

3.B. Capitalization and Indebtedness

Not applicable.

3.C. Reasons for the Offer and Use of Proceeds

Not applicable.

3.D. Risk Factors

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This involvement, as well as Brazilian political and economic conditions, could adversely affect us and the market price of our 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 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 contracts;
- interest rates;
- exchange controls and restrictions, such as those which were briefly imposed in 1989 and 1990;
- currency fluctuations;
- inflation;
- liquidity of the Brazilian capital and lending markets;
- tax and regulatory policies; and
- other political, social and economic developments in or affecting Brazil.

Uncertainty over whether the Brazilian government will implement changes in policy or regulation affecting these or other factors in the future 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 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 value of our shares or ADSs.

Brazil experienced extremely high rates of inflation in the past. Inflation and the Brazilian government's measures to fight 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 official overnight interest rate in Brazil, (SELIC), at the end of 2005, 2006 and 2007 was 18.00%, 13.19% and 11.18%, respectively, in line with the target rate set by the Brazilian Committee on Monetary Policy (Comitê de Política Monetária), or COPOM. On June 30, 2008, the official interest rate in Brazil was 12.25% .

The annual rate of inflation, as measured by the General Market Price Index (*Índice Geral de Preços–Mercado*), or IGP-M index, has fallen from 9.95% in 2000 to 3.83% in 2006 and increased to 7.75% in 2007. If Brazil again experiences high inflation, our costs and expenses may rise and our overall financial performance may be adversely affected. In addition, a substantial increase in inflation may weaken investor's confidence in Brazil, causing the decline in the market value of our 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 value of our shares or ADSs.

Exchange rate instability may adversely affect us and the market price of our 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 has 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* depreciated against the U.S. dollar by 9.3% in 2000, 18.7% in 2001 and 34.3% in 2002. Although the *real* appreciated 13.4%, 9.5% and 20.7% against the U.S. dollar in 2005, 2006 and 2007, respectively, no assurance can be given that the *real* will not depreciate against the U.S. dollar again. On June 30, 2008, the exchange rate was R\$ 1.5919 per US\$1.00.

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 based solely in *reais*. In addition, because we have foreign currency-denominated indebtedness, any significant devaluation of the *real* during a financial period 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\$1,242.3 million as of December 31, 2007, and we anticipate that we may incur substantial amounts of foreign currency-denominated indebtedness in the future. Our overall results of operations were positively affected by the 20.7% appreciation of the *real* against the U.S. dollar in 2007, which amounted to R\$188.4 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 shares or ADSs.

Developments and the perception of risk in other countries, especially emerging market countries, may adversely affect our financing and the market price of our shares or ADSs.

The market value of securities of Brazilian issuers is affected to varying degrees by economic and market conditions in other countries, including other Latin American and emerging market countries. Although economic conditions in those 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 value of securities of Brazilian issuers. Crises in other emerging countries may diminish investors' interest in securities of Brazilian issuers, including our securities. This could adversely affect the market price of our shares or ADSs and could also make it more difficult for us to gain access to the capital markets and finance our operations in the future on acceptable terms, or at all.

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 December 31, 2007, the State owned 50.3% of our outstanding common shares.

The State has from time to time in the past, and may in the future, through its control of our board of directors, direct 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 Energy (*Secretaria de Saneamento e Energia do Estado de São Paulo*).

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 (1) the provision of water and sewage services and (2) 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, 2007, the amounts owed to us by the State for the provision of water and sewage services totaled R\$446.4 million and, with respect to payment of pensions on behalf of the State, the State owed us R\$879.1 million. 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. Major Shareholders and Related Party Transactions—Related Party Transactions"*, and note 6 (ii), (iii), (iv), (v) to our financial statements. Pursuant to these agreements, the amounts due with respect to water and sewage services could be settled through the application of dividends payable to the State by us to the repayment of amounts owed to us through December 2007. The second amendment signed on December 2007, does not require the application of dividends to offset accounts receivable from the State. The second amendment instead requires the: i) implementation of an electronic account management system; ii) structuring of the Rational Water Use Program (PURA) to ration the consumption of water and the amount of the water and sewage bills under the responsibility of the State; iii) establishment, by the State, of criteria for budgeting; iv) possibility of registering State bodies and entities in a delinquency system or reference file; v) possibility of interrupting water supply to State bodies and entities in the case of nonpayment of water and sewage bills. Furthermore, there can be no assurance that the government will pay the total amount owed to us. On March 26, 2008, the São Paulo State Government and we, entered into a commitment agreement for the settlement of outstanding debts related to the reimbursement of pension benefits. Pursuant to the commitment agreement, part of the amounts due to us with respect to payments of pensions on behalf of the State may be settled through the transfer to us of certain reservoirs in the Alto Tietê system that we use and are owned by the State. 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) filled a civil public action alleging that a transfer to us of ownership of the Alto Tietê system reservoirs is illegal. See *"Item 8.A. Consolidated Statements and other Financial Information—Legal Proceedings."*

