

The Central Bank has intervened occasionally to instability in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate through a currency band system or otherwise. The *real* may fluctuate against the U.S. dollar substantially in the future. For further information on these risks, see “Item 3.D. Risk Factors—Risks Relating to Brazil—Exchange rate instability may adversely affect us and the market price of our common shares or ADSs.”

The following tables set forth the selling rate, expressed in *reais* per U.S. dollar (R\$/US\$), for the periods indicated.

Year ended December 31,	R\$ per US\$1.00			
	Year end	Average ⁽¹⁾	High	Low
2006	2.138	2.177	2.371	2.059
2007	1.771	1.948	2.156	1.733
2008	2.337	1.837	2.500	1.559
2009	1.741	1.994	2.422	1.702
2010	1.666	1.759	1.881	1.655

Month ended	R\$ per US\$1.00			
	Period end	Average ⁽¹⁾	High	Low
December 31, 2010	1.666	1.693	1.712	1.666
January 31, 2011	1.673	1.675	1.691	1.651
February 28, 2011	1.661	1.668	1.678	1.661
March 31, 2011	1.629	1.659	1.676	1.629
April 30, 2011	1.573	1.586	1.619	1.565
May 31, 2011	1.580	1.614	1.634	1.575
June 30, 2001 (through June 20, 2011)	1.597	1.588	1.611	1.574

Source: Central Bank

(1) Average of the exchange rates on the last day of each period.

On June 20, 2011, the exchange rate published by the Central Bank was R\$1.597 per US\$1.00. Exchange rate fluctuations will affect the U.S. dollar equivalent of the *real* price of our common shares on the São Paulo Stock Exchange (BM&FBOVESPA S.A. - *Bolsa de Valores, Mercadorias e Futuros*), or the BM&FBOVESPA, as well as the U.S. dollar equivalent of any distributions we make in *reais* with respect to our common shares.

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, increases in interest rates, changes in tax policies, price and tariff controls, currency devaluations, 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.

Uncertainty over whether the Brazilian government will implement changes in policies or regulations affecting these or other factors may contribute to economic uncertainty in Brazil and to heightened volatility in the Brazilian securities markets and in the 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.

Brazil has, in the past, experienced extremely high rates of inflation. Inflation and the Brazilian government's measures to combat inflation have had significant negative effects on the Brazilian economy, contributing to economic uncertainty and heightened volatility in the Brazilian securities markets. The Brazilian government's measures to control inflation have often included maintaining a tight monetary policy with high interest rates, thereby restricting the availability of credit and reducing economic growth. The Special Clearing and Settlement System (*Sistema Especial de Liquidação e Custódia*), or SELIC, the official overnight interest rate in Brazil, at the end of 2008, 2009 and 2010 was 13.66%, 8.65% and 10.66%, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (*Comitê de Política Monetária*), or COPOM.

The annual rate of inflation, as measured by the General Market Price Index (*Índice Geral de Preços-Mercado*), or IGP-M index, fell from 9.95% in 2000 to 3.83% in 2006, increased to 7.75% in 2007 and further increased to 9.81% in 2008. According to the IGP-M index, in 2009, there was a deflation of 1.71% and the rate of inflation for 2010 was 11.32%. Brazilian governmental actions, including interest rate decreases, intervention in the foreign exchange market and actions to adjust or fix the value of the *real*, may trigger increases in inflation. If Brazil again experiences high inflation, our costs and expenses may rise, we may be unable to increase our tariffs 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 decline in the market price of our common shares or ADSs.

Additionally, in the event of an increase in inflation, the Brazilian government may choose to raise official interest rates. Increases in interest rates would not only affect our cost of funding, but could also have a material adverse effect on us and may also adversely affect the market price of our common shares or ADSs.

Exchange rate instability 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 last decades. Throughout this period, the Brazilian government has implemented various economic plans and utilized a number of 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, there have been 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, as a result of the worsening of the international economic crisis, the *real* depreciated by 31.9% against the U.S. dollar. In 2009 and 2010, the *real* appreciated 25.5% and 4.3% against the U.S. dollar, closing at R\$1.741 and R\$1.666 per US\$1.00, respectively. There can be no assurance that the *real* will not further depreciate against the U.S. dollar. As of June 20, 2011, the commercial selling rate as reported by the Central Bank was R\$1.597 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 access to financial markets and prompt government intervention, including recessionary governmental policies. Depreciation of the *real* against the U.S. dollar can also, as in the context of the current global economic recovery, lead to decreased consumer spending, deflationary pressures and reduced growth of the economy as whole.

