008), the authorizations resulting from this auction would be combined with the existing SMP authorizations of the bid winners when pertaining to the same region of the general authorization plan of SMP. In accordance with this Invitation Document, in January 2010, ANATEL published an act determining the unification of our SMP authorizations in Regions II (states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with only one SMP authorization for each of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010, for Region II and III, respectively). Vivo acquired spectrum licenses in band “J” in regions where it possesses SMP licenses. Moreover, the Invitation Document modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- related Invitation Document No. 002/2010/ANATEL, regarding the auction organized in December 2010 of new licenses for the 1900-2100 MHz radio frequency band denominated the “H” band, for extension bands and for available frequencies at “A,” “D,” “E,” “M” and TDD bands, which modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- the regulation for the exploration of SMP by means of Virtual Network, which makes possible the creation of the “agent” and the Authorized of Mobile Virtual Network (Resolution No. 550/2010). In accordance with this regulation approved by ANATEL, Mobile Virtual Network Operators may operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through the establishment of a representation agreement, which must be ratified by ANATEL. The agent’s activity is not defined as a “telecommunications service” so this is of significant interest to companies that operate in other sectors such as large retailers, banks and football teams. However, the activity of the virtual network licensee does fall within the definition of “telecommunications service” and is thus subject to all applicable rules;

- the assignment of the bands of 451 MHz to 458 MHz and 461 MHz to 468 MHz to the Personal Mobile Service, Fixed Switched Telephone Service and to the Multimedia Communication Service, for access to the services of telephony and data in broadband, particularly in rural areas (Resolution No. 558/2010);

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- the assignment of the bands of 2500 MHz to 2690 MHz to the Personal Mobile Service and Fixed Switched Telephone beyond Multimedia Communication Service and Pay Television by means of Multichannel Multipoint Distribution Service (MMDS) for which it was previously assigned (Resolution No. 544/2010);
- the regulation for evaluation of the efficiency of use of the radio frequency spectrum (Resolution No. 548/2010); and
- the addition of a ninth digit in the numbers of the mobile telephones of area 11, raising the capacity of numeration in the metropolitan region of São Paulo and eliminating definitively the problem of scarcity of numeration in this area (Resolution No. 553/2010).
- with an aim to restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to verify the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ). The new Regulation innovates by providing assessments of the network connection and their respective data transmission rate, especially aspects of availability, stability and connection speed data network. In addition, the resolution established the formation of “GIPAQ” (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the “Guaranteed Instant Transmission Rate” and “Guaranteed Average Transmission Rate.” The methodology and procedures regarding the collection of indicator data for data connections will be defined by this group, composed of providers, ANATEL and a “Quality Measurement Authority” (EAq), which shall be responsible for implementing these processes and will be hired by the service providers until February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be paid by providers of the SMP and the impacts of the Regulations are still being evaluated, mainly its financial aspect. Also, through the issuance of Resolution No. 574/2011, which approved the Rules of Quality Management (SCM-SCM RGQ) on October 28, 2011 (published in the D.O.U. on October 31, 2011), ANATEL set targets for service quality, as well as updated definitions for indicators and their calculation methods.
- the Regulation on criteria for adjustment of tariffs for calls from the STFC involving access the SMP or SME, approved by Resolution No. 576/2011, dated October 28, 2011, establishes criteria for the gradual readjustment of VCs until 2014. With respect to VU-M fees, for the period before the effectiveness of the cost model established by this Resolution, ANATEL defined transition rules if no pact is reached regarding the VU-M fees. A reduction factor (R) to be applied in the formula for readjustment of the calls involving the PSTN access the Personal Mobile Service.
- $VC_t \leq VC_{t0} \times (1-R-FA) \times (IST_t / IST_{t0})$, where R corresponds to the “Reduction Factor” (Fator de Redução) and FA to the “Damping Factor” (Fator de Amortecimento), the percentage of which depends on inflation in the corresponding period.

The Reduction Factor to be applied in the next readjustment of the VC rate for fixed-mobile calls will follow the schedule below:

- for the first readjustment, ANATEL will apply a Reduction Factor of 18%;
- for readjustments to follow, ANATEL will apply a Reduction Factor of 12%; and
- if the cost model has not yet produced results, the third readjustment will be subject to a Reduction Factor of 10%.

The “Damping Factor” has the following scale: 0 if inflation is less than 10%; 0.01 if inflation is between 10% and 20% and 0.02 if inflation is above 20%.

For the VU-M fees, they remain freely negotiated and in case there is no agreement as a result of the new VC determined according the formula above, any reduction of these fees will be applied to the VU-M fee up to the VU-

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M / VC1 ratio to achieve 70%. From this level, the reduction will also be assessed in other components of the VCs, maintaining this ratio.

Also in 2011, ANATEL issued a Public Consultation on the Plano Geral de Metas de Competição (General Plan of Competition), or PGMC, which has not yet been converted into an ANATEL resolution. The purpose of this consultation is to maintain competition in the telecommunications sector, in line with the framework established by the “General Plan for Update of Telecommunications Regulation in Brazil” (PGR). The PGMC was created by ANATEL was proposed by ANATEL to organize a control scheme for the actions of economic agents in the telecommunications industry, imposing, removing or altering obligations on providers, according to their market power, with a view to increasing competition. The consultation highlighted the reservation of network capacity for sharing and provided criteria for determination of significant market power in the provision of interconnection services on mobile networks.

The consultation also provides sets of regulatory measures applicable to groups with significant market power: structural measures (applicable to all markets) and specific measures (applicable only to specific markets). The consultation also contained provisions for the creation of three entities: the “Representative” (responsible for gathering the groups without SMP and represent them in case of conflict), the “Supervisor” (responsible for resolving conflicts between groups with and without SMP and assess or certify wholesale offers) and the “Comparer” (responsible for receiving and comparing offers retail).

Rate Regulation

With respect to our Basic Plan and certain roaming charges incurred in connection with alternative service plans, our authorizations continue to provide for a price cap mechanism to set and adjust rates on an annual basis. The cap is the value with the rate of inflation deducted from the productivity estimated by ANATEL. The price cap is revised annually to reflect the rate of inflation as measured by the IGP DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and us in our authorizations had been based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in our authorizations. The price cap has been revised to reflect the rate of inflation as measured by the IGP DI.

Other telecommunications companies that interconnect with and use our network must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use. Since 2005, ANATEL has permitted free negotiations for mobile interconnection, or VU-M, fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in fees). ANATEL approved that provisional agreement, and in March 2006, approved another provisional agreement for VU-M fees for long-distance calls, VC2, VC3 and international, among the same operators that made the VC1 agreement.

In July 2007, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.97143% to interconnection fees in Region I (Telemar’s Region) and an annual adjustment of 2.25356% in Region II (Brasil Telecom’s Region) and Region III (Telefônica’s Region).

In January 2008, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, taking into consideration the period since January 2004, that provides for an annual adjustment of 4.5% as of March 2006 and an annual adjustment of 1.97143% or 2.25356% as of July 2007.

In July 2008, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.89409% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

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In March 2009, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2007 to 2008, that provides for an annual adjustment of 1.89409% in Region I (Telemar's Region) or 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region) as of July 2008.

In September 2009, even though it had a provisional agreement between the fixed-line operators Telefônica, Telemar, Brasil Telecom and Sercomtel and the mobile operators, without CTBC Celular, ANATEL decided not to approve the readjustment of the local (VC1) and long-distance (VC2 and VC3) fixed-to-mobile calls. In February 2010, this readjustment of the VC1, VC2 and VC3, relative to the period from 2008 to 2009, was approved by ANATEL and the provisional agreement of VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC1) could be applied.

