

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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 market price of our common shares and ADSs.

The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation and other policies and regulations have often involved, among other measures, changes in interest rates, tax policies, price and tariff controls, currency devaluation or appreciation, capital controls and limits on imports. Our business, financial condition and results of operations, as well as the market price of our common shares or ADSs, may be adversely affected by changes in public policy at federal, state and municipal levels with respect to public tariffs and exchange controls, as well as other factors, such as:

- the regulatory environment related to our business operations and concession agreements;
- interest rates;
- exchange rates and exchange controls and restrictions on remittances abroad;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;
- tax and regulatory policies and laws;
- economic and social instability; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

For example, the Brazilian government may change its tax policy, such as by changing tax rates or imposing temporary taxes. If overall taxes are increased, we may be unable to immediately recover the difference from our consumers, which may have an adverse effect on our financial condition and results of operations.

Uncertainty over whether the Brazilian government will implement changes in policies or regulations affecting these factors or others may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities market and in securities issued abroad by Brazilian issuers, which could have a material adverse effect on us and on our common shares and ADSs.

Inflation and the Brazilian government's measures to combat inflation may contribute to economic uncertainty in Brazil, adversely affecting us and the market price of our common shares or ADSs.

Inflation and the Brazilian government's measures to combat it have had and may in the future have significant effects on the Brazilian economy and our business. Tight monetary policies with high interest rates may restrict Brazil's growth, the availability of credit and our cost of funding. Conversely, other Brazilian governmental actions, including lowering interest rates, intervention in the foreign exchange market and actions to adjust or fix the value of the *real*, may trigger increases in inflation. The Special Clearing and Settlement System (*Sistema Especial de Liquidação e Custódia*), or "SELIC", the official overnight interest rate in Brazil, equaled 11.65%, 9.90% and 7.14% at the end of 2014, 2013, and 2012, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*).

The Brazilian annual inflation rates, as measured by the Amplified Consumer Price Index (*Índice Nacional de Preços ao Consumidor Amplo*), or "IPCA", the Brazilian annual inflation rates were 6.41%, 5.91% and 5.80% during 2014, 2013 and 2012, respectively. If Brazil experiences increases in inflation, our costs and expenses may rise, we may be unable to increase our tariffs at the same rate to counter the effects of inflation, and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investors' confidence in Brazil, causing a decrease in the market price of our common shares or ADSs.

The devaluation of the real to foreign currencies may adversely affect us and the market price of our common shares or ADSs.

The Brazilian currency experienced frequent and substantial devaluations in relation to the U.S. dollar and other foreign currencies during the decades leading up to the mid-1990s. Throughout this period, the Brazilian government implemented various economic plans and exchange rate policies, including sudden devaluations, periodic mini-devaluations (during which the frequency of adjustments ranged from daily to monthly), floating exchange rate systems, exchange controls and dual exchange rate markets. From time to time since that period, there have continued to be significant fluctuations in the exchange rate between the Brazilian *real* and the U.S. dollar and other currencies. For example, the *real* appreciated 13.8%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively. In 2008, primarily as a result of the global financial crisis, the *real* depreciated 32.0% against the U.S. dollar and closed the year at R\$2.337 per US\$1.00. The *real* strengthened again by 25.5% in 2009 and 4.3% in 2010, but depreciated against the U.S. dollar by 12.6% in 2011, 8.94% in 2012, 14.63% in 2013, and 13.39% in 2014. On December 31, 2014, 2013 and 2012, the *real*/U.S. dollar exchange rate was R\$2.6562, R\$2.343 and R\$2.043 per US\$1.00, respectively. There can be no assurance that the *real* will not depreciate further against the U.S. dollar. As of April 22, 2015, the commercial selling rate as reported by the Central Bank was R\$3.0186 per US\$1.00.

Depreciation of the *real* against the U.S. dollar could create inflationary pressures in Brazil and cause increases in interest rates, which could negatively affect the growth of the Brazilian economy as a whole and harm our financial condition and results of operations, curtail our access to financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar could also lead to decreased consumer spending, deflationary pressures and reduced economic growth.

In the event of a significant devaluation of the *real* in relation to the U.S. dollar or other currencies, our ability to meet our foreign currency denominated obligations could be adversely affected because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have debt denominated in foreign currencies, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had a total foreign currency denominated debt of R\$4,346.3 million as of December 31, 2014 and we anticipate that we may incur additional amounts of foreign currency denominated debt in the future. In 2014, our results of operations were negatively affected by the 13.39% depreciation of the *real* against the U.S. dollar, and an appreciation of the *real* against the yen by 0.45% which led to a R\$345.1 million negative impact on our foreign exchange result, net. We do not currently have any derivative instruments in place to protect us against a devaluation of the *real* in relation to any foreign currency. A devaluation of the *real* may adversely affect us and the market price of our common shares or ADSs. For more information, see Note 5(a) of our 2014 financial statements.

For further information on exchange rate instability impacts, see “Item 5.B. Liquidity and Capital Resources–Capital Sources–Indebtedness Financing–Financial Covenants”.

Developments and the perception of risk in other countries, especially in the United States and in emerging market countries, may adversely affect the market price of Brazilian securities, including our common shares and ADSs.

The market price of securities of Brazilian companies is affected to varying degrees by economic and market conditions in other countries, including the United States and other Latin American and emerging market countries. Although economic conditions in these countries may differ significantly from economic conditions in Brazil, investors’ reactions to developments in these other countries may have an adverse effect on the market price of securities of Brazilian issuers. Crises in other emerging market countries or economic policies of other countries may diminish investor interest in securities of Brazilian issuers, including ours. This could adversely affect the market price of our common shares or ADSs, and could also make it more difficult for us to access the capital markets and finance our operations in the future, on acceptable terms or at all.