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, particularly because our tariff revenue and other sources of income are denominated solely in *reais*. In addition, because we have foreign currency denominated indebtedness, any significant devaluation of the *real* will increase our financial expenses as a result of foreign exchange losses that we must record. We had total foreign currency-denominated indebtedness of R\$2,248.9 million as of December 31, 2010, and we anticipate that we may incur substantial amounts of foreign currency-denominated indebtedness in the future. In 2010, our results of operations were positively affected by the 4.3% appreciation of the *real* against the U.S. dollar, which amounted to R\$66.1 million. We do not currently have any hedging 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.

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. Crisis 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 had 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 ours or from minority shareholders' interests, and which could have a material adverse effect on us.

The State of São Paulo, through its ownership of our common shares, has the ability to determine our operating policies and strategy, to control the election of a majority of the members of our board of directors and to appoint our senior management. As of June 20, 2011, the State owned 50.3% of our outstanding common shares.

The State has directed from time to time in the past, and may direct in the future, through its control of our board of directors and through the enactment of State decrees, that we engage in certain business activities and make certain expenditures that promote political, economic or social goals but that do not necessarily also enhance our business and results of operations. See "Item 5.A. Operating and Financial Review and Prospects—Factors Affecting Our Results of Operations."

Newly elected governors of the State typically make significant changes in our board of directors and senior management and, historically, the chairman of our board of directors has been the Secretary of State for the State Secretariat for Sanitation and Water Resources (*Secretaria de Saneamento e Recursos Hídricos do Estado de São Paulo*). As a result of the 2010 elections for governor, in 2011 the new governor elected Ms. Dilma Seli Pena as our chief executive officer and in April 28, 2011 the Secretary of State for the State Secretariat for Sanitation and Water Resources was elected as the new chairman of our board of directors.

We have a substantial amount of accounts receivable owed to us by the State and some State entities, and we cannot assure you as to when or whether the State will pay us.

Historically, the State and some State entities have had substantial overdue accounts payable to us relating to (i) the provision of water and sewage services and (ii) 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, 2010, the amounts owed to us by the State for the provision of water and sewage services totaled R\$157.2 million. With respect to payment of pensions on behalf of the State, as of December 31, 2010, we believe that the State owed to us R\$1,230.1 million, but due to the uncertainty regarding the recovery of the amount our management decided not to recognize the reimbursements. In addition, as of December 31, 2010, we had recorded a provision for actuarial liability in the amount of R\$1,316.7 million in respect of future supplemental pension payments the State does not believe it is responsible for paying. Amounts owed to us by the State for water and sewage services and reimbursements for pensions paid may increase in the future.

We have entered into agreements with the State to settle these overdue amounts payable to us. For a detailed discussion of these agreements, see "Item 7.B. Related Party Transactions," and Note 8 to our consolidated financial statements. Pursuant to these agreements, the amounts due with respect to water and sewage services could be settled with respect to amounts owed to us through December 2007 through the application of dividends payable by us to the State. In December 2007, the State agreed to pay us the outstanding balance in the amount of R\$133.7 million (as of November 30, 2007), in 60 consecutive monthly installments, beginning on January 2, 2008, and the amount of R\$236.1 million relating to part of the accounts overdue and unpaid from March 2004 through October 2007 regarding the provision of water supply and sewage collection services. We agreed to pay the State the outstanding balance of dividends, in the form of interest on shareholders' equity, due from March 2004 through December 2006, in the amount of R\$400.8 million, in the period from January through March 2008.