We cannot assure you as to when or if the State will pay overdue amounts owed to us. In addition, even though the State acknowledges its debts to us related to pension benefits, the State disagrees with the criteria adopted by us to grant and pay the benefits. The State based its disagreement on legal opinions issued by the State Attorney General, which restrict State actions and prevent the voluntary reimbursement of amounts paid by us. We will not waive the receivables from the State to which we consider ourselves to be legally entitled. Accordingly, we will take all possible actions to resolve the issue at all technical and court levels. Should this dispute persist, we will take all the necessary actions to protect our interests. 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. In addition, we have not established any provisions for any amounts due to us by the State, as we do not expect to incur any significant losses relating to these amounts. If the State does not pay the amount it owes to us, we will be adversely affected.

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. Our right to use these reservoirs is provided for through a grant issued by the State Department of Water and Energy (*Departamento de Águas e Energia Elétrica do Estado de São Paulo-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 properties, we could be adversely affected.

Risks Relating to Our Business

We cannot anticipate the effects that the new legislation enacted in January 2007 will have on the basic sanitation sector in Brazil.

On January 5, 2007, Law No. 11,445 was enacted to regulate the basic sanitation industry in Brazil. Although this law has been enacted for more than one year, it is in its initial stage of implementation and we cannot anticipate the effects that it will have on our operations and business. In compliance with Law No. 11,445, the State of São Paulo created in December 2007, ARSESP – the São Paulo State Sanitation and Energy Regulatory Agency, which is the regulatory agency that regulates the basic sanitation services pertaining to the State, respecting they federal and municipal jurisdictions and prerogatives and exercising the following functions:

- complying with and enforcing state and federal basic sanitation legislation;
- publishing the organizational platform for the services, indicating the types of services provided by the state as well the equipment and facilities composing the system;
- assuming, where applicable, the legal attributions of the jurisdictional authority;
- establishing, in accordance with the tariff guidelines defined by the decree, tariffs and other manners for the compensation of services, adjusting and reviewing them to ensure the financial-economic balance of services and low-cost tariffs through mechanisms that increase service efficiency and lead to the appropriation of productivity gains by society; and
- to approve, oversee and regulate (including tariff issues) sewage treatment and wholesale water supply agreements entered into between the state supplier and other suppliers, pursuant to Article 12 of new basic sanitation law.

There are several uncertainties related to the new legislation which could have a material adverse effect on us. See *“Item 4.B. Business Overview–The Basic Sanitation Law – Public Consortia Law and Cooperation Agreements.”*

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 may become subject to substantial water-related and sewage-related charges imposed by governmental water agencies of the State and of the Federal Government related to the abstraction of water from, or dumping of sewage into, water resources controlled by these agencies, 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 as to when or whether these municipalities will pay us;
- our tariffs may not increase in line with increases in inflation and operating expenses, including taxes, or to increase them in a timely manner, due to political and legal constraints that may hinder us from passing on to our customers increases in our cost structure. These constraints may also have an adverse effect on our capability 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 droughts that may adversely affect our water supply systems, resulting in a decrease in the volume of water distributed and billed as well as in the revenue from water supply; and
- we are dependent upon energy to conduct our operations and shortages or rationing of energy may prevent us from providing water and sewage services and may also cause material damages to our water and sewage systems when we resume operations. Also, we may not be able to pass on to customers significant increases in energy tariffs.

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

We do not hold formal concessions to provide water and sewage services to the City of São Paulo and several other municipalities that we serve, and therefore we may not be able to enforce our rights to continue to provide services in these municipalities.

Our operations are concentrated in the City of São Paulo with which we have not entered into a concession contract. As of December 31, 2007, the City of São Paulo accounted for 56.3% of our sales and services rendered. In addition, we do not hold formal concessions in 36 other municipalities in the State of São Paulo, particularly in the municipality of Santos, in the coastal region, where we operate under a deed of authorization (*escritura pública de autorização*) and that has a significant population of approximately 428,000 as of December 31, 2007.

Because we do not hold concessions or formal contract rights to provide services in these municipalities, we may not be able to effectively enforce our right to continue to provide services or to be paid for the services we provide. In the future, our rights in respect of the City of São Paulo and these other municipalities could be modified or adversely affected by Brazilian federal, state or local governmental actions, judicial decisions or other factors.

From time to time, mayors of the City of São Paulo have initiated or proposed discussions with the State regarding entering into a formal concession contract with us to provide water and sewage services in the City of São Paulo. For a detailed discussion of these initiatives, see *“Item 4.B. Business Overview—Government Regulation—Concessions.”*

The sanitation legislation, Law No. 11,445, enacted in January 2007, sets December 31, 2010 as the deadline for water and sewage service companies, such as us, to regularize the provision of water and sewage services to municipalities, in case there is no formal concession to provide services to municipalities. We cannot anticipate the terms and conditions of these contracts and their effects on the provision of our services in these municipalities, particularly with respect to the City of São Paulo which is awaiting a court ruling regarding the ownership of services in metropolitan regions.