The global financial crisis has caused significant consequences, including in Brazil, such as stock and credit market volatility, unavailability of credit, higher interest rates, a general slowdown of the world economy, volatile exchange rates, and inflationary pressure, among others, which have and may continue to, directly or indirectly, materially and adversely affect us and the price of securities issued by Brazilian companies, including our common shares and ADSs.

Risks Relating to Our Control by the State of São Paulo

We are controlled by the State of São Paulo, whose interests may differ from the interests of non-controlling, including holders of ADSs.

As it owns the majority of our common shares, the State is able to determine our operating policies and strategy, control the election of a majority of the members of our board of directors and appoint our senior management. As of April 22, 2015, the State owned 50.3% of our outstanding common shares. Both through its control of our board of directors as well as by enacting State decrees, the State has in the past directed our company to engage in business activities and make expenditures that promoted political, economic or social goals, but that did not necessarily enhance our business and results of operations. The State may direct our company to act in this manner again in the future. These decisions by the State may not be in the interests of our non-controlling, including holders of ADSs. See “Item 5.A. Operating and Financial Review and Prospects–Certain Transactions with Controlling Shareholder”.

Following the elections for State governor in 2014, the re-elected governor appointed Mr. Jerson Kelman as our Chief Executive Officer in January 2015, and Mr. Benedito Pinto Ferreira Braga Junior, the Secretary of State for the State Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*), was elected our Chairman for the current board of directors’ term of two years, ending in April 2016. Future changes in policy by State government may cause changes in all or some of the members of our management, which may have a material adverse effect on our business and results of operations.

The State and some State entities owe us substantial unpaid debts. We cannot assure you as to when or whether the State will pay us.

Historically, the State and some State entities have delayed payment of substantial amounts owed to us related to water and sewage services. Additionally, the State also owes us substantial amounts related to reimbursements of State-mandated special retirement and pension payments that we make to some of our former employees for which the State is required to reimburse us. As of December 31, 2014, the State owed us R\$50.8 million for water and sewage services.

With respect to payment of pensions on behalf of the State, we had a non-contested reimbursement credit in the amount of R\$155.5 million as of December 31, 2014 for reimbursement of additional retirement and pension benefits, and a contested credit amount of R\$1,479.7 million as of the same date. We do not record this contested amount as a reimbursement credit for actuarial liability due to the uncertainty of payment by the State. In addition, as of December 31, 2014, we had a provision for an actuarial liability in the amount of R\$2,053.5 million with respect to future supplemental pension payments for which the State does not accept responsibility. On March 18, 2015, we, the State and DAEE, with the intervention of the Department of Sanitation and Water Resources, executed a term of agreement, in the amount of R\$1,012.3 million, of which R\$696.3 million refers to the principal amount and R\$316.0 million refers to the monetary adjustment of the principal through February 2015. For a detailed discussion of this agreement, see “Item 7.B. Related Party Transactions–Agreements with the State of São Paulo” and Note 31 of our 2014 financial statements.

We have entered into agreements with the State to settle the overdue amounts that relate to water and sewage services. For a detailed discussion of these agreements, see “Item 7.B. Related Party Transactions, Agreements with the State of São Paulo” and Note 10 of our 2014 financial statements.

Although the State has complied with agreements negotiated with us in past years, we cannot assure you when or if the State will pay the contested credit amount, which is still under discussion, and the remaining overdue amounts it owes us. The amounts owed to us by the State for water and sewage services and reimbursements for pensions paid may increase in the future.

In addition, certain municipalities and other government entities also owe us payments. See “Risks Relating to Our Business—We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities”.

A state controlled company that has a concession to produce energy in the Guarapiranga and Billings reservoirs may require us to pay damages for the use of water from these reservoirs.

Empresa Metropolitana de Águas e Energia S.A., or EMAE, may require us to financially compensate them for our use of water from the Guarapiranga and Billings reservoirs, which they view as a loss of electricity that could otherwise be generated and sold. As such, EMAE has requested compensation from us. In the event water from these reservoirs were no longer made available to us, we would have to bring water in from locations farther away, which would increase the risk of not being able to provide adequate service in the region and increase the costs of water transportation.

The majority shareholder of both EMAE and us, the State, may force a resolution regarding the dispute of water use from the Guarapiranga and Billings reservoirs, which may have an adverse effect on our business. Currently, this matter is under judicial review due to various actions brought by EMAE. On April 10, 2014, we issued an Announcement to the Market to communicate that we are negotiating with EMAE regarding a potential future agreement. However, no adjustment has been confirmed and no agreement has been executed by either party as of yet.

Additionally, in the event we are required to make payments and compensation, our cash position and overall liquidity may be adversely affected.

We may be required to pay substantial charges for the use of reservoirs that are not our property.

We use the Billings and Guarapiranga reservoirs in order to provide water services. We are entitled to withdraw water from these reservoirs under a grant from DAEE. We are not currently charged for the use of these reservoirs and are uncertain as to whether we will continue to be able to use the reservoirs without paying charges or what the likely fee scale would be if one were imposed.

We may also be required to pay additional maintenance and operational costs to utilize these reservoirs. If we were required to pay substantial charges or additional maintenance or operational costs for our use of these reservoirs, we could be materially and adversely affected.

Risks Relating to Our Business

The measures we took to mitigate the effects of the drought resulted in a significant decrease in the volume of water billed and revenues from services we provide, which had a material adverse effect on our company and that may worsen if the drought escalates in severity.