In March 2008, we entered into a commitment agreement with the State for the settlement of outstanding debts related to the reimbursement of pension benefits. Pursuant to the commitment agreement, the amounts due to us with respect to payments of pensions on behalf of the State may be partially settled through the transfer to us of certain reservoirs in the Alto Tietê System that we use and are owned by the State. In November 2008, we entered into an agreement with the State relating to payments of pension benefits made by us on its behalf. The State acknowledged that it owed us the outstanding balance of R\$915.3 million as of September 30, 2008 relating to payments of pension benefits made by us on its behalf. We provisionally accepted the reservoirs in the Alto Tietê System as partial payment (R\$696.3 million) subject to the transfer of the property rights of these reservoirs to us. Since November 2008, the State has been paying the remaining balance in the amount of R\$219.0 million in 114 successive monthly installments. We are unable to predict whether and when these reservoirs will be transferred to us because the Public Prosecution Office of the State of São Paulo (*Ministério Público do Estado de São Paulo*) filed a civil public action alleging that a transfer to us of ownership of the Alto Tietê System reservoirs is illegal.

See "Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings—Other Legal Proceedings." In addition to the R\$915.3 million that the State acknowledges it owes us pursuant to the November 2008 agreement, we are negotiating with the State further amounts that the State does not recognize it owes us. While we continue to negotiate directly with the State, we are not able to assure you that we will be successful in these negotiations. Accordingly, as of December 31, 2010, we have not recorded R\$1,230.1 million related to reimbursements for pension benefits paid on behalf of the State and have recorded R\$1,316.7 million pension obligation.

We cannot assure you when or if the State will pay the total overdue amounts owed to us. Due to the State's history of not making timely payments to us in respect of services and of not reimbursing us in a timely manner for the payments of pensions on behalf of the State, we cannot assure you that the amount of accounts receivable owed to us by the State and some State entities will not significantly increase in the future.

We may be required to acquire reservoirs that we use and that are owned by a State-controlled company, or we may be required to pay substantial charges to the owner with respect to our use of these reservoirs.

In connection with the provision of water services, we use the Billings and Guarapiranga reservoirs that are owned by a State-controlled company, the Water and Energy Metropolitan Company (*Empresa Metropolitana de Águas e Energia S.A.*), or the EMAE. We are entitled to use these reservoirs based on a grant issued by the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo*), or DAEE. The State, through its control of our board of directors, could require us to acquire the Billings and Guarapiranga reservoirs. As a result of these acquisitions, our cash position and overall financial condition could be adversely affected. In addition, since we are not currently charged for the use of these reservoirs, we 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 imposed. We may also be required to pay additional maintenance and operational costs for our use of the Billings and Guarapiranga reservoirs. If we were required to pay substantial charges to the owner or additional maintenance or operational costs for our use of these reservoirs, we could be materially and adversely affected.

Risks Relating to Our Business

We cannot anticipate the effects that further developments of the Basic Sanitation Law and its interpretation will have on the basic sanitation industry in Brazil and on us.

Law No. 11,445, or the Basic Sanitation Law, was enacted on January 5, 2007. While it has been in effect for more than four years, it is still in its early stages of implementation in Brazil, and we continue to be unable to anticipate all of the effects that it might have on our operations and business. There are still several uncertainties related to the interpretation of the Basic Sanitation Law. On June 21, 2010, the federal government enacted Federal Decree No. 7,217 regulating the Basic Sanitation Law. Among other things, Federal Decree No. 7,217 provided that (i) public hearings regarding the bid announcements and technical and economic viability studies are requirements for the validity of public-public partnership contracts (*contratos de programa*); (ii) the rights and obligations, including penalties, of customers and service providers shall be ruled by the owner of the public service, not by the regulatory agency; (iii) financial feasibility may be demonstrated by means of the requirement for new investments, other than the proceeds arising from the rendering of services; and (iv) when a service is divided and rendered by different service providers, the services will be considered as interdependent and will be subject to an agreement that will regulate the activities of the different services providers. We cannot currently anticipate the effects that the decree will have on our business and operations, if any.

In addition, the ARSESP is the State agency responsible for regulating the basic sanitation industry, including tariff regulation. The ARSESP acts as tariff regulator both in municipalities where the State provides basic sanitation services, and in those municipalities that have delegated their regulatory powers to the State through cooperation agreements. The ARSESP presently regulates our tariff structure and adjustments pursuant to the same tariff structure and adjustment formula that we otherwise apply. Pursuant to a cooperation agreement among the State and some municipalities, the ARSESP also regulates our tariffs in municipalities that selected the ARSESP to regulate our tariffs.