In June 2010, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2008 to 2009, for the application of the VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC2 and VC3).

By the end of 2011, our subsidiary Vivo entered into an agreement with Oi (Regions I and II) and us (Region III) for the recognition of the VU-M fee paid at the time and agreed to maintain this amount for an additional 24 months, based on the VC1 readjustment pleaded by both these companies to ANATEL. However, these fees were not approved by ANATEL due to the publication of ANATEL's Resolution No. 576/2011, which addresses the criteria for adjustment of fees for calls from fixed-lines involving access to the SMP or SME. On January 25, 2012, ANATEL published Act No. 486, with the new fees for VC1, VC2 and VC3 (with an average reduction of 10.78%) and, on February 22, 2012, ANATEL published Act No. 1,055 with new VU-M fees (with an average reduction of 14%). However, Oi obtained an injunction in Federal Court to have its readjustment request analyzed by ANATEL. This decision is subject to appeal. See “—Interconnection Regulation.”

Also, ANATEL published the Invitation Document No. 002/2007/SPV-ANATEL, which relates to the December 2007 auction of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses). Under this Invitation Document, the authorizations resulting from the auction of will be combined with the existing authorizations belonging to the bid winners when pertaining to the same region of the general authorization plan of SMP (PGA-SMP) in the period of eighteen months from the publication of the Terms of Authorization (which occurred on April 30, 2008).

As a result, ANATEL published in January 2010 an act determining the merger of our SMP authorizations in Regions II (State of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with an SMP authorization for each one of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010 for Regions II and III, respectively).

Moreover, ANATEL determined that the value of the VU-M fee should be unified for each Region of the PGA-SMP and freely negotiated beginning on November 1, 2009 (eighteen months from April 30, 2008). Until this date, mobile operators charged a VU-M fee for authorization of the SMP. In February 2010, ANATEL defined the VU-M fee to be paid for Oi (fixed and mobile operators) and Brasil Telecom (fixed and mobile operators) to Claro, TIM, Vivo and Vivo Participações (the latter being the result of the ANATEL-authorized merger of Telemig Celular S.A. into Vivo Participações S.A. in March 2010), for the region of the PGA-SMP, as a result of the unification of the SMP authorizations.

In 2007, ANATEL developed a new model which will be in use starting with a date yet to be determined by ANATEL to determine values of reference in connection with remuneration for use of mobile networks—RVU-M—of SMP providers having significant market power, which will be used in the case of arbitration by ANATEL of the value of VU-M. ANATEL did not implement this new model in 2010, as provided by Resolution No. 480/2007, and has not yet defined the new date expected for such implementation. See “—SMP Licenses” for more information on the status of this agreement.

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ANATEL launched on August 25, 2011 the “Project Cost Model” (Projeto Modelo de Custos). The project is associated, among other things, with determining fees for the use of the fixed telephony network and the calculation of reference values of the VU-M fee and EILD (Industrial Use of Dedicated Lines) for telecommunications service providers.

At launch, ANATEL signed a US\$8.22 million agreement with the consortium of Advisia, Analysis Mason and Grant Thornton, which has two years to perform work in support of ANATEL. This consortium won the international bidding process conducted by the International Telecommunication Union (ITU).

The cost model is of great relevance to ANATEL in carrying out public sector policies, as its development will allow access to cost management information of the different business areas and product lines of telecommunications services providers, contributing to the improvement of regulation of the sector as a whole.

Internet and Related Services in Brazil

In Brazil, Internet service providers, or ISPs, are deemed to be suppliers of value-added services and not telecommunications service providers. ANATEL’s Resolution No. 190 requires cable operators to act as carriers of third-party Internet service providers. The Brazilian House of Representatives is considering a law that would penalize Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet, and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks.

Customer Service

In 2011, our subsidiary Vivo managed to consolidate and expand the personalized sales project to all remote consumer relation channels, such as text message, chat, email and web. This practice had been put in place at inbound customer service since 2009, and consists on exclusive offers that are tailored towards each client’s consuming habits and needs. This successful strategy of cross-selling changed Vivo inbound customer service into a powerful sales tool, that generated new business opportunities while capturing opportunities in which the customer initiated contact and respecting their willingness to communicate with Vivo.

Improved services and functionalities made www.meuvivo.com.br website register 6.1 million unique users and 253 million online transactions. Through the “Fale Conosco” service, 1.1 million email-generated solicitations were solved. Driven by the goals of innovation and customer satisfaction, Vivo expanded its text-message-based customer service channel to all customers, achieving more than 4.2 million contacts served all year.

We managed to continue as the top telecommunications company in ANATEL’s ranking of mobile operators in Brazil. By the end of 2011, ANATEL’s ranking demonstrated that Vivo had the best performance among the largest companies operating in Brazil as measured by the IDA (Attendance Performance Index). Vivo also placed as the best among the key competitors in the telecom industry by having the smallest complaint ratio. Those numbers were supported by Vivo’s actions towards quality and expansion of the customer service channels.

Our challenge in 2012 is to capture more synergies with all contact channels (Internet, SMS, Call Center – inbound and outbound, Chat, Email, etc.) through the Genesys platform as well as integrating Telefônica Brasil’s in-land operations, planned to be rebranded to Vivo in 2012. Also, we aim to improve customer experience in every channel to get closer to the customers and their needs, considering all aspects of Brazil’s demography and regional distribution.

Higher quality, with efficiency

We implemented a strategy to increase the quality of our services while lowering costs. While achieving the best signal quality, surpassing all of our competitors (according to ANATEL's scoring system in 2011), we also took steps designed to improve the level of service of our customer care, generate greater customer satisfaction with our call centers and stores and reduce billing errors, leading to fewer claims against us. This strategy has been successful in increasing our customer satisfaction rating in 2011 and in lowering costs.

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Marketing and Sales

Following our merger with Vivo, we are integrating processes and portfolios of fixed and mobile services, in order to offer customers complete solutions in telecommunications. During 2012, we will integrate channels to offer standardized solutions and customer service along with innovation and best practices for the sale of fixed and mobile services.

We bring our solutions to our clients through the following sales channels:

- **Vivo Own Stores:** focused on individual clients and located on strategic points, our own stores provide a highly trained team built up to guarantee the best sales experience for the customer. The main drive of this channel is innovation. As a result, most stores have available self assistance services for value added services and recharges. We also offer special treatment for Premium clients with scheduled appointments via the Internet to assure “no waiting in line.”
- **Indirect channels:** are divided in two types: resale and retail. The resale channel is composed by certified companies in the telecommunications segments providing our full portfolio and an adequately sized network for our services to attend the geographic dimensions of the market. Our presence is also established in the retail channel especially for prepaid, recharges and data services.
- **Recharge channels:** are represented by small companies in various market sectors throughout the country. They became the largest channel for prepaid users and provide new means of virtual recharge for customers.
- **Telesales:** sales through active and passive telemarketing call centers, employing highly trained sales associates, focused on fixed and data services.
- **Internet:** “Portal Telefônica,” with online information on our products and services specifically targeted toward our corporate clients; we also offer the option of selling services via online chat through highly trained partners and appropriate tools.
- **Online Store:** currently offers mobile services to clients with home delivery, payment in installments and different prices of handsets. In 2012, we will launch a new online store covering all the services portfolio of fixed and mobile, and offering improvements in navigation, quality purchase, reduction in SLA, etc. supported by a communications marketing strategy.
- **Door-to-door sales:** aiming to approach corporate and individual clients, we dispose physical channels of assistance, such as door-to-door sales of services by outsourced small companies and own team consultants. Main focus in fixed and data services.
- **Person-to-person sales:** our business management team offers customized sales services, ensuring high customer loyalty and a strong customer relationship resulting from customized consulting telecommunication and IT services and technical and commercial support.