We experience decreases in our water availability from time to time due to droughts. The southeastern region of Brazil, particularly the southern region of Minas Gerais State and the Piracicaba, Capivari and Jundiaí river basin, or “PCJ River Basin” (from which we extract the water used in the Cantareira System), and the northern area of the São Paulo metropolitan region have been experiencing below average rainfall since 2012. In late 2013 and throughout 2014 rain levels and water inflow into the reservoirs reach record low levels in 84 years of recorded rainfall in the region. During the rainy season, from October 2014 to January 2015, the level of rainfall in the region remained significantly below average, although it reached above average levels in February and March 2015. We expected the water levels in the Cantareira System to recover, but given the already low levels due to the water shortage during the summers of 2013 and 2014, the amount of rainfall in the region during the rainy season from October 2014 to March 2015 was not enough to restore the reservoirs to sufficient levels.

The depletion of water storage is worse in the Cantareira System, the largest system of the São Paulo metropolitan region. As a result of the drought and low water volume in the Cantareira System, DAEE and ANA have, since March 2014, continuously reduced the amount of water we are permitted to extract from this system. In March 2015, we received authorization to extract only 13.5 cubic meters per second, or m³/s, from the PCJ River Basin, compared to the period prior to March 2014 when we were allowed to extract up to a total of 31 m³/s.

In order to balance supply and demand despite the restricted water availability, we have adopted and will continue adopting a series of measures, including: (i) using water from other production systems to serve consumers originally supplied by the Cantareira system; (ii) to offer discounts (bonus) to consumers that would use below average amounts of water, compared to average consumption; (iii) reducing pressure in the water distribution lines in order to decrease leakage; (iv) reducing the volume of water sold to municipalities that own their distribution network; and (v) to use pumps in order to extract water located below the intakes of the Cantareira system, from the so-called “technical reserve”, which has never before been used to serve the population. See “Item 4.B. Business Overview—The Current Water Crisis”.

If the drought continues and reservoir levels remain low, we cannot guarantee that the water consumption incentive program (the bonus program) and other mitigation measures we took in 2014 and are taking in 2015 will be discontinued. In case of this unfortunate scenario, we are unsure whether we will be able to continuously serve the entire population of our service area, which is a possibility that, in addition to a reduction in revenue, may also affect our reputation. Furthermore, we cannot guarantee that at the end of the bonus program, per capita consumption of water will return to levels that existed prior to the current water crisis. A lower consumption per capita may adversely affect our business and results in the future, including if ARSESP does not approve future price increases to offset the billed volume decline.

The drought has prompted a continuous reduction in the volume of water billed and thus a reduction in revenue. In 2014, the water volume billed decreased 3.1% and the gross operational revenue fell by 6.7% compared to 2013. Therefore, there was and may continue to be a negative impact on our financial ratios linked to revenue, such as the debt to EBITDA ratio. We are required to maintain certain financial ratios at specified levels pursuant to restrictions and covenants of our existing debt agreements and failure to maintain these ratios may lead to a default under such agreements. Breach of any such covenant may result in a default under certain of our debt agreements and, due to customary cross-default provisions, could permit some of our creditors to accelerate our indebtedness unless we are able to renegotiate the terms of these agreements or receive waivers from the affected creditors. If such events were to occur, our financial condition would be adversely affected. See “Item 5.B. Liquidity and Capital Resources—Indebtedness Financing—Financial Covenants”.

Due to the crisis, we have been obligated and will continue to be obligated to make a series of short-term and medium-term emergency investments to continue providing water to the population, which resulted in an increase in our costs and changes in our capital expenditure. If the current water crisis does not end and court orders prevent us from concluding the construction of works related to the emergency investments designed to increase the bulk water availability for our production systems in 2015, we may need to take more drastic measures, including implementing a water rotating rationing scheme, which will impose a hardship on the population we serve. Such drastic measures may adversely and materially affect our business.

Assuming that the hydrological stochastic process is stationary, the 2014-2015 drought is a rare event (very low probability). However, the 2014-2015 drought may be an outcome of a non-stationary process, either due to climate or soil use change. In this case, the historic time series of inflows to the reservoirs would be of limited use in estimate the probability of future rare events. That is, we would be limited in our ability to evaluate the likelihood that the drought will persist. This uncertainty may impair our ability to plan and react to future events, which may adversely and materially affect our business. For more information about the water crisis, see "Item 4.B. Business Overview–The Current Water Crisis".

We are exposed to risks associated with the provision of water and sewage services.

Our industry is affected by the following risks relating to the provision of water and sewage services:

- We are dependent upon energy supplies to conduct our business. Any shortages or rationing of energy may prevent us from providing water and sewage services and may also cause material damage to our water and sewage systems when we resume operations. We anticipate incurring significant increases in our energy expenses in 2015. In addition, we may not be able to pass on any significant increases in energy tariffs to our customers. In March 2015, we filed with ARSESP an extraordinary revision request based on the decline in the volume of water due to the water crisis and based on the unexpected increase in electricity tariffs. See "Item 4.B. Business Overview–Energy Consumption".
- In addition to the risks discussed under "– New laws and regulations relating to climate change and changes in existing regulation, as well as the escalation of the physical effects of extreme weather events, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us," we are exposed to various weather-related risks, since our financial performance is closely linked to climate patterns. The possible increase in the frequency of extreme weather conditions in the future may adversely affect the water available for abstraction, treatment, and supply. Droughts could adversely affect the water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue derived from water supply services. An increase in heavy rainfall could impact the regular operation of water sources, including abstraction of water from our dams due to increased soil erosion, silting, and runoff of pollutants that affect the aquatic ecosystems. See "Item 4.B. Business Overview–The Current Water Crisis".
- We depend on a water right issued by DAEE – ANA in order to extract water from the Cantareira System. The water right was renewed in 2004 and would have expired in August 2014. However, due to current climate conditions, particularly the severe drought, the water right was extended until October 31, 2015. We are in the process of gathering technical and analytical data to present to ANA and DAEE our proposal to renew it before the end of April 2015. The terms of this water right will define the volume of water that we will be authorized to extract from the PCJ River Basin to provide to the São Paulo metropolitan region. The current drought may affect the decision of ANA and DAEE. Therefore, we cannot guarantee that we will be able to simply extend in a timely manner the current water right because there is no way to predict whether the current water crisis will persist, worsen or be resolved in the immediate future.
- In addition to the risks discussed under "–The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us," we may not be able to increase our tariffs on a timely basis, or at all, in order to pass on increases in inflation or operating expenses, including taxes, to our customers. These constraints may have an adverse effect on our ability to fund our capital expenditure program and financing activities and to meet our debt service requirements. See "Item 5.A. Operating and Financial Review and Prospects–Factors Affecting Our Results of Operations–Effects of Tariff Increases".