In 2009, the ARSESP enacted certain rules establishing (i) the general conditions for the services we render, (ii) the communication process for any failure in our services and (iii) the penalties for deficiencies in the provision of basic sanitation services. We are currently evaluating the enforceability and legality of some of these rules. These rules are expected to be implemented during 2011 and 2012, and will impact mainly our commercial and operations processes and may adversely affect us.

Since 2008, the ARSESP has been developing new concepts in the tariff structure and adjustment formula. In July 30, 2010, the ARSESP published Resolution No. 156 establishing the methodology and general criteria for the definition of our regulatory asset base, in order to move forward with the tariff review process and to define the initial parameters of the auditing process that the ARSESP will have to conduct pursuant to the terms of the Basic Sanitation Law. The methodology has been defined and, in general terms, assets will be evaluated by reposition costs and weighted by the respective usage ratio. In March 2011, the ARSESP published the tariff review schedule and opened a public hearing for the proposed methodology for the calculation of the weighted average cost of capital (WACC). In May 2011, the ARSESP released a regulatory post-tax weighted average cost of capital of 8.06%. According to the schedule released in March 2011, the economic regulation model will be discussed and the regulatory asset base will be defined. In 2012, the new tariff will be applied after the finalization of the model, tariff structure discussions, public consultations and publication of results. We cannot anticipate the additional changes that the ARSESP will implement on our tariff structure and adjustment formula nor the effects that these changes will have on us. If the changes are unfavorable to us, they could materially and adversely affect us. Moreover, although the ARSESP has indicated that it will implement the new methodology by 2012, we cannot assure when the new rules will be enacted.

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

Our provision of water and sewage services in the city of São Paulo accounted for 54.7% of our gross revenues from sales and services (excluding revenues relating to the construction of concession infrastructure) in the year ended December 31, 2010.

On June 23, 2010 the State and the city of São Paulo entered into a convention (*convênio*) with the intermediation and consent of SABESP and of the ARSESP pursuant to which they agreed to jointly manage the planning of and investment in the basic sanitation system of the city of São Paulo, among other things. This agreement established that the State and the city of São Paulo would enter into an agreement with us, granting us exclusive rights with respect to the provision of water and sewage services in the city of São Paulo. In addition, the agreement established the role of the ARSESP in regulating and overseeing our activities and established a management committee (*Comitê Gestor*) that will be responsible for planning the water and sewage services and for reviewing our investment plans. The management committee will be composed of six members appointed for renewable two year terms. The State and the city of São Paulo will have the right to appoint three members each. We are permitted to participate in the meetings of the management committee; however, we are not afforded any voting rights.

Also, on June 23, 2010, we entered into a formal agreement with the State and the city of São Paulo to regulate the provision of these services. This agreement requires us, among other things, (i) to invest at least 13.0% of the gross revenues from sales and services we obtain from the agreement, net of the contribution for social security financing (*Contribuição para Financiamento da Seguridade Social*), or COFINS, and the contribution for the program for government Employee Fund (*Programa de Formação do Patrimônio do Servidor Público*), or PASEP, in the improvement of water and sewage infrastructure in the city of São Paulo; and (ii) to contribute 7.5% of the gross revenues from sales and services we obtain from this agreement, net of COFINS and PASEP taxes, to the Municipal Fund for Environmental Sanitation and Infrastructure (*Fundo Municipal de Saneamento Ambiental e Infraestrutura*), or the São Paulo Municipal Sanitation Fund, established by Municipal Law No. 14,934/2009. In addition, the agreement provides that the ARSESP will ensure that the tariffs charged (a) will adequately compensate us for the services we provide and (b) can be adjusted to restore the original balance between each party's obligation and economic gain (*equilíbrio econômico-financeiro*).

Because we were not previously required to make the mandatory allocations described in items (i) and (ii) above, they were not taken into account in calculating our existing tariff and its adjustment formula. Despite the contractual provisions and the ARSESP's role in setting and adjusting adequate tariffs, we cannot guarantee that the tariffs we will be allowed to charge for the provision of water and sewage services in the city of São Paulo will continue to adequately compensate us.

