

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

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.

***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

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 depository), 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;

- 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

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,

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:

- 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



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 to 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.
- 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).

- 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.

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

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

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%