- The increasing degradation of watershed areas may affect the quantity and quality of water available to meet demand from our customers. See “Item 4.A. History and Development of the Company–Capital Expenditure Program” and “–Main Projects of Our Capital Expenditure Program”.
- The state and federal government agencies that manage water resources could impose substantial charges for the abstraction of water from bodies of water and the discharge of sewage. We may not be able to pass these charges on to our customers. See “Item 4.B. Business Overview–Government Regulation–Water Usage”.

Any of the above may have a material adverse effect on us.

Current regulatory uncertainty, especially with regard to implementation and interpretation of the Brazilian Basic Sanitation Law, may have an adverse effect on our business.

Our operations in the state of São Paulo occur both in locations where the planning, monitoring and tariff regulation of basic sanitation services are responsibilities of the municipalities and in locations where such responsibilities are shared between the State and municipalities but remain subject to the jurisdiction of the latter.

The Basic Sanitation Law No. 11,445/2007 went into effect in early 2007, and although Federal Decree No. 7,217/2010 (as modified by Federal Decree No. 8,211/2014) implemented a series of new principles under the Basic Sanitation Law in 2010, the full implementation of a number of its provisions remains subject to regulations that the federal government has not yet published. Moreover, the Basic Sanitation Law requires that the federal government, states and municipalities establish independent regulators who monitor basic sanitation services and regulate tariffs. In compliance with this law, the state of São Paulo established ARSESP in 2007. Currently, our regional and local operations, including tariff regulation, are monitored and regulated by ARSESP, and the remainder of our operations is in the process of negotiating new contractual bases. Regulatory agencies determine tariff increases for our water and sewage services, on which our results of operations and financial condition are highly dependent. As a result, we cannot anticipate all the effects that the Basic Sanitation Law and the decree will have on our business and operations, if any.

In 2009, ARSESP enacted rules regarding the following: (i) general terms and conditions for water and sewage services; (ii) procedures for communication regarding any failure in our services; (iii) penalties for deficiencies in the provision of basic sanitation services; and (iv) procedures for confidential treatment of our customers’ private information. The implementation of these and other more recent rules will particularly impact our commercial and operations processes, and may adversely affect us in ways we cannot currently predict. Implementation of these rules started in 2011 and is expected to continue for the next few years. For more information, see “Item 4.B. Business Overview–Government Regulation–ARSESP Rule Enactments”.

In 2011, ARSESP altered the standard contract that we are required to use in our relationships with retail customers. This alteration requires that invoices be sent to the consumer of the service rather than the owner of the property. We estimate that this change will affect ongoing legal disputes, particularly those regarding collection procedures, as well as business discussions in general. However, since this change is still being implemented, we are not currently able to predict its impact on our business.

In August 2012, ARSESP issued Resolution No. 346/2012, which established that users should be compensated for any interruptions in water supply. Implementation of this regulation has been suspended pending further technical discussions. In 2013, ARSESP held public consultations that resumed technical discussions on the subject, but the new resolution that will replace Resolution No. 346/2012 has not yet been published.

The Basic Sanitation Law No. 11,445/2007 also allows municipalities to create their own regulatory agencies rather than being regulated by ARSESP. As a result, a number of municipalities have created their own regulatory agencies. If other municipalities create new agencies or retain regulatory powers, we may be subject to their regulation and to any limitations on our services that such agencies may set. We are involved in legal proceedings that dispute the authority of these new agencies to regulate and monitor our local contracts and our operations in metropolitan regions and urban clusters instituted by the State. We cannot foresee any changes that any such new agencies may implement regarding our business. If any such changes are unfavorable, they could materially and adversely affect us.

The State of São Paulo, pursuant to Article 25, Section 3 of the Brazilian Constitution, enacted the State Complementary Law, or “LCE”, creating the metropolitan regions of São Paulo (LCE No. 94/1974), Baixada Santista (LCE No. 815/1996), Campinas (LCE No. 870/2000), Vale do Paraíba and Litoral Norte (LCE No. 1,166/2012), Sorocaba (LCE No. 1,241/2014), and the urban clusters of Jundiaí (LCE No. 1,146/2011) and Piracicaba (LCE No. 1,178/2012). These areas incorporate independent municipalities that modify the exercise of their constitutional competencies, including those related to basic sanitation services, and increase the number of judicial disputes concerning the regulation and oversight of services in areas currently served by us and regulated by ARSESP. We cannot anticipate the result of these judicial disputes and the adverse material effects that may result from them, especially if the rules of regulation and monitoring of services issued by municipal agencies come to coexist with those already published by ARSESP and implemented into our operational and corporate processes since 2011.

For more information on ARSESP regulations, see “Item 4.B. Business Overview–Tariffs–Government Regulation–Tariff Regulation in the State of São Paulo” and “ARSESP Rule Enactments–Consumer Relations in the State of São Paulo”.