The decision of the Brazilian Supreme Court regarding whether State or municipal governments have the right to execute concession and program agreements could have a material adverse effect on us.

The agreement with the State and the city of São Paulo regulates the provision of water and sewage services in the city of São Paulo. It remains uncertain whether state or municipal governments have the authority to plan and regulate basic sanitation services rendered to metropolitan regions, as well as the right to execute concession and program agreements. This issue is under discussion before the Brazilian Supreme Court in a suit initiated by third parties. If the Brazilian Supreme Court grants this authority to municipal governments, under certain circumstances, we may be required to cease our operations in certain areas of the São Paulo metropolitan region in the event that certain municipalities opt to use another water and sewage service provider. We cannot anticipate the effects of the Brazilian Supreme Court decision on the provision of our services in the city of São Paulo and in these other municipalities located in the São Paulo and in other metropolitan regions, either of which may affect our existing agreements to provide water and sewage services in these municipalities in a manner we cannot anticipate and could have a material adverse effect on us.

We have not entered into formal agreements for the provision of water and sewage services with certain of the municipalities we serve, including municipalities in metropolitan regions, as required by the Basic Sanitation Law, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities.

Under the Basic Sanitation Law, we were required to have entered into formal agreements, before December 31, 2010, with every municipality with which we did not have a formal agreement in place or with which our agreements had already expired, as is the case of certain municipalities located in the metropolitan regions where we are authorized to operate in accordance with local legislation. If such contractual arrangements were not entered into by December 31, 2010, the services concessions would no longer be valid.

As of the date of this annual report, of the 364 municipalities we provide water and sewage services to, 119 concessions had expired. These 119 concessions include 21 municipalities located in and outside metropolitan regions, including the municipality of Santos, located in the coastal region. Until December 31, 2010, we provided our services to these 21 municipalities through informal arrangements, such as deeds of authorization (*escritura pública de autorização*) or other similar arrangements. As mentioned above, pursuant to the Basic Sanitation Law, as of December 31, 2010 these informal arrangements were considered terminated. Although the Basic Sanitation Law does not impose any sanctions with respect to the non formalization of these arrangements, and we continue to provide our services to these municipalities, the total number of municipalities with which we have informal or expired arrangements add up to 119. Together, these 119 municipalities accounted for 26.5% of our total revenues for the year ended December 31, 2010, and 31.4% of our intangible assets as of that same date. We are currently negotiating with these municipalities the renewal of the concessions through the execution of program agreements.

The 119 municipalities are located in and outside the metropolitan regions. In order to renegotiate or formalize the agreements, we face the following problems: (i) we are still awaiting the final decision of the Brazilian Supreme Court regarding whether the State or the municipalities have the right to enter into contractual arrangements for the provision of the basic sanitation services in the metropolitan regions (until the execution of the agreement with the city and State of São Paulo in June 2010 there was no precedent for a joint management contractual arrangement between the State, the municipalities and us); (ii) the execution of new agreements will depend on certain acts that are beyond our control, such as the compliance by the municipalities located outside the metropolitan regions with certain legal procedures.

The Basic Sanitation Law did not define any penalty for the non-compliance with the December 31, 2010 deadline by the municipalities or for the water and sewage service companies in case the deadline is not observed. Consequently, we cannot anticipate if we are going to be subject to any penalty due to the lack of a formal agreement with some municipalities or if any eventual penalty will have a material adverse effect on us.

In addition, because we do not hold concessions or contractual rights to provide services in 119 of these municipalities, we may not be able to effectively enforce our right to continue to provide services or may face difficulties in being timely paid for the services that we provide. In the future, our rights in respect of these other municipalities could be modified or adversely affected by Brazilian federal, state or municipal governmental actions, judicial decisions or other factors. For further information, see "Item 4.B. Business Overview—Government Regulation—The Basic Sanitation Law" and "Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

We cannot assure you when or whether there will be changes to the conditions under which we currently provide water and sewage services to the municipalities with which we do not have formal concession agreements or are renegotiating expired agreements or whether we will be able to continue to provide water and sewage services in any municipalities where we are unable to renew or enter into a formal concession agreement.

