

## 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 occasionally made drastic 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 adversely affected by changes in government policies, 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 (including reforms currently under discussion in the Brazilian Congress); 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 global financial system has experienced difficult credit and liquidity conditions and disruptions leading to greater volatility. Since the fall of 2008, global financial markets deteriorated sharply and a number of major foreign financial institutions, including some of the largest global commercial banks, investment banks, mortgage lenders,

mortgage guarantors and insurance companies, were experiencing significant difficulties including runs on their deposits and inadequate liquidity.

In an attempt to increase liquidity in the financial markets and prevent the failure of the financial system, various governments have intervened on an unprecedented scale, but there is no assurance that these measures will successfully alleviate the current financial crisis.

Despite the extent of the above-mentioned intervention, global investor confidence remains low and credit remains relatively lacking. Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on our ability to access capital and liquidity on acceptable financial terms, and consequently on our operations. Furthermore, an economic downturn could negatively affect the financial stability of our customers, which could result in a general reduction in business activity and a consequent loss of income for us.

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

Political crises in Brazil in the past have affected 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 and results of operations and the market price of our preferred shares and ADSs.

***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. The Consumer Prices Index (*Índice de Preços ao Consumidor*), or the IPCA, published by the *Instituto Brasileiro de Geografia e Estatística*, rose 5.9% in 2008, reaching the target fixed by the National Monetary Council. The inflation rate was 4.5% in 2007, 3.1% in 2006, 5.7% in 2005 and 7.6% in 2004.

Since 2006, telephone fees for fixed-line services have been indexed to the *Índice de Serviços de Telecomunicações* (Telecommunications Service Index or IST), which is a basket of national indexes that reflect our industry's operating costs. As a result, this index serves to reduce the apparent incongruity between our industry's revenues and costs, and thus reduce the apparent adverse effects of inflation upon our operations. In contrast, Brazilian monetary policy has been using the IPCA as an inflation targeting system. The inflation target for 2009 is 4.5% and if inflation increases beyond this target, basic interest rates may rise, causing direct effects on the cost of debt and indirect effects on the demand for telecommunication goods and services.

***Our results of operations have been negatively affected by a decrease in our customer growth and could also be affected if our rate of customer turnover increases.***

Our rate of acquisition of new customers can be negatively affected by market penetration. For example, our fixed-line customer base decreased 1.2% from December 31, 2006 to December 31, 2007 and decreased another 2.5% from December 31, 2007 to December 31, 2008. The decrease was mostly due to an increase in competition in the fixed telephony industry from cable and fixed-wireless operators, and an increase in substitution of fixed lines with mobiles. This decrease in customer acquisition has negatively affected our results of operations and could continue to do so in the future. In addition, if our rate of customer turnover were to increase significantly, our results of operations and or competitive position could be adversely affected. Several factors could influence our rate of acquisition of new customers and our rate of customer turnover, including competitive pressures from mobile telecommunication service providers and other fixed-line telecommunications providers, and economic conditions in Brazil.

***Fluctuations in the real/U.S. dollar exchange rate may adversely affect our ability to pay U.S. dollar-denominated or U.S. dollar-linked obligations and could lower the market value of our preferred shares and ADSs.***

The Brazilian currency has experienced devaluations in the past. The *real* was devalued against the U.S. dollar by 18.7% in 2001 and 52.3% in 2002. Over the next few years, in contrast, the *real* began appreciating against the U.S. dollar, increasing 18.2%, 8.1%, 11.8%, 8.7% and 17.2%, respectively, in 2003, 2004, 2005, 2006 and 2007. However, the *real* depreciated against the U.S. dollar by 31.9% in 2008. 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 as compared to the previously applicable index, the IGP-DI. Thus, since 2006, telecommunication revenues, when converted to U.S. dollars, do not adequately reflect the true effect of exchange rate fluctuations, so that our results of operations could be adversely affected. See “– Selected Financial Data – Exchange Rates” for more information on exchange rates.

As of December 31, 2008, 13.7% of our R\$3.74 billion total indebtedness was denominated in foreign currencies, primarily in Japanese yen, Euro and U.S. dollars. As of December 31, 2008, we had currency hedges in place to cover virtually all of our foreign currency-denominated bank debt. Part of the costs relating to our network infrastructure is payable or linked to payment by us in U.S. dollars. However, other than income derived from hedging transactions and international long distance interconnection, all of our revenues are generated in *reais*. To the extent that the value of the *real* decreases relative to the U.S. dollar, our debt becomes more expensive to service and it becomes more costly for us to acquire technology and goods necessary to operate our business that have their prices linked to exchange rate fluctuations. The additional costs from our debt, however, are offset by revenues from corresponding hedging transactions and the exposure of our capital expenditures is constantly monitored so that it does not reach a material amount. Nevertheless, currency fluctuations are expected to continue to affect our financial income and expenses.

***Political, economic and social developments, and the perception of risk in other countries, especially emerging market 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, in varying degrees, by economic and international market conditions, especially by those in Latin American and other emerging markets. 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, in particular those of the United States, 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 depositary for the ADSs 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.