New joint entities have been, and may continue to be, set up to oversee basic sanitation services in metropolitan regions, including the São Paulo metropolitan region. We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other metropolitan regions we operate or what effect this may have on our business, financial condition or results of operations.

There are some pending cases before the Brazilian Supreme Court regarding whether the right to execute concession and program agreements in metropolitan regions belongs to the State or the municipal government. On February 28, 2013, the Brazilian Supreme Court decided a then pending case on this matter related to the state of Rio de Janeiro. A majority of the court held that the state of Rio de Janeiro must set up new entities to oversee the planning, regulation and auditing of basic sanitation services in the metropolitan region with the non-partisan participation of all the municipalities located in the metropolitan region.

On March 6, 2013, the court ruled that this holding would come into effect in the state of Rio de Janeiro after a remaining appeal of its holding is decided. The court’s holding represents a new paradigm in the management and provision of services. The Supreme Court has yet to clarify the effects and extension of its decision. The São Paulo metropolitan region (including the municipalities to which we provide water on a wholesale basis), to which a decision on such pending or new cases may apply, accounted for 70.0% of our gross revenue from services in 2014 (excluding revenues relating to the construction of concession infrastructure).

In January 2015, the Federal Government issued the Metropolitan Bylaws (Law No. 13,089/2015) which establishes general guidelines for the planning, management and performance of public interest projects in metropolitan regions and in urban clusters instituted by the states; the general planning standards for integrated urban development and other international governance instruments; and the criteria to receive federal loans for initiatives related to international governance in the field of urban development.

We cannot predict how the shared management of these operations will be carried out in the São Paulo metropolitan region and other municipalities in which we operate or what effect the shared management may have on our business, financial condition or results of operation.

The terms of our agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us.

The provision of water and sewage services in the city of São Paulo accounted for 50.4% of our gross operating revenues (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2014.

On June 23, 2010, the State and the city of São Paulo executed an agreement in the form of a *convênio* with our and ARSESP’s consent, under which they agreed to manage the planning and investment for the basic sanitation system of the city of São Paulo on a joint basis. In application of the *convênio*, we executed a separate contract dated June 23, 2010 with the State and the city of São Paulo, to regulate the provision of these services for the following 30 years. Among other principal terms of this separate agreement, we must transfer 7.5% of the gross revenues we derive under the *convênio* and subtract (i) COFINS and PASESP taxes and (ii) unpaid bills of publicly owned properties in the city of São Paulo, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), established by Municipal Law No. 14,934/2009. See “Item 7.B. Related Party Transactions–Agreement with the State and the city of São Paulo” for further discussion of the principal terms of the *convênio* and principal terms of the separate contract we executed in application of the *convênio*.

Because we were not previously required to transfer 7.5% of the gross revenues obtained from providing sanitation services in the municipality of São Paulo to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure as established under the *convênio*, our existing tariff and adjustment formulas do not account for this requirement. Nonetheless, ARSESP is required to ensure that the tariffs will adequately compensate us for the services we provide, which includes the pass-through to tariffs.

In March 2013, ARSESP issued Resolution No. 407/2013 authorizing us to pass through to the service bill the 7.5% transfer to the São Paulo Municipal Sanitation and Infrastructure Fund as a legal charge, as defined by municipal legislation. However, pursuant to the Program Contracts and the Sewage and Water Supply Service Contracts, this charge must be considered in the tariff revision.

In April 2013, ARSESP issued Resolution No. 413/2013, which suspended Resolution No. 407/2013 until the tariff revision process is concluded, thereby postponing our authorization to pass the charge through to consumers on the service bill. The postponement of Resolution No. 407/2013 was due to a request from the São Paulo State Government to analyze, among other things, methods of reducing the impact on consumers.

In April 2014, ARSESP issued Resolution No. 484/2014, (further ratified by Resolution No. 520, issued November 2014), which establishes the conclusion of the tariff revision. However, the State and the city of São Paulo requested to maintain the suspension of ARSESP Resolution No. 407/2013, postponing our authorization to pass the charge through to consumers on the service bill, until the revision of our contract with the State and city of São Paulo is concluded.

In May 2014, ARSESP issued Resolution No. 488/2014, which maintained the suspension of Resolution ARSESP No. 407/2013 until the results are obtained in the revision of the contract signed between us, the city and the State of São Paulo, thereby delaying the authorization to pass the charge through to consumers on the service bill. We cannot know when we will be able to pass the 7.5% charge on to consumers through the service bill.

As of December 31, 2014, we have transferred approximately R\$1.5 billion to the São Paulo Municipal Fund for Environmental Sanitation and Infrastructure since 2010. We cannot assure you when and how we will recover this amount.

We cannot assure you that this charge will eventually be passed through to customers or that the continued delay in passing this charge through to customers will not further affect our financial condition. For additional information on ARSESP regulations, see "Item 4.B. Business Overview–Government Regulation–Tariff Regulation in the State of São Paulo" and "Item 4.B. Business Overview–Government Regulation–Public Consortia and Cooperation Agreement Law for Joint Management".

We currently lack formal agreements or concessions with 54 of the municipalities to which we provide service, and 38 of our existing concession agreements will expire between 2015 and 2030. We may face difficulties in continuing to provide water and sewage services in return for payment in these and other municipalities, and we cannot assure you that they will continue to purchase services from us on the same terms or at all.