Besides the growth of sales volume, the main challenges for the Company in 2012 are the synergy of fixed and mobile services, the increased use of services in the virtual channels and the strengthening of Brazil’s largest accredited network.

Our Network

In 2011, we consolidated even more our network as a robust network, capable of delivering to the customer its expectation. We moved forward with the migration of TDM to NGM core, reaching 26% of fixed traffic, continued the modernization of cores as well as the adaptation of the data centers' infrastructure.

We launched the FWT, allowing the operation of fixed telephony outside São Paulo, result of the integration between mobile and fixed worlds.

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We also expanded our fixed network's broadband access. Our broadband ADSL's product portfolio has speeds that vary from 250 kbps to 8 Mbps. The product "Banda Larga Popular," which is an initiative of the state of São Paulo, provides broadband at affordable prices to low-income population. This product is already used by 600,000 customers and can deliver speeds between 250 kbps and 1 Mbps. Broadband connections through coaxial cables are offered as well as a product called "Ajato" and its speeds may vary from 8 Mbps to 30 Mbps.

We implemented a platform, known as MLD ASSIA, to improve the diagnosis and stability of our customers and, furthermore, increase the index of assertiveness in recommendation to upgrade the speed.

We use the most advanced technology available in broadband optical fiber: the FTTx, allowing our customers to reach speeds up to 100 Mbps. We closed out 2011 with fifty thousand fiber's customers. However, five thousands of these customers use IPTV—a system through which television services are delivered using the Internet Protocol suite.

In 2011, Speedy peaked at 3.5 million customers and we started marketing new products (16 Mbps and 25 Mbps) with VDSL2 technology.

Before November 1998, our subsidiary Vivo network used only AMPS analog technology. After privatization, we began to use CDMA digital and TDMA digital technologies. In 2006, we began to implement a GSM Network. In 2007, we began to implement a WCDMA Network. In 2011, launched the HSPA+ technology, commercially known as 3GPlus, working across our 3G network. This technology was commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11), allowing customers who have compatible terminals achieve even higher transmission rates, reaching up to three times the value of traditional 3G's rate. Digitalization offers certain advantages, such as greater network capacity and additional revenue through the sale of value-added services. We continue to increase network capacity and coverage to improve our quality of service and to meet customer demand.

Our advanced network management technology ensures global management and supervision of all our network processes and network performance. The network management centers are located in São Paulo, Brasília and Minas Gerais. The network management center of São Paulo monitors the critical network operational parameters of the countrywide transmission backbone, third parties' networks, IP networks and service platforms. The network management center in Brasília monitors the critical network operational parameters in the Midwestern Region (CO), Rio de Janeiro, Espírito Santo, Rio Grande do Sul and Paraná/Santa Catarina. The network management center in Minas Gerais monitors the critical network operational parameters in the Northeastern region (NE), the Northern region (NO), Bahia, Sergipe, São Paulo and Minas Gerais. These centers are able to identify abnormalities in both our network and in third parties' networks, using failure and signaling monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with maintenance and operations teams that maintain and operate cellular network elements, as well as cellular infrastructure and transmission, in addition to the radio network elements and computing bases, service platforms and communications backbones.

Our network is prepared to provide continuity of service for our customers in the event of network interruptions. We have developed contingency plans for potential catastrophes in our switching centers, power supply interruptions and security breaches.

Pursuant to the terms of our authorization to perform our services, we are obligated to meet certain requirements for service quality. See "—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies."

Contract Customers for Mobile Services

Since October 1994, cellular telecommunications service in Brazil has been offered on a “calling party pays” basis, under which customers pay only for calls that they originate. In addition, customers pay roaming charges on calls made or received outside their home registration area.

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Customer charges are calculated based on the customer's calling plan, the location of the party called, the place from which the call originates and certain other factors, as described below. Our Region is divided into areas designated for payment purposes, called registration areas, as follows:

- Areas 1 & 2: 9 areas in the state of São Paulo;
- Area 3: 5 areas, comprising 1 area in the metropolitan area of Rio de Janeiro, two areas in upstate Rio de Janeiro and two areas in the state of Espírito Santo;
- Area 4: 7 areas in the state of Minas Gerais;
- Area 5: 9 areas, comprising 6 areas in the state of Paraná and 3 areas in the state of Santa Catarina;
- Area 6: 4 areas in the state of Rio Grande do Sul;
- Areas 7 & 8: 18 areas, comprising 9 areas in Brasilia and the states of Goiás, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and Tocantins and 9 areas in the states of Amapá, Amazonas, Maranhão, Pará and Roraima;
- Area 9: 6 areas, comprised of 5 areas in the state of Bahia and 1 area in the state of Sergipe; and
- Area 10: 9 areas in the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.

Interconnection Charges

We earn revenue from any call that originates from another cellular or fixed-line service provider network connecting to one of our customers. We charge the service provider from whose network the call originates a network usage charge for every minute that our network is used in connection with the call. See “—Operating Agreements—Interconnection Agreements.” Tariff adjustments are subject to agreement between the operators and then subject to approval by ANATEL.

Bill and Keep

ANATEL adopted partial “Bill & Keep” rules for interconnection charges in July 2003. The rules provided that an SMP operator paid for the use of another SMP operator's network in the same registration area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them. In that case, only those calls that surpassed the 55% level were subject to payment for network usage. Under Resolution No. 438 published in 2006, ANATEL eliminated the rule of the partial “Bill and Keep.” The current rule is “full billing,” in which the SMP operator pays the entire call termination fee of the other mobile network. The rule of the partial “Bill & Keep” was maintained between SMP and SME (trunking) networks.

Roaming Fees

We receive revenue pursuant to roaming agreements with other cellular service providers. When a customer of another cellular service provider makes a call within our area, that service provider pays us for the call at the applicable rate. Conversely, when one of our customers makes a cellular call outside of our Region, we must pay the charges associated with that call to the cellular service provider in whose Region the call originates. See “—Roaming Agreements.”

Wireless Device Sales

Through our stores and authorized dealers we sell only GSM and WCDMA devices such as handsets, smartphones, broadband USB modems and netbooks that are certified to be compatible with the Vivo network and service. We have special offers on smartphones, USB modems and other data devices for customers of bundled packages. Our current handset suppliers are Motorola, LG, Samsung, Nokia, Sony, Alcatel, ZTE, HTC, Apple, RIM (BlackBerry) and Huawei.

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Operating Agreements

We have agreements with major fixed-line and mobile operators in Brazil to lease physical space, real estate, air conditioning, energy, security and cleaning services. We also lease transmission capacity necessary to complete the construction of our network infrastructure.

Interconnection Agreements

The terms of our interconnection agreements include provisions with respect to the number of connection points and traffic signals. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies” and “—Regulation of the Brazilian Telecommunications Industry—Interconnection Regulation.”

We believe that our subsidiaries have adequate interconnection agreements with necessary fixed-line operators to provide services. We also believe that our subsidiaries have all the necessary interconnection agreements with long-distance carriers.