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

Our industry is specifically affected by the following risks associated with the provision of water and sewage services:

- we are subject to substantial charges imposed by state and federal government agencies that manage water resources related to the abstraction of water from, or dumping of sewage into, water bodies, which we may not be able to pass on to our customers. See "Item 4.B. Business Overview–Government Regulation–Water Usage;"
- in some cases, we are required to continue providing services to certain municipalities to which we provide water on a wholesale basis that have overdue amounts owed to us and are not paying us on a regular basis and we cannot assure you of when or whether these municipalities will pay us in a timely manner. See "Item 4.B. Business Overview–Billing Procedures;"
- the degradation of watershed areas may affect the quantity and quality of water available to meet our customers' demand. See "Item 4.A History and Development of the Company–Capital Expenditure Program;"
- our tariffs may not increase in line with increases in inflation and operating expenses, including taxes, or increase in a timely manner, which may hinder us from passing on to our customers increases in our cost structure. See "–The terms of our new agreement to provide water and sewage services in the city of São Paulo could have a material adverse effect on us". These constraints may also 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;"
- we are exposed to probable increases in the frequency of extreme weather conditions in the future, which may adversely affect both the quality and quantity of waters available for abstraction, treatment, and supply. Given that our financial performance is closely linked to climate patterns, 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 distribution services. An increase in heavy rainfalls could impact water quality and regular operations of water sources, including abstraction of waters from our dams, due to increased soil erosion, silting, pollution and eutrophication of aquatic exosystems. See "Item 5.A. Operating and Financial Review and Prospects–Factors Affecting Our Results of Operations–Effects of Climate Change (Drought and Intense Rainfalls);" and
- we are dependent upon energy to conduct our operations and eventual 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. Also, we may not be able to pass on to our customers significant increases in energy tariffs. See "Item 4.A. History and Development of the Company–Energy Consumption."

The occurrence of any of the above may have a material adverse effect on us.

We may face difficulties in continuing to provide water and sewage services in the municipalities we serve and we cannot assure you that these municipalities will continue to require our provision of services under the same terms.

As of December 31, 2010, we were a provider of water and sewage services to 364 municipalities. Between January 1, 2007 and December 31, 2010, we had entered into 30-year agreements with 200 of these municipalities (including our services agreement with the city of São Paulo), of which 26 were entered into in 2010. These 200 municipalities accounted for 61.5% of our total revenues for the year ended December 31, 2010 and 59.5% of our intangible assets as of December 31, 2010. As of December 31, 2010, we have been renegotiating 119 concession agreements that expired, including the one with the municipality of Santos. Together, these 119 municipalities accounted for 26.5% of our total revenues for the year ended December 31, 2010 and 31.4% of our intangible assets as of that same date.

From January 1, 2011 to 2033, 45 concession agreements will expire. These 45 concession agreements accounted for 9.8% of our total revenues for the year ended December 31, 2010 and 8.3% of our intangible assets as of that same date.

We cannot assure you that these municipalities will continue to require our services and enter into new concession agreements or program agreements with us. In the event that we are successful in renegotiating our concession agreements or entering into program agreements with the municipalities whose concession agreements expired or will expire, we cannot assure you that the new concession or program agreements will have the same terms under which we currently provide services to these municipalities. 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 the ARSESP.

In addition, these municipalities may choose to assume the direct provision of water and sewage services or promote a public bidding process to select another water and sewage service provider. Depending on the eligibility requirements to participate in the public bidding processes, we may not qualify to participate in some or all of these public bidding processes. If we participate in these public bidding processes, we cannot assure you that we will win the bid. In the event that these municipalities assume the direct provision of water and sewage services or promote a public bidding process to select another water and sewage service provider, or the new terms or conditions of the concession or program agreements are less favorable to us, we may be materially and adversely affected. See "Item 4.B. Business Overview—Our Operations" and "Item 4.B. Business Overview—Government Regulation—Concessions—Public Consortia and Cooperation Agreement Law for Joint Management."

Municipalities may, under certain circumstances, terminate our concessions before their expiration and the indemnification may be inadequate to recover the full value of our investments.