As of December 31, 2014, we held formal 30-year agreements with 274 municipalities (including the city of São Paulo) of the 364 municipalities we serve. We entered into 8 of these agreements during 2014. The 274 municipalities with which we had formal agreements at year-end accounted for 73.4% of our total revenues for the year ended December 31, 2014, and 65.7% of our intangible assets as of December 31, 2014. Of the 54 served municipalities for which we lacked formal agreements at year-end, we were in the process of actively renegotiating with all municipalities, including the municipality of Santos. Together, these 54 municipalities accounted for 16.5% of our total revenues for the year ended December 31, 2014 and 23.8% of our intangible assets as of that same date. In December 2014, none of our existing concession agreements expired. Between 2015 and 2030, 38 of our existing concession agreements will expire. These 38 concession agreements accounted for 8.7% of our total revenues for the year ended December 31, 2014 and 8.0% of our intangible assets as of that same date.

We may not be able to continue providing service on current terms, or at all, in the municipalities for which we do not have formal agreements, including the 54 for which we are renegotiating expired agreements. In particular, the lack of formal concessions or contractual rights in these municipalities means that we may not be able to enforce our right to continue to provide services and we may face difficulties in being paid on a timely basis, or at all, for the unamortized assets. If we are successful in renegotiating the expired agreements, or executing formal agreements with the municipalities for which we have never had agreements, those agreements may not contain terms that are as favorable as those under which we currently operate. We cannot make any such assumption because the Basic Sanitation Law prevents us from planning, regulating and monitoring our services and it requires more stringent control by the municipalities or by ARSESP. The municipalities for which we do not have formal agreements may choose to start providing water and sewage services directly themselves, or may run public tenders to select another provider. They may set eligibility requirements for which we do not qualify and, if we do qualify and participate in these tenders, we may not win.

Any of these events could have a material adverse effect on our business, results of operations and financial condition. See “Item 4.B. Business Overview—Our Operations” and “Item 4.B. Business Overview—Government Regulation—Public Consortia and Cooperation Agreement Law for Joint Management”.

In the municipalities with which we did not have formal agreements by December 31, 2014, we continued operating with municipal approval or with judicial support.

Municipalities may terminate our concessions before they expire in certain circumstances. The indemnification payments we receive in such cases may be less than the value of the investments we made.

Municipalities have the right to terminate our concessions if we fail to comply with our contractual or legal obligations or if the municipality determines in an expropriation proceeding that early termination of the concession is in the public interest. If a municipality terminates our concession, we are entitled to be indemnified for the unamortized portion of our investments.

The Basic Sanitation Law provides that on early termination of a concession, the entity that provides sanitation services should carry out a valuation of the assets that relate to the services provided, in order to calculate the unamortized portion of its investments. This valuation uses the criteria defined in the service contract or, in the absence of a contract, is based on customary practice with respect to the services for the preceding 20 years. The resulting indemnification payment may be less than the remaining value of the investments the sanitation service provider made. Nonetheless, the indemnification payments may not occur voluntarily by the municipality, creating an opportunity for judicial dispute. If faced with such a situation, there is the risk that the judicial decision will consider the indemnification as undue or set it at a lower value than that of our investments.

With regards to our operations that lack contracts or have indefinite or overdue timeframes, the Basic Sanitation Law reduced the maximum time period for payment of indemnification in such cases to four years. This provision applies to concession agreements entered into prior to the enactment of the Basic Sanitation Law only to the extent that the concession agreement does not contain a contractual indemnification provision, or we have not otherwise entered into an agreement with the municipality with regard to such early termination. These provisions have not yet been tested by the courts and we are therefore unable to predict the effect of the Basic Sanitation Law on our rights to indemnification for the early termination of any particular concession.

In 1997, the municipality of Santos enacted a law in order to repossess our water and sewage systems in Santos. We adopted the necessary judicial measures to contest this and we filed an ordinary suit against the municipality of Santos, after which the appellate court issued a decision in our favor. The proceedings were terminated and we have continued operations in the municipality.

In 1995, the municipality of Diadema terminated its concession agreement with us and did not pay the indemnification for our investments. We commenced legal proceedings against the municipality, which were settled in 1996, but the municipality did not comply with the terms of the settlement. In December 2008, we entered into a memorandum of understanding with the State of São Paulo, the municipality of Diadema and the State Secretariat for Sanitation and Water Resources, previously known as the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*). Under this memorandum of understanding the parties agreed to negotiate a solution to all outstanding amounts, and we agreed to drop the collection proceedings we had filed against the municipality.

In March 2014, we entered into an agreement with the municipality of Diadema to resolve water supply-related debt and indemnities. This agreement includes a contract to resume direct supply of water and sewage services to the municipality of Diadema for 30 years. Guarantees are in place if the municipality of Diadema breaches the agreement entered into with us.

Other municipalities may seek to terminate their concession agreements before the contractual expiration date. If this occurs and we do not receive adequate indemnification for our investments, or the indemnification is paid over an extended period, we may suffer material harm to our financial position.

We may face difficulties in collecting overdue amounts owed to us by municipalities to which we provide water on a wholesale basis and municipal government entities.

As of December 31, 2014, our total accounts receivable was R\$4,388.6 million. Of this amount, certain municipalities to which we provide water on a wholesale basis owed us R\$2,158.8 million, and certain municipal government entities owed us R\$726.2 million. Of the total amount owed by municipalities, R\$279.8 million was overdue by between 30 and 360 days and R\$1,832.7 million was overdue by over 360 days.

The Brazilian courts are entitled to obligate us to continue to supply water to these municipalities, even when we have not received payments due to us. We have no way of ensuring that negotiations with these municipalities or legal action taken against the municipalities will result in payments being made. Some entities associated with municipal governments for which we provide services also do not make regular payments. We cannot guarantee if or when these entities will make payments on a regular basis or pay the amounts owed to us. If the municipalities and related entities do not pay the amounts owed to us, we may experience a material adverse effect on our financial position.