Roaming Agreements

We provide international GSM roaming in over 200 destinations worldwide by means of over 500 roaming agreements.

Fraud Detection and Prevention

In 2011, we consolidated efforts to reach our targets for reduction of amounts and financial loss expenses for our operations related with fraud and fraud costs for the fixed operation, which are considered a reduction of revenue.

Compared with the year 2010, we had a 16.1% reduction in the volumes of financial loss for our mobile operation and a 51.5% increase in the cost of fraud for our fixed operation, resulting in an increase of 22.1% in financial revenues, considering our consolidated operations (fixed and mobile).

The main impact of this increase is related to the implementation of various actions to protect the Company from possible litigation. Thus, we focused our analysis in cases classified in our accounts receivable as having evidence of fraud.

During 2011, we continued our work in combating the two main types of fraud, as follows:

- **Subscription fraud:** type of fraud that occurs when the emission of one or more qualifications without the consent of the real “owner” of documents with the main objective of not paying the phone bill. Fraud can occur through subscription data and information from individuals or companies obtained illegally. In our mobile operation, subscription fraud showed a reduction in expenses of 14.9% as compared to the end of 2010. As for cases in our fixed operations, several actions were implemented to protect us from possible increases in litigation, by working on the analysis of cases classified in our accounts receivable with evidence of fraud. With this new guideline, we had a 51.5% increase in fraud costs compared to what was achieved in 2010.
- **Identity Fraud:** also known as “social engineering,” the term identity fraud characterizes in the mobile operation the use the service provider phone channels (Call Center) with the use of real data from clients for false identification, allowing undue changes to be made in the customer’s line. We had a 78.2% reduction in financial expenses with this type of fraud compared to that achieved in the previous year.

C.

Organizational Structure

On December 31, 2011, our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. with 50.47%, Telefonica S.A. with 25.68% and Telefônica Internacional S.A. with 15.43%. Telefônica Internacional is the controlling shareholder of SP Telecomunicações and, consequently, holds directly

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and indirectly 43.33% of our common shares and 38.68% of our preferred shares. Telefónica Internacional is a wholly owned subsidiary of Telefónica, S.A. of Spain.

Subsidiaries

A. TELECOM S.A. (formerly Assist Telefônica) is our wholly owned subsidiary. A. TELECOM was formed in Brazil on October 29, 1999, and it is engaged primarily in providing telecommunications and data services and internal telephone network maintenance for customers. The principal services are as follows: (i) digital condominium which is a value-added service for commercial buildings, integrated solution for equipments and services for voice transmission, data and images on commercial buildings under a Building Local Exchange Carrier (“BLEC”) model; (ii) installation, maintenance, exchange and extension of new points of internal telephony wire in companies and dwellings under a basic plan of maintenance (BPM); and (iii) provision of free ISP service under the brand name “I-Telefônica.” In addition, on December 30, 2004, we entered into a transaction to acquire indirect control of Atrium Telecomunicações Ltda. The transaction was approved by our shareholders on January 19, 2005. The acquisition was carried out through the purchase of the total share capital of Santo Genovese Participações Ltda., which held 99.99% of the representative share capital of Atrium. On March 1, 2006 then-subsubsidiary Santo Genovese Participações Ltda., having merged into its subsidiary Atrium Telecomunicações Ltda., was acquired by A. TELECOM S.A. and both Santo Genovese Participações Ltda. and Atrium Telecomunicações Ltda. ceased to exist. A. TELECOM remained a wholly owned subsidiary of TELESP, and began carrying out the activities formerly performed by Atrium. See “—B. Business Overview—Overview.”

From the second half of 2006, A. TELECOM began providing pay TV services, fully focusing on the development of this new product line. In February 2008, A. TELECOM became an owned subsidiary of Telefônica Televisão Participações S.A. (TTP). In November 2008, TTP was merged into TELESP and A. TELECOM became a wholly owned subsidiary of TELESP. See “—A. History and Development of the Company—Historical Background—Corporate Reorganization involving DABR and TTP.”

Telefônica Data S.A.’s business purpose is to render telecommunications services such as the development, implementation and installation of projects related to integrated business solutions and telecommunications consulting, as well as activities related to the rendering of technical assistance and equipment and telecommunications network maintenance services.

Telefônica Empresas, currently (“Telefônica Data”), became a wholly owned subsidiary of the Company after the corporate reorganization that was carried out in July 2006. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.” In July 2008, Telefônica Data became a wholly owned subsidiary of TTP. In November 2008, TTP was merged into TELESP and Telefônica Data became a wholly owned subsidiary of TELESP. See “—A. History and Development of the Company—Historical Background—Corporate Reorganization involving DABR and TTP.”

Telefônica Sistema de Televisão S.A. (“TST”) is a company that provides pay television services through the Multipoint Multichannel Distribution Services (“MMDS”) modality.

Vivo S.A. is a company that provides mobile services in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (also encompassing the area of Distrito Federal, or the Federal district), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São Paulo, Sergipe, Tocantins and Minas Gerais. See “—A. History and Development of the Company.”

Ajato Telecomunicações Ltda. The corporate purpose of Ajato Telecommunications Ltd is to provide telecommunications and IT services, access to telecommunications network, internet and radio, including telemarketing, image and data services, trade lease, import, export, maintenance and repair for those equipments.

Aliança Atlântica Holding B.V. based in Netherlands, Amsterdam, with a 50% interest owned by Telefonica Brasil, holds cash from the sale of Portugal Telecom's shares in June 2010 and a small interest in Zon Multimedia, a company of Portugal Telecom Group which provides pay-TV services, internet, distribution of audiovisual content, cinema and telecommunications services.

Companhia AIX de Participações. This company is engaged in the Refibra consortium, as a leader, as well as in both direct and indirect development of activities related to the construction, conclusion and operation of underground fiber optic networks. Currently, Telefônica Brasil holds a 50% interest in this company.

Companhia ACT de Participações is engaged in the Refibra consortium, as a leader, as well as in activities related to providing technical assistance for the preparation of the network conclusion project by providing studies to make it more profitable, as well as to inspect the activities in progress related to the project. Currently, Telefônica Brasil holds a 50% interest in this company.

GTR Participações e Empreendimentos S.A.'S business purpose is to hold equity interest in other companies, which are engaged in providing cable and pay-TV services, telecommunications services in general, the production, purchase, licensing, import and distribution of television programs, either its own or third parties', spare parts and equipment, management and rendering of telecommunications and pay-TV service platforms.

TVA Sul Paraná S.A.'s business purpose is to provide cable and pay-tv services, telecommunications services in general, produce, purchase, license, import and distribute television programs, either its own or third parties', spare parts and equipment, manage, update and exploit telecommunications and pay-TV service platforms and publish journals.

Lemontree Participações S.A.'s business purpose is to hold equity interest in other companies, which are engaged in providing cable and pay-TV services, telecommunications services in general, the production, purchase, licensing, import and distribution of television programs, either its own or third parties', spare parts and equipments, management, updating and exploitation of telecommunications and pay-TV services platforms, and data management and trading.

Comercial Cabo TV São Paulo S.A.'s business purpose is to provide cable and pay-TV services, advisory and consultancy services in telecommunications in general, to produce, purchase, license, import and distribute television programs, either its own or third parties', spare parts and equipment, manage, update and exploit telecommunications and pay-TV service platforms, and to engage in all types of marketing and advertisement.