The concessions we hold are subject to early termination provisions, which entitle municipalities to terminate our concessions prior to their expiration date under certain circumstances. Municipalities may terminate our concessions if we fail to comply with our obligations under the relevant concession agreement or applicable law, or if the municipality determines, through an expropriation proceeding, that terminating our concession prior to its expiration date is in the public interest. If any municipality terminates our concession before the expiration date, we are entitled to be indemnified for the unamortized portion of our investments, but the indemnification may not be sufficient for us to recover the full value of our investments. Further, under the terms of the Constitution of the State of São Paulo, municipalities may pay the indemnification over a term of 25 years. However, the Brazilian Supreme Court stayed the application of this provision of the Constitution of the State of São Paulo in 1997, and the decision remains valid until final judgment.

In 1997, the municipality of Santos enacted a law expropriating our water and sewage systems in Santos. There are pending legal proceedings concerning the expropriation carried out by this municipality. We continue to provide water and sewage services to the city of Santos.

In 1995, the municipality of Diadema terminated the concession agreement that had been entered into with us prior to the expiration of the concession agreement. As a result, we filed a lawsuit against the municipality of Diadema which we eventually settled in 1996. The municipality of Diadema did not comply with this 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, formerly known as the State Secretariat for Sanitation and Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*). This memorandum establishes our agreement to conclude negotiations and settle all outstanding amounts. In addition, it indicates our intent to develop a share infrastructure for the provision of water and sewage services. This memorandum of understanding stayed the collection proceedings we had filed against the municipality of Diadema. We continue to supply water on a wholesale basis to the city of Diadema.

For further information on these lawsuits, see “Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings.”

We cannot assure you that other municipalities will not seek to terminate their concession agreements before the contractual expiration date. The early termination of concession agreements by municipalities, our inability to receive adequate indemnification for the investments we made, or the payment of indemnification due to us over a long period, may have a material adverse effect on us.

The Basic Sanitation Law has established provisions governing the indemnification of water and sewage service providers in case of early termination of concession agreements by a municipality and reduced the term over which indemnification must be paid to four years. These provisions are also applicable to concession agreements entered into prior to the enactment of the Basic Sanitation Law, as long as these concession agreements do not have a contractual indemnification provision in case of early termination or we have not otherwise entered into an agreement with the municipality with regard to such early termination. Nevertheless, we cannot anticipate the effects of the Basic Sanitation Law on the amount of, and enforceability of the right to, indemnification and how Brazilian courts will enforce the provisions of the Basic Sanitation Law.

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

Our capital expenditure program will require substantial liquidity and capital resources of approximately R\$8.6 billion in the period from 2009 through 2013. We recorded R\$2.2 billion of capital expenditure in 2010 in connection with our capital expenditure program.

We have funded in the past, and we plan to continue to fund these expenditures with funds generated by operations and domestic and foreign currency borrowings on acceptable terms. A significant portion of our financing needs have been funded by lenders controlled by the federal government. We also benefit from long-term financing from domestic and international multilateral agencies and development banks at attractive interest rates. Changes in the policies of the federal government regarding the financing of water and sewage services, or our failure to continue to benefit from long-term financing from domestic and international multilateral agencies and development banks at attractive interest rates may impair our ability to meet our obligations or finance our capital expenditure program, which could have a material adverse effect on us.

As a general rule, financial institutions and other institutions authorized to provide credit by the Central Bank may only provide loans to public sector entities, such as us, up to a certain percentage of the entity’s shareholders’ equity. Because of these limitations on our ability to obtain credit from domestic financial institutions, our options for raising funds, other than the cash generated by our operations, consist mainly of borrowing from governmental agencies, national and international financial institutions or multilateral agencies and issuing debt securities in both the domestic and international capital markets. These legal limitations could adversely affect our ability to continue our capital expenditure program.

We are also subject to financial covenants limiting our ability to incur additional indebtedness, 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.” Our failure to comply with these covenants could impair our ability to finance our capital expenditure program, which could have a material adverse effect on us.

We are subject to cost increases to comply with environmental law requirements and potential environmental liability that could have a material adverse effect on us.