Any failure to obtain new financing may adversely affect our ability to continue our capital expenditure program.

Our capital expenditure program will require resources of approximately R\$13.5 billion in the period from 2015 through 2019. In 2014 we recorded R\$3.2 billion in capital expenditures.

In addition to cash generated by our operations, we have funded and intend to continue funding these capital expenditures with issuances of debt securities in the domestic and international capital markets as well as borrowings in Brazilian reais and foreign currencies. A significant portion of our financing needs is obtained through long-term financing at attractive interest rates from Brazilian federal public banks, multilateral agencies and international governmental development banks. If the Brazilian government changes its policies regarding the financing of water and sewage services, or if we fail to obtain long-term financing at attractive interest rates from domestic and international multilateral agencies and development banks in the future, we may not be able to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on our business and financial condition.

Furthermore, Brazilian public and private financial institutions are legally limited up to a certain percentage of their shareholder's equity to provide loans to public sector entities, including, for example, us. These limitations could adversely affect our ability to continue our capital expenditure program.

Our debt includes financial covenants that impose indebtedness limits on us. Our failure to comply with these covenants could seriously impair our ability to finance our capital expenditure program, which could have a material adverse effect on us. For further information on these covenants, see "Item 5.B. Liquidity and Capital Resources—Capital Sources—Indebtedness Financing—Financial Covenants".

Compliance with environmental laws and environmental liability payments could have a material adverse effect on us.

We are subject to extensive Brazilian federal, state and municipal laws and regulations relating to the protection of human health and the environment. These laws and regulations set potable water standards and limit or prohibit the discharge or spillage of effluent produced in our operations, particularly raw sewage. We occasionally suffer accidents such as leakages or breaks in pipes that could lead to liability for damages under environmental law. We could be subject to various types of criminal, administrative and civil proceedings for non-compliance with environmental laws and regulations that could expose us to penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. The scope and enforcement of environmental laws in Brazil are becoming more stringent, and our capital expenditures and environmental compliance costs may increase substantially as a result. These expenses may lead us to reduce expenditure on strategic investments, which could harm our business. In addition, Brazilian courts are enforcing environmental laws more stringently than in the past, which may result in fines or liability for damages that are significantly higher than those we currently anticipate. We are party to various environmental proceedings that could have a material adverse impact on us, including civil processes and investigations relating to the release of untreated sewage into waterways and the disposal of sludge generated by treatment plants. More recently, we are involved in proceedings challenging the extraction of water resources in the face of the current water crisis. Any unfavorable judgment in relation to these proceedings, or any material unforeseen environmental liabilities, may have a material adverse effect on us. For further information on these proceedings, see "Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings". For further information on investments in environmental programs, see "Item 4.A. History and Development of the Company—Main Projects of our Capital Expenditure Program", "Item 4.B. Business Overview—Sewage Treatment and Disposal", "Item 4.B Business Overview—Environmental Matters" and "Item 4.B. Business Overview—Environmental Regulation". For further information on the Water Crisis, see "Item 4.B. Business Overview—The Current Water Crisis".

New laws and regulations relating to climate change and changes in existing regulation, as well as the escalation of the physical effects of extreme weather events, may result in increased liabilities and increased capital expenditures, which could have a material adverse effect on us.

Current federal, state and municipal laws and regulations on climate change establish global goals, which we will have to meet, concerning greenhouse gas emissions and this may require us to increase our investments in order to comply with these laws. Currently, however, if we increase our capital expenditures for this purpose, we may be required to reduce expenditures on other strategic investments.

In addition, climate change may lead to increases in extreme weather events such as droughts or torrential rain, which may affect our ability to deliver our services and require us to strengthen our actions such as:

- investing in seeking new water sources located further from major consumer centers;
- investing in new technologies;
- improvement of water conservation practices and demand management alternatives such as economic mechanisms or educational programs; and
- increasing the capacity of our water reserves.

A rise in sea level could result in increased salinity in the river estuaries where we abstract water, which could affect water treatment in these areas. Rising sea levels could also cause damage in our sewage collection network.

Additionally, increases in air temperature could affect demand for water. The escalation of extreme weather events may also further reduce water levels in the reservoirs that power hydroelectric power plants in Brazil, which may cause energy shortages and increase electricity prices, which may adversely affect our costs and operations.

We cannot predict all of the effects of extreme weather events, therefore making it difficult to predict necessary investments. We have not provisioned any funds for climate change events as current technology and scientific understandings of climate change make it difficult to predict potential expenses and liabilities.

We may be required to adopt new norms to improve our energy use efficiency and minimize the release of greenhouse gases when we renew the environmental licenses for the systems already in operation or when we obtain environmental licenses for new enterprises.

We may need to make substantial new expenditures, either to comply with new environmental regulations linked to climate change or to prevent or correct the physical effects of extreme weather events, any of which could have a material adverse effect on our results of operations.

For more information, see “Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG) Emissions” and “Item 4.B. Business Overview—Energy Consumption”.

Any substantial monetary judgment against us in legal proceedings may have a material adverse effect on us.

We are party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, tax, labor, corporate and environmental issues. As of December 31, 2014, the total value of all outstanding claims against us was R\$41,964.6 million (net of R\$362.5 million in escrow deposits). A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on our financial condition. We have provisioned a total aggregate amount of R\$1,220.3 million (net of escrow deposits) as of December 31, 2014 to cover probable losses related to legal proceedings. This provision does not cover all legal proceedings involving monetary claims filed against us and it may be insufficient to cover our liabilities related to these claims. Any unfavorable judgment in relation to these proceedings may have a material adverse effect on us. For more information, see “Item 8.A. Financial Statements and Other Financial Information—Legal Proceedings”.