Associated Companies

Since June 30, 2000, we have consolidated under the Brazilian Corporate Law Method, and since January 1, 2009, under IFRS, the operations of Aliança Atlântica Holding B.V., an investment company incorporated under the laws of the Netherlands, that had as its main asset a 0.61% interest in the equity capital of Portugal Telecom, which was disposed of in June 2010. As of December 31, 2011, we held a 50% share ownership in Aliança Atlântica Holding B.V. and Telefónica S.A. held the remaining 50%. Aliança Atlântica Holding B.V. is currently in the process of liquidation and, as a result, its remaining assets are being appraised.

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Furthermore, since December 31, 2003, we have also consolidated under the Brazilian Corporate Law Method, and since January 1, 2009, under IFRS, our investment under proportional consolidation in Companhia AIX de Participações, or AIX. At December 31, 2011, we held a 50% share ownership in AIX and Telemar Participações S.A. held the remaining 50%. AIX was formed in 2001 to explore, directly and indirectly, activities related to the execution, conclusion and commercial exploitation of underground cables to fiber optic. See Note 1 to the consolidated financial statements included in this annual report starting at page F-13. We also consolidate on a pro rata basis, as required under the Brazilian Corporate Law Method and under IFRS, Companhia ACT de Participações, in which we hold a 50% interest.

D. Property, Plants and Equipment

Our main physical properties for providing fixed services involve the segments of switching (public switching telephone network-PSTN), transmission (optic and wireless systems), data communication (multiplex devices, IP network), infrastructure (Energy systems and air conditioned) and external Network (fiber optic and metallic cables), which are distributed in many buildings in the State of São Paulo and in the main cities out of the State of São Paulo. Some of these buildings are also used in administrative and commercial areas.

Our properties are located throughout the State of São Paulo. At December 31, 2011, we used 2,178 properties in our operations, 1,419 of which we own, and we have entered into standard leasing agreements to rent the remaining properties. We own a building in the City of São Paulo where the majority of our management activities are conducted.

Pursuant to Brazilian legal procedures, liens have been attached to several properties pending the outcome of various legal proceedings to which we are a party. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings.”

Our principal physical property for mobile services consists of transmission equipment, switching equipment, base stations, and other communication devices, such as voicemail, prepaid service, Short Message Service, Home Location Registers, Signaling Transfer Point, Packet Data Switching Network and gateways. All switches, cell sites, administrative buildings, administrative facilities, warehouses and stores are insured against damages for operation risks.

As of December 31, 2011, our subsidiary Vivo had 202 cellular switches and other equipment installed in 59 owned spaces, nine leased spaces and 24 shared spaces. We lease most of the sites in which our cellular telecommunications network equipment is installed. The average term of these leases is five years (subject to renewal for additional five-year terms) and ten years in the Northeast. Our 28,293 base stations and other network equipment are installed in cell sites, administrative buildings and administrative facilities. In addition, our subsidiary own 14 administrative building and we lease 33 administrative areas, 11 kiosks and 302 retail stores.

On December 31, 2011 the net book value of our property, plant and equipment amounted R\$17.2 billion (R\$10.2 billion in December 31, 2010).

ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes and other information appearing elsewhere in this annual report and in conjunction with the financial information included under “Item 3. Key Information—A. Selected Financial Data.” We prepared our consolidated financial statements included in this annual report in accordance with the IFRS.

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Overview

Our results of operations are principally affected by the following key factors.

Brazilian Political and Economic Environment

The Brazilian economy has experienced different rates of growth this decade. According to IBGE, the Brazilian GDP for 2011 expanded 2.7% in 2011, compared to 7.5% in 2010.

Consumer prices, as measured by the IPCA, registered a variation of 6.5% in 2011. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank, of 4.5%. In 2009 and 2010, the variations of IPCA were 4.3% and 5.9%, respectively. Inflation, as measured by the General Price Index, or the IGP-DI, calculated by Fundação Getúlio Vargas, which includes wholesale, retail and home-building prices, decreased 1.4% and increased 11.3% in 2009 and 2010, respectively. In 2011, the IGP-DI increased 5.0%.

As a result of the acceleration of inflation and of the economic activity, the Central Bank increased the basic interest rate during 2011, but began a series of decreases of the rate during the second semester. As a result, the SELIC rate increased to 11.0% by the end of 2011, from 10.75% in 2010.

Brazil finished 2011 with a trade balance surplus of US\$29.8 billion, compared to US\$20.3 billion in 2010. Exports increased by 26.8% to US\$256.0 billion, and imports increased 24.5% to US\$226.2 billion. Financial inflows into the country increased, with foreign direct investments of US\$66.7 billion, compared to US\$48.5 billion in 2010. Portfolio investments increased by US\$25.1 billion in 2011, in comparison to the increase of US\$63.0 billion in 2010. The positive performance of external accounts allowed international reserves to increase by US\$63.4 billion to the record level of US\$352.0 billion.

Despite the improvement in domestic economic data, such as inflation, external accounts, and interest rates, increased risk aversion in the international capital markets led to a higher country risk in 2011. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil), which tracks total returns for traded external debt instruments in the emerging markets, increased to 233 basis points by the end of 2011 from 180 basis points at the end of 2010.

As a result, the real depreciated against the U.S. dollar in 2011 by 12.6%. The exchange rate on December 31, 2011 was R\$1.88/US\$1.00, from R\$1.67/US\$1.00 on December 31, 2010.

Our business is directly affected by trends in the international economy and the Brazilian economy. If the Brazilian economy enters a period of continued recession, then demand for telecommunications services is likely to decline. Similarly, depreciation of the Brazilian real against the U.S. dollar may reduce the purchasing power of Brazilian consumers and, as a consequence, negatively affect the ability of our customers to pay for our telecommunications services.

Impact of Inflation on Our Results of Operations

Before 2006, the fees we charged our customers were periodically adjusted by ANATEL based on the inflation rates measured by the General Price Index (IGP-DI).

Starting in 2006, telephone fees were indexed to the IST, which is a basket of national indexes that reflect the telecommunications sector's operating costs. Such indexing will thus reduce inconsistencies between revenue and costs in our industry and therefore reduce the adverse effects of inflation on our business. The IST for the last 12 months is 4.92% according to the last data published by ANATEL with reference to December 2011.

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2007 through 2011:

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	Inflation Rate (%) as Measured by IGP-DI(1)	Inflation Rate (%) as Measured by IPCA(2)	Inflation Rate (%) as Measured by IST(3)
December 31, 2011	5.0	6.5	4.9
December 31, 2010	11.3	5.9	5.6
December 31, 2009	(1.4)	4.3	2.1
December 31, 2008	9.1	5.9	6.6
December 31, 2007	7.9	4.5	3.2

(1) Source: IGP-DI, as published by the Fundação Getúlio Vargas.

(2) Source: IPCA, as published by the Instituto Brasileiro de Geografia e Estatística.

(3) Source: IST, as published by the Agência Nacional de Telecomunicações.

Regulatory and Competitive Factors

Our business, including the services we provide and the rates we charge, is subject to comprehensive regulation under the General Telecommunications Law. As a result, our business, results of operations and financial conditions could be impacted by the actions of the Brazilian authorities, including:

- delays in the granting, or the failure to grant, approvals for rate adjustment;
- the granting of licenses to new competitors in our region; and
- the introduction of new or stricter requirements for our operating concession.

A series of new regulations became effective in 2011. See “Item 4. Information on the Company—B. Business Overview.” The most important among these regulations were:

- regulation of quality management of SMP and SCM;
- regulation of the criteria for readjustment of fees involving STFC calls involving access from the SMP or SME;
- local area regulation of the STFC; and
- free determination of rates for international long distance (LDI).