Our facilities are subject to extensive Brazilian federal, state and municipal laws and regulations and environmental covenants relating to the protection of human health and the environment. These laws and regulations limit or prohibit emissions or spills of effluents, such as raw sewage, produced in connection with our operations. We could be subject to civil public actions and criminal, administrative and other civil proceedings for non-compliance with environmental laws and regulations, which could expose us to administrative and civil penalties and criminal sanctions, such as fines, closure orders and significant indemnification obligations. Since environmental laws and their enforcement by Brazilian authorities are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially. Expenditures required for compliance with environmental laws and regulations may result in reductions in other strategic investments that we have planned, which could negatively affect us. In addition, due to more stringent enforcement of environmental laws by Brazilian courts, we may be required to pay substantial fines and indemnifications in amounts that may vary widely from those currently anticipated. We are presently a party to a number of civil public actions related to environmental matters, with regard to which we are unable to calculate our estimated amount of potential liability. 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 lawsuits, see “Item 8.A. Financial Information—Consolidated Statements and Other Financial Information—Legal Proceedings.”

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

As new laws and regulations relating to climate change, including carbon controls, become applicable to us, and as existing environmental regulations relating to climate change become more stringent, it is possible that our capital expenditure for compliance with these laws and regulations will increase substantially in the future. If we increase capital expenditure to comply with these laws and regulations, we may be required to reduce expenditure on other strategic investments.

In addition, if climate change leads to significant physical effects, such as variations in the intensity of droughts and rain, our services may be affected and we may be required, among other things, to: (i) make significant investments in seeking new hydric sources located further from major consumer centers and (ii) make significant investments in new technologies.

We do not adopt any method for calculating the investments that would be necessary in the event of a significant physical effect from climate change. Any substantial increase in expenditure related to climate change, whether for compliance with environmental regulations or for preventing or remedying the physical effects of climate change, may have a material adverse effect on us. See "Item 4.B. Business Overview—Environmental Matters—Climate Change Regulations: Reduction of Greenhouse Gases (GHG)."

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

We are a party to a number of legal proceedings involving significant monetary claims. These legal proceedings include, among others, civil, environmental, tax, labor, condemnation and other proceedings. As of December 31, 2010, the total value of all outstanding claims was R\$23,960.1 million (net of court deposits). A substantial monetary judgment against us in one or more of these legal proceedings may have a material adverse effect on us. Based on advice from our legal counsel, we have provisioned a total aggregate amount of R\$1,459.8 million (net of court deposits) as of December 31, 2010 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 Information—Consolidated Statements and Other Financial Information—Legal Proceedings."

Risks Relating to Our Common Shares and ADSs

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 that trade in emerging markets, such as Brazil, often 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 48.8% of the aggregate market capitalization of the BM&FBOVESPA as of December 31, 2010. The top ten stocks in terms of trading volume accounted for approximately 53.1%, 50.4% and 48.8% of all shares traded on the BM&FBOVESPA in 2008, 2009 and 2010, respectively.

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

The Brazilian custodian for the common shares underlying our ADSs must obtain a certificate of registration from the Central Bank to be entitled to remit U.S. dollars abroad for payments of dividends and other distributions relating to our common shares or upon the disposition of our common shares. If an ADR holder decides to exchange ADSs for the underlying common shares, this 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 the disposition of our common shares, or distributions relating to our common shares, unless he or she obtains his or her own certificate of registration or register under Resolution No. 2,689, dated January 26, 2000, of the Brazilian National Monetary Council (*Conselho Monetário Nacional*), or the CMN, which entitles registered foreign investors to buy and sell on the Brazilian stock exchanges. If the holder does not obtain a certificate of registration or register under Resolution No. 2,689, this 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. We cannot assure you that the custodian's certificate of registration or any foreign capital registration obtained by a holder may not be affected by future legislative changes, or that additional restrictions applicable to the holder, the disposition of the underlying common shares or the repatriation of the proceeds from disposition will not 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 intangible assets and those of these other persons 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 difficulties 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 as payment of the judgment must be made pursuant to the State's budget in a subsequent fiscal year. None of the public property of our controlling shareholder is subject to 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 application of *Novo Mercado* rules, Brazilian Corporate Law and the application of the rules and regulations regarding Brazilian capital markets will be resolved by arbitration conducted pursuant to the BM&FBOVESPA Arbitration Rules in the Market Arbitration Chamber. Any disputes among shareholders, including ADR holders, and disputes between us and our shareholders, including 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.