Risks Relating to Our Common Shares and ADSs

We may not always be in a position to pay dividends or interest on shareholders’ equity and ADSs.

Depending on our future results, our shareholders may not receive dividends or interest on own capital if we do not generate a profit. Despite the requirement to distribute a minimum of 25% of our annual net income to shareholders, our future financial position may not permit us to distribute dividends or pay interest on own capital.

The relative volatility and illiquidity of the Brazilian securities markets may substantially limit your ability to sell our common shares underlying the ADSs at the price and time you desire.

Investing in securities from emerging markets such as Brazil involves greater risk than investing in securities of issuers in major securities markets, and these investments are often considered to be more speculative in nature. The Brazilian securities market is substantially smaller, less liquid, more concentrated and can be more volatile than major securities markets. Accordingly, although you are entitled to withdraw the common shares underlying the ADSs from the depositary at any time, your ability to sell the common shares underlying the ADSs at a price and time at which you wish to do so may be substantially limited. There is also significantly greater concentration in the Brazilian securities market than in major securities markets. The ten largest companies in terms of market capitalization represented approximately 50.7% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2014. The top ten stocks in terms of trading volume accounted for approximately 46.3%, 41.3% and 43.0% of all shares traded on the BM&FBOVESPA in 2014, 2013 and 2012, respectively.

Investors who exchange ADSs for common shares may lose their ability to remit foreign currency abroad and obtain Brazilian tax advantages.

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank in order to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon sales of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, the holder will be entitled to continue to rely on the custodian’s certificate of registration for five business days from the date of exchange. After that period, the holder may not be able to obtain and remit U.S. dollars abroad upon sale of our common shares, or distributions relating to our common shares, unless he or she obtains his or her own certificate of registration or registers the investment under CMN Resolution No. 4,373/2014, dated September 29, 2014, which entitles registered foreign investors (the “4,373 Holder”) to buy and sell on a Brazilian stock exchange. If the holder does not obtain a certificate of registration or register under Resolution No. 4,373/2014, the holder will generally be subject to less favorable tax treatment on gains with respect to our common shares.

If a holder attempts to obtain his or her own certificate of registration, the holder may incur expenses or suffer delays in the application process, which could delay his or her ability to receive dividends or distributions relating to our common shares or the return of his or her capital in a timely manner. The custodian's certificate of registration or any foreign capital registration obtained by a holder may be affected by future legislative changes, and additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds of disposition may be imposed in the future.

A holder of common shares or ADSs may face difficulties in protecting his or her interests as a shareholder because we are a Brazilian mixed capital company.

We are a mixed capital company (*sociedade de economia mista*) organized under the laws of Brazil, and all of our directors and officers and our controlling shareholder reside in Brazil. All of our assets are located in Brazil. As a result, it may not be possible for a holder to effect service of process upon us or these other persons within the United States 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 requirements are met, a holder may face more difficulty in protecting his or her interests in the case of actions by our directors, officers or our controlling shareholder than would shareholders of a corporation incorporated in a state or other jurisdiction of the United States. In addition, under Brazilian law, none of our assets which are essential to our ability to render public services are subject to seizure or attachment. Furthermore, the execution of a judgment against our controlling shareholder may be delayed, since the State may only be able to pay a judgment if it is provided for in its budget in a subsequent fiscal year. None of the public property of our controlling shareholder is available for seizure or attachment, either prior to or after judgment.

Mandatory arbitration provisions in our bylaws may limit the ability of a holder of our ADSs to enforce liability under U.S. securities laws.

Under our bylaws, any disputes among us, our shareholders and our management with respect to the *Novo Mercado* rules, Law No. 6,404 of December 15, 1976, as amended ("Brazilian Corporate Law") and Brazilian capital markets regulations will be resolved by arbitration conducted pursuant to the BM&FBOVESPA Arbitration Rules in the Market Arbitration Chamber. Any disputes among shareholders and ADR holders, and any disputes between us and our shareholders and ADR holders, will also be submitted to arbitration. As a result, a court in the United States might require that a claim brought by an ADR holder predicated upon the U.S. securities laws be submitted to arbitration in accordance with our bylaws. In that event, a purchaser of ADSs would be effectively precluded from pursuing remedies under the U.S. securities laws in the U.S. courts.

A holder of our common shares and ADSs might be unable to exercise preemptive rights and tag-along rights with respect to the common shares.

U.S. holders of common shares and ADSs may not be able to exercise the preemptive rights and tag-along rights relating to common shares unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to those rights or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement with respect to our common shares relating to these rights, and we cannot assure you that we will file any such registration statement. Unless we file a registration statement or an exemption from registration is available, an ADR holder may receive only the net proceeds from the sale of his or her preemptive rights and tag-along rights or, if these rights cannot be sold, they will lapse and the ADR holder will receive no value for them.

Holders of our ADSs do not have the same voting rights as our shareholders.

Holders of our ADSs do not have the same voting rights as holders of our shares. Holders of our ADSs are entitled to the contractual rights set forth for their benefit under the deposit agreements. ADS holders exercise voting rights by providing instructions to the depository, as opposed to attending shareholders meetings or voting by other means available to shareholders. In practice, the ability of a holder of ADSs to instruct the depository as to voting will depend on the timing and procedures for providing instructions to the depository, either directly or through the holder's custodian and clearing system. The deposit agreement also provides that if the depository does not receive any instructions from a holder of ADRs, the ADR holder may be deemed to have given a discretionary proxy to a person designated by our company and the underlying shares may be voted by such person. However, we have chosen not to designate any person to exercise these deemed proxy rights with respect to any annual or special general meetings, and ADSs for which no specific voting instructions were received by the Depository were therefore not voted at that meeting.