We expect the following issues to become effective as new regulations or to be subject of one or more Public Notices in 2012, with an exact timeline yet to be determined by ANATEL.

- development of a General Competition Plan that would regulate standards for service providers with significant market power;
- change in the STFC regulation;

- draft regulation on the provision of STFC out of the Basic Fee Area (Área de Tarifação Básica), or ATB;
 - proposed revision of the rules of usage remuneration of providers of STFC networks;
 - invitation for bids for 3.5 GHz frequencies;
 - proposed amendment of the Regulation of Multimedia Communication Services (SCM);
 - proposed rules for industrial exploration of dedicated lines – EILD;
- proposed regulations for the Certification of External Telecommunications Networks in regard to power protection;

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- review of the General Plan on Quality Targets to the STFC (PGMQ-STFC);
- creation of a General Plan on Quality Targets of Television Subscription Services (PGMQ-TV);
- proposal for regulation the monitoring and control of goods, rights and services linked to existing concessions;
 - proposed amendment of the Regulation of Inspection Powers;
- proposal to amend the rules of implementation of administrative sanctions; and
 - calculation rules for productivity factor (Transfer Factor X).

Number Portability came into effect in Brazil in September 2008. Number Portability allows clients within a limited geographic locale to relocate or change their telephone operator without the need to change their telephone number (for either a fixed or mobile line). Number Portability rights for all of our clients became effective in March 2009.

In addition to regulatory considerations, our business is affected by competition from other telecommunications providers. We began to face competition in our region in July 1999, and we anticipate that competition will contribute to declining prices for fixed-line telecommunications services and increasing pressure on operating margins. Our future growth and results of operations will depend significantly on a variety of factors, including:

- Brazil's economic growth and its impact on the greater demand for services;
- the costs and availability of financing; and
- the exchange rate between the real and other currencies.

Foreign Exchange and Interest Rate Exposure

We face foreign exchange risk due to our foreign currency-denominated indebtedness, accounts payable (including our capital expenditures, particularly equipment) and receivables in foreign currency. A real devaluation may increase our cost of debt and certain commitments in a foreign currency. Our revenue is earned in reais, and we have no material foreign currency-denominated assets, except income from hedging transactions, interconnection of international long-distance services and services rendered to customers outside Brazil. Equity investments in foreign companies also suffer effects with variations in the exchange rate.

On December 31, 2011, 19.32% of our R\$6.20 billion of financial indebtedness was denominated in U.S. dollars and UMBNDES. See Note 18 to the Consolidated Financial Statements. Devaluation of the real causes exchange losses on foreign currency-denominated indebtedness and commitments and exchange gain on foreign currency-denominated assets and corporate stakes in foreign companies.

We use derivative instruments to limit our exposure to exchange rate risk. Since September 1999, we have hedged all of our foreign currency-denominated bank debt using swaps. Since May 2010, the Company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures, or assets (issued invoices) minus liabilities (received invoices) for foreign exchange exposures, substantially reducing the Company's risk to fluctuations in exchange rates. However, we remain exposed to market risk resulting from changes in local interest rates, principally the CDI – Certificate of Interbank Deposits (Certificado de Depósito Interbancário), which is an index based upon the average rate of operations transacted among the banks within Brazil). This exposure to the CDI is present in long derivatives positions and financial investments, which are indexed to percentages of the CDI. Substantially, most

of our debt is exposed to long term interest rates. On December 31, 2011, R\$3.06 billion of our indebtedness was subject to the variations of the TJLP, which remained stable since July 2009, and R\$1.20 billion was subject to the variation of the U.S. dollar and UMBNDES. However, the portion in U.S. dollars of our foreign currency debt is swapped under hedging arrangements for variable-rate real-denominated obligations based on the CDI. We invest our excess cash mainly in short-term instruments that earn interest based on the CDI. See

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Note 36 to the Consolidated Financial Statements and “Item 11. Quantitative and Qualitative Disclosures about Market Risk.”

Since we have foreign currency derivatives with notional amounts substantially equivalent to our borrowings and invoices issued and received denominated in foreign currency, we do not have material exchange rate exposure with respect to these contracts. However, we could still continue to have exchange rate exposure with respect to our planned capital expenditures, approximately 16.7% of which are indexed in foreign currencies (mostly U.S. dollars). We systematically monitor the amounts and time of exposure to exchange rate fluctuations and may contract for hedging positions, when appropriate, at our discretion.

Discussion of Critical Accounting Estimates and Policies

The preparation of financial statements included in this annual report in accordance with IFRS involves certain assumptions and estimates that affect the amounts presented for revenue, expenses, assets and liabilities and disclosures of contingent liabilities in the notes to the financial statements. Therefore, the uncertainty relating to these assumptions and estimates could lead to results that require a significant adjustment to the accounting value of assets or liabilities affected in future periods. Although we review these estimates and assumptions in the ordinary course of business, the presentation of our financial condition and results of operation often requires our management to make judgments regarding the effects on our financial condition and results of operations of matters that are inherently uncertain. Actual results may differ from those estimated under different variables, assumptions or conditions. Note 3 of our Consolidated Financial Statements includes methods used in the preparation of those financial statements and includes a summary of the significant accounting policies. To provide an understanding of how we form the foregoing judgments and estimates, we have summarized certain critical accounting policies below.

Accounting for long-lived assets, including goodwill

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the fair value at their acquisition dates, particularly for assets acquired in business combinations and for determining the useful lives of the assets over which they are to be depreciated or amortized as well as their residual value. We believe that the estimates we make to determine an asset’s useful life and residual value are “critical accounting estimates” because they require our management to make estimates about future technological developments and alternative uses for assets.

An impairment loss exists when the accounting value of an asset or cash-generating unit exceeds its recoverable amount, which is the higher between the fair value less selling costs and the value in use. The estimated fair value less selling costs is based on the information available from transactions involving the sale of similar assets or the market price less additional costs regarding the disposition of such asset. The value in use is based on the model of discounted cash flow. Cash flows are derived from the budget and do not include activities of reorganization for which the Company has not yet been committed or significant future investments that will improve the group of assets of the cash-generating unit subject to the test. The recoverable amount is sensitive to the discount rate used in the method of discounted cash flow as well as to the projected future cash flow and the expected future growth rate used for the purposes of overestimation. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. We record provisions based on reasonable estimates for possible auditing by tax authorities from the jurisdictions in which we operate. The value of these provisions is based on several factors such as experience from previous tax audits and different interpretations of tax regulations by the taxable entity and the

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competent tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the prevailing conditions in the domicile of the Company. As a result, we may be required to pay more than our provisions or to recover less than the assets recognized.

Pension plan benefits

The cost of pension plans with determined benefits and other post-employment medical care benefits and the present value of pension obligations are determined using actuarial valuation methods. The actuarial valuation involves the use of assumptions about discount rates, expected return rates of assets, expected future salary increases, mortality rates, health care costs trend rates and future increases in retirement benefits and pensions. The obligation of a defined benefit is highly sensitive to changes in these assumptions. All assumptions are reviewed at each year-end. The mortality rate is based on mortality tables available in the country. Future increases in wages and retirement benefits and pensions are based on expected future inflation rates for the country and could significantly impact the value of the obligations to provide these benefits.