***Increases in interest rates may have a material adverse effect on our business.***

The Central Bank’s Monetary Policy Committee (Comitê de Política Monetária do Banco Central – COPOM), establishes the basic interest rate target for the Brazilian financial system by reference to the level of economic growth of the Brazilian economy, the level of inflation and other economic indicators. As of December 31, 2004,

2005, 2006, 2007 and 2008, the basic interest rate was 17.8%, 18.0%, 13.3%, 11.3% and 13.8%, respectively, and as of March 31, 2009, was 11.25%. Increases in interest rates may have a material adverse effect on us.

#### **Risks Relating to the Brazilian Telecommunications Industry and Us**

***Extensive government regulation of the telecommunications industry and our concession may limit 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. ANATEL, which is the primary telecommunications industry regulator in Brazil, is responsible for, among other things:

- industry policies and regulations;
- licensing;
- fees and tariffs;
- competition;
- telecommunications resource allocation;
- service standards;
- technical standards;
- quality standards;
- interconnection and settlement arrangements; and
- supervision of universal service obligations.

For further information concerning specific regulations or resolutions issued by ANATEL, refer to section “Item 5.A –Operating and Financial Review and Prospects–Operating Results–Regulatory and Competitive Factors.”

***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 areas with populations in excess of 100, expansion of our network to provide private individual telephone service for all areas 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 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, 2008, the net book value of reversible assets is estimated at R\$6.9 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. A Public Notice (consulta pública) was published

on March 31, 2009 with the proposed revisions to the concession contracts. ANATEL will accept comments until June 1, 2009, and then it is expected that it will revise the concession contracts in 2010.

***We face substantial competition from other fixed-line providers that may reduce our market share.***

We have experienced, and expect to continue to experience, market adjustments in which providers take actions in order to compete for clients, especially corporate and premium residential clients. Such actions result in pressure on market prices and shifts in market share.

At the end of 2008, ANATEL approved a change to the General Plan of Grants or *Plano Geral de Outorgas*, allowing fixed-line providers to hold concession licenses within the same business group in more than one region. This change allowed for the merger between Oi and Brasil Telecom, operators in Regions I and II, respectively, thus redefining the competitive landscape in Brazil.

Number Portability was also introduced in 2008, which we expect will result in significant changes in the competitive dynamic of the Brazilian telecommunications market. 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 was introduced for certain of our clients in September of 2008 and as of December 31, 2008, approximately 18% of our clients had Number Portability rights. Number Portability rights for all of our clients became effective in March 2009. Though it is difficult to estimate the impact of Number Portability on the Brazilian telecommunications market, we expect, as an operator with significant market share, that we will initially lose more clients (and hence, market share) than we gain as a result of this change.

Any loss of market share as a result of competition from fixed-line providers could have an adverse effect on our business, financial condition and results of operations.

***We face increasing competition from cellular service providers.***

Rapid growth of the cellular telecommunications industry and intense competition among cellular service providers have resulted in lower prices for cellular services. Cellular services are increasingly becoming an alternative to fixed-line services, primarily for residential customers. We expect this to negatively impact the use of fixed telecommunications services and, therefore, mobile services are still the main competitive product to our services. Certain fixed-line services operating on mobile platforms are already common in the market, wherein a user will have two numbers, a mobile number and a fixed number, the latter functioning only in the user's area of residence or "home zone." Additionally, with Oi and AEIOU now operating in the state of São Paulo beginning in the second half of 2008, competition in the mobile telecommunications market has intensified, putting further pressure on the fixed-line telecommunications market. Any loss of market share as a result of competition from cellular service providers could have an adverse effect on our business, financial condition and results of operations.

***The industry in which we conduct our business is subject to rapid technological changes that could have a material adverse effect on our ability to provide competitive services.***

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. 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.

As an example of the alternative technology, in December 2007, ANATEL auctioned frequencies for 3G services (third generation cellular telephone services) at premiums of almost 80% over minimum bid prices, for which all current operators as well as other new entrants into the market submitted bids. The 3G networks allow mobile broadband access at speeds and prices competitive with currently offered fixed broadband services, which

could have an adverse effect on Speedy's growth and our results. Currently, all current mobile operators in the State of São Paulo (except AEIOU) provide 3G services at prices competitive with those of the fixed technology players in the market.

We seek to invest in new technology to remain competitive in a rapidly changing market. If we do not make sufficient investments in new technology or if our networks and technologies otherwise become outdated or obsolete, we may not be able to compete effectively against new, alternative technologies, which could have an adverse effect on our business, financial condition and results of operations.

**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 most of our directors and executive officers and our independent public accountants 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 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.B-Additional Information-Memorandum and Articles of Association."

***You 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.***

You 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 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, you may receive only the net proceeds from the sale of your preemptive rights by the depositary, 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 your rights, see "Item 10.B-Additional Information-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 depositary, 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 depositary'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 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 2,689, they will generally be subject to less favorable tax treatment on distributions with respect to our preferred shares. There can be no assurance that the depositary's certificate of registration or any certificate of foreign capital registration obtained by holders of ADSs will not be