Fair value of financial instruments

When the fair value of financial assets and liabilities presented on the balance sheet cannot be obtained in active markets, it is determined using valuation techniques, including the method of discounted cash flow. The data obtained for the use of these methods are based as much on the information prevailing in the market as possible. However, when it is not feasible to obtain such information in the market, a certain assumption level is required to establish the fair value. The assumption includes consideration of the data that was used, such as the liquidity risk, credit risk and volatility. Changes in the assumptions regarding these factors could affect the presented fair value of financial instruments.

Provisions for civil and labor contingencies

We record provisions for civil, labor and tax claims. The assessment of the likelihood of loss includes assessing the available evidence, the hierarchy of laws, the available jurisprudence, the most recent court decisions and its materiality in the legal system as well as the evaluation of the case by external counsels. Provisions are reviewed and adjusted to take into account changes in circumstances such as the applicable prescriptive period, results from tax inspections or additional exposure identified based on newly issued court decisions. A significant change in these circumstances or assumptions could result in a corresponding increase or decrease into the amount of our provisions.

Revenue recognition

Customer Loyalty Program

We have a customer loyalty program that allows customers to accumulate points when generating traffic for the use of our mobile services. The accrued points may be exchanged for handsets or services, provided the customer has a minimum stipulated balance of points. The consideration received is allocated to the cost of the handsets or services redeemed at their fair value. The fair value of the points is calculated by dividing the discount value granted as a result of the customer loyalty program by the amount of points needed to carry out the redemption. The fair value accrued on the balances of generated points is deferred and recognized as income upon redemption of points.

For determining the quantity of points to be recognized, we apply statistical techniques, which take into consideration assumptions such as estimated redemption rates, expiration rates, cancellation of points and other factors. These estimates are subject to variations and uncertainties due to changes in the redemption behavior of the customers.

A change in the assumptions regarding these factors could affect the estimated fair value of the points under the customer loyalty program and it could affect the apportionment of revenue among the elements and, as a result, revenues in future years.

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Multiple-element arrangements

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

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

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

Sources of Revenue

The breakdown of our gross operating revenue is presented net of discounts granted. In addition, we categorized our revenue according to the following groups:

- Telephony services

Includes revenues from fixed and mobile telephony highlighting:

- Local: includes the sum of revenues from monthly subscription fees, installation fees, local services, public telephony and fixed-to-mobile revenues (VC1);
- Domestic long-distance: includes the sum of fixed-to-mobile revenues (VC2 and VC3), public long-distance telephony and domestic long-distance;
- International long-distance: includes the sum of revenues from international public telephony and international long-distance; and
 - Usage charges: which include measured service charges for calls, monthly fee and other similar charges;
- Data Transmission and value added services
 - Data Transmission: includes the sum of infrastructure rental revenues and data transmission; and
- Charges for call forwarding, call waiting, text messaging (SMS), call blocking and Data Services, such as WAP and ZAP, downloads and MMS services, which are charged only when the customer's plan excludes these services.

- Interconnection charges

- Interconnection charges (or network usage charges) are amounts we charge other cellular and fixed-line service providers for the use of our network;

- Pay TV

- Includes cable TV services, through satellite, cable or MMDS technology (multichannel multipoint distribution service);

- Sale of goods and equipment
- The sale of wireless devices and accessories;
 - Other Services
- Other services include integrated solution services offered to residential and corporate clients, such as Internet access, private network connectivity and leasing of computer equipment, and

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- Other telecommunications services such as extended service, detects, voice mail, cellular blocker, among others.

Results of Operations

The following table sets forth certain components of our net income for each period ended December 31, 2011 and December 31, 2010, as well as the percentage change of each component. The Company acquired 100% of shares of Vivo Participações S.A. amounting to R\$31,222,630. See Note 1 and Note 4 to our consolidated financial statements. The Company's consolidated financial statements include Vivo Participações S.A. and Vivo S.A. as of April 1, 2011. Vivo Participações S.A. and Vivo S.A. were included in the Company's consolidated financial statements through the full consolidation method.

Because Vivo Participações S.A. and Vivo S.A. are included in our financial statements for only nine months in 2011, our results of operations in 2010 and 2009 are not fully comparable with our results of operations in 2011. We have also made certain changes to our accounting criteria and elected to apply these changes retroactively to part of our financial statements for the year 2010 to make them comparable to our 2011 financial statements. Implementation of these accounting changes did not create any difference for our results of operations or shareholders' equity.

	Year ended December 31,		Percent change	
	2011	2010	2011-2010	
	(in millions of reais)			
Net operating revenue	29,128.7	15,798.2	84.4	%
Cost of services and goods	(14,728.2)	(8,844.8)	66.5	%
Gross profit	14,400.5	6,953.4	107.1	%
Operating expenses:				
Selling	(7,259.7)	(2,964.6)	144.9	%
General and administrative	(1,785.7)	(738.8)	141.7	%
Other operating revenues, net	442.2	312.4	41.5	%
Total operating expenses, net	(8,603.2)	(3,391.0)	153.7	%
Equity in earnings (losses) of associates	–	2.9	(100.0)	%
Operating income before financial expense, net	5,797.4	3,565.3	62.6	%
Net financial expenses	(139.7)	(120.7)	15.7	%
Net income before income and social contribution taxes	5,657.7	3,444.6	64.2	%
Income and social contribution taxes	(1,295.5)	(1,045.8)	23.9	%
Net income	4,362.2	2,398.8	81.8	%
Net income attributable to:				
Shareholders of company	4,355.3	2,398.8	81.6	%
Noncontrolling interests	6.9	–	100.0	%
Net income for year	4,362.2	2,398.8	81.8	%

Net Operating Revenue

Net operating revenues increased by 84.4% to R\$29,128.7 in 2011 from R\$15,798.2 million in 2010. The increase in 2011 reflects the consolidation of R\$13,728.1 million of net operating revenues attributable to Vivo and Vivo Participações for the months of April through December 2011. Our net operating revenues excluding Vivo and Vivo Participações decreased by 2.5% to R\$15,400.6 million in 2011, from R\$15,798.2 million in 2010, primarily due to the reduction in the traffic originated by fixed-line and to the lower fixed-voice customer base, partially offset by the increased international long-distance revenue in comparison to 2010.

Capital Expenditures (Capex)

In 2011, the Company invested R\$5,401.5 million, including the consolidation of Vivo and Vivo Participações for the months of April through December 2011, in projects that sustain its current annual results and position the Company for competitive environment in the medium term representing an increase of 121.2% compared to 2010. As a percentage over net operating revenues the ratio was from 15.5% in 2010 to 18.5% in 2011. A significant portion of resources was

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allocated to allow growth quality in our services. The investments in quality maintenance and expansion of our client base represented 67% of the total amount invested by us in 2011.

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of our data users, both fixed and mobile, or dedicated high speed services for our corporate clients. We are building the future of broadband by increasing the expansion of the optical fiber network in São Paulo. We are also investing in the expansion of the backbone for national data transmission to meet the increase in mobile data traffic throughout the country.

Results of Operations for the Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010

Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 90.5% to R\$43,073.1 million in 2011 from R\$22,609.0 million in 2010, impacted by the incorporation of Vivo Participações and Vivo S.A. which we consolidated as of April 1, 2011. Excluding the effect of such acquisition, which totaled R\$20,349.8 million, gross operating revenue would be R\$22,723.3 million, an increase of 0.5%, or R\$114.3 million, compared to 2010. The variations are explained as follows:

	Year ended December 31,		Percent change
	2011	2010	2011-2010
	(in millions of reais)		
Telephony services	24,331.3	15,366.0	58.3
Data transmission and value added services	10,929.3	5,028.4	117.4
Interconnection charges	3,785.0	523.8	622.6
Pay TV	865.4	587.4	47.3
Sale of goods and equipment	2,135.2	166.5	1,182.4
Other services	1,026.9	936.9	9.6
Gross operating revenue	43,073.1	22,609.0	90.5
Value-added and other indirect taxes	(13,944.4)	(6,810.8)	104.7
Net operating revenues	29,128.7	15,798.2	84.4

Telephony service: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$9,237.8 million, there was a decrease of R\$272.5 million in the revenue, or 1.8%, explained by the reduction in the traffic originated by fixed-line services and to the lower fixed-voice customer base, that was partially offset by the increased international long-distance revenue in comparison to 2010. Fixed-line accesses in service reduced 2.7% in 2011 to 11.0 million from 11.3 million in 2010, due mainly to fixed to mobile substitution.

Data transmission and value added services: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$5,421.0 million, the variation in 2011 totaled R\$479.9 million, an increase of 9.5% compared to 2010. This growth is explained by a significant increase in the customer base for the data access services, mainly due to strong performance in the corporate segment.

Interconnection charges: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$3,375.9 million, the variation in 2011 totaled R\$409.1 million, which was a decrease of 21.9% in relation to 2010

This variation is mainly related to reduction in incoming traffic, given the concentration in selling efforts by the operators for stimulating the on-net mobile traffic.

Pay TV: Revenue from Pay TV in 2011 totaled R\$865.4 million, an increase of 47.3% in the Pay TV's gross revenue in relation to 2010. This variation is related to consolidation of TVA's pay TV business results from the second quarter of 2011.

Sale of goods and equipment: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$1,953.6 million, the variation in 2011 totaled R\$181.6 million, an increase of 9.1% compared to 2010. Revenues from sales of wireless devices and accessories are reported before commissions and promotional discounts, and include value-added taxes. In general, the purpose of wireless device sales is to encourage growth in

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customers and traffic (and not necessarily to generate profits). Accordingly, we subsidize part of the costs of wireless devices for post-paid customers.

Others services: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$31.4 million, the variation in 2011 was R\$58.6 million, an increase of 6.3% compared to 2010. This growth is mainly explained by the increased revenues from the supply of integrated solutions to the corporate segment.

Cost of Services and Goods

The following table sets forth the components of our costs of services and goods sold for 2011 and 2010, as well as the percentage change from the previous year.

	Year ended December		Percent change 2011-2010	
	2011	31, 2010		
	(in millions of reais)			
Cost of goods sold	(1,343.1)	(155.7)	762.6	%
Depreciation and amortization	(3,582.6)	(1,687.4)	112.3	%
Outside services, concession renewal fee and other	(2,616.0)	(1,963.0)	33.3	%
Interconnection charges	(4,537.1)	(4,176.7)	8.6	%
Rent, insurance, condominium fees, and leased lines	(910.5)	(364.3)	149.9	%
Personnel	(380.1)	(257.4)	47.7	%
Taxes	(1,358.8)	(240.3)	465.5	%
Cost of services and goods	(14,728.2)	(8,844.8)	66.5	%

Cost of services and goods increased by 66.5% to R\$14,728.2 million in 2011 from R\$8,844.8 million in 2010. The increase in 2011 reflects the consolidation of R\$6,678.6 million of cost of services and goods attributable to Vivo and Vivo Participações for the months of April through December 2011. Our cost of services and goods excluding Vivo and Vivo Participações decreased 9.0% to R\$8,049.6 million in 2011 from R\$8,844.8 million in 2010. The variations are explained as follows:

Cost of goods sold: Cost of wireless devices and accessories increased by 762.6% to R\$1,343.1 million in 2011, from R\$155.7 million in 2010. The increase in 2011 reflects the consolidation of R\$1,178.7 million of cost of goods sold attributable to Vivo and Vivo Participações for the months of April through December 2011. Our cost of goods sold excluding Vivo and Vivo Participações increased 5.6% to R\$164.4 million in 2011 from R\$155.7 million in 2010 and was mainly due to an increase in expenses related to maintenance of terminals to access the network and acquisition of other related goods, among others.

Depreciation and amortization: Depreciation and amortization expenses increased by 91.7% to R\$3,234.6 million in 2011, from R\$1,687.4 million in 2010. The increase in 2011 reflects the consolidation of R\$1,290.0 million of depreciation and amortization attributable to Vivo and Vivo Participações for the months of April through December 2011. Our depreciation and amortization excluding Vivo and Vivo Participações increased 15.2% to R\$1,944.6 million in 2011 from R\$1,687.4 million in 2010 mainly due to expenses for higher investments in our network and amortization of licences on acquisition of Vivo.

Outside services, concession renewal fee and other: Cost of third-party services increased by 33.3% to R\$2,616.0 million in 2011, from R\$1,963.0 million in 2010. The increase in 2011 reflects the consolidation of R\$527.5 million of outside services and other attributable to Vivo and Vivo Participações for the months of April through December 2011. Our outside services and other excluding Vivo and Vivo Participações increased 6.4% to R\$2,088.5 million in

2011 from R\$1,963.0 million in 2010 mainly due to network maintenance and purchase of TV content.

Interconnection charges: Interconnection charges increased by 8.6% to R\$4,537.1 million in 2011, from R\$4,176.7 million in 2010. The increase in 2011 reflects the consolidation of R\$240.3 million of interconnection charges attributable to Vivo and Vivo Participações for the months of April through December 2011. Our interconnection charges excluding Vivo and Vivo Participações increased 2.9% to R\$4,296.8 million in 2011 from R\$4,176.7 million in 2010 mainly due to an increase in the use of the network for fixed-mobile traffic, among others.

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Rent, insurance, condominium fees, and leased lines: Rent, insurance, condominium fees, and leased lines increased by 149.9% to R\$910.5 million in 2011, from R\$364.3 million in 2010. The increase in 2011 reflects the consolidation of R\$488.7 million of rent, insurance, condominium fees, and leased lines attributable to Vivo and Vivo Participações for the months of April through December 2011. Our rent, insurance, condominium fees, and leased lines excluding Vivo and Vivo Participações increased 15.8% to R\$421.8 million in 2011 from R\$364.3 million in 2010 mainly due to greater expenses with service fees for use of towers and poles and insurance.

Personnel: Personnel expenses increased by 47.7% to R\$380.1 million in 2011, from R\$257.4 million in 2010. The increase in 2011 reflects the consolidation of R\$109.0 million of personnel expenses attributable to Vivo and Vivo Participações for the months of April through December 2011. Our personnel expenses excluding Vivo and Vivo Participações increased 5.3% to R\$271.1 million in 2011 from R\$257.4 million in 2010 mainly due to the collective agreement in this period under which we provided a salary readjustment in September 2011 of approximately 5%.

Taxes: Taxes increased by 465.5% to R\$1,358.8 million in 2011, from R\$240.3 million in 2010. The increase in 2011 reflects the consolidation of R\$1,070.1 million of taxes attributable to Vivo and Vivo Participações for the months of April through December 2011. Our taxes excluding Vivo and Vivo Participações increased 20.1% to R\$288.7 million in 2011 from R\$240.3 million in 2010 mainly due to expenses with the FUST and FUNTEL taxes, due to the growth in the number of new subscribers.

Operating Expenses

The following table sets forth the components of our operating expenses for each of the years ended December 31, 2011 and 2010, as well as the percentage change from the prior year.

Year ended December 31,	Percent change
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