In the case of the City of São Paulo, in November 2007, we entered into a cooperation agreement with the City of São Paulo that determined certain basic sanitation and environmental actions and resolved outstanding financial obligations of the City of São Paulo until it is possible to formalize definitive legal instruments that assure stability in the provision of public basic sanitation services, regardless of the substance of the legal ruling currently awaited.

Furthermore, we cannot assure you when and if there will be changes to the conditions under which we currently provide water and sewage services to these municipalities without holding formal concessions and we cannot anticipate their effects on the provision of our services in the City of São Paulo and in these other municipalities.

We may face difficulties to continue 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. At the end of 2007, we were a provider of water and sewage services to 366 municipalities, although, due to judicial orders, we had temporarily stopped operating three of them (Araçoiaba da Serra, Cajobi e Monte Alto). We have recently resumed providing service to Monte Alto. As for the other two municipalities (Araçoiaba da Serra and Cajobi) we are still in litigation. Even if we cannot resume providing services to these municipalities, there will be no major impact on us as: i) revenue from these operations account for less than 0.2% of our total revenues, and ii) we will continue to be entitled to indemnities related to the assets invested in these municipalities and not yet amortized. Substantially all of these concessions have 30-year terms. As of December 31, 2007, we had 106 program contracts in place. In December 2008, 104 concession contracts will expire or be under negotiation with the respective municipalities. Between 2009 and 2034, 117 concession contracts will expire. The remaining concession contracts have no expiration date. As of December 31, 2007, the carrying value of our assets at the municipalities with concession contracts under negotiation or expiring in 2007 and 2008 totaled R\$ 2.02 billion and revenues from these municipalities for the year ended December 31, 2007 totaled R\$935 million.

In case certain municipalities continue to require our provision of water and sewage services, we cannot assure you that we will obtain in the new contracts the same terms under which we currently provide services to them because the new basic sanitation law prevents us from planning, regulating and monitoring our services and it requires a more stringent control by the municipalities or by the São Paulo State Sanitation and Energy Regulatory Agency (ARSEP), which was created by the São Paulo State government through Supplementary Law 1,025 of December 7, 2007.

In case certain municipalities no longer require our provision of water and sewage services, we may be adversely affected. See *“Item 4.B. Business Overview—Our Operations”* and *“Item 4.B. Business Overview—Government Regulation—Public Consortia Law and Cooperation Agreements.”*

We may also face difficulties in continuing to provide water and sewage services to certain municipalities by means of new contracts because of an increase in competition and in case we are outbid from a public bidding process.

Municipalities may terminate our concessions before their expiration and the compensation may be inadequate to recover the full value of our investments.

The concessions we hold are subject to early termination by the municipalities under certain circumstances. Municipalities may terminate our concessions if we fail to comply with our obligations under the relevant concession contract and applicable law, or if the municipality determines, based on authorization by municipal law, through an expropriation proceeding, that terminating our concession prior to the contractual expiration date is in the public interest. If any municipality terminates our concession, we are entitled to be indemnified for the unamortized portion of our investments, but the compensation 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, we may receive the compensation over a term of 25 years. The early termination by municipalities of any of our concession contracts, or our inability to receive adequate compensation for the investments we made, or if compensation is paid over a term of 25 years, would have a material adverse effect on us.

In 1997, the municipality of Santos enacted a law expropriating our water and sewage systems in Santos. In 1995, the municipality of Diadema terminated the concession contract that had been entered into with us prior to the expiration of the agreement. There are pending legal proceedings discussing both the expropriation carried out by the municipality of Santos and early termination by the municipality of Diadema. We continue to provide water and sewage services to Santos and sell water on a wholesale basis to Diadema. For further information on these lawsuits, See *“Item 8.A. Consolidated Statements and other Financial Information—Legal Proceedings.”*

We cannot assure you that other municipalities will not seek to terminate their concessions before the contractual expiration date. Exercise of concession termination rights by substantial numbers of municipalities could have a material adverse effect on us.

Law No. 11,445/07, the new basic sanitation law, provides that the parties to new contracts have to establish the amount of the compensation in the agreement for the unamortized portion of the investment in case of termination of the agreement prior to the contractual expiration date. In the event there is no agreement between the parties for the unamortized portion of the investment to be repaid to the service provider in case of termination of the agreement prior to the contractual expiration date, the new law determines a default provision, i.e., the valuation of the investment by an independent expert based on the economic value or revaluation of the book value of the investment. This default provision of Law No. 11,445/07 may also be applicable to current concessions but in the absence of mutual agreements, the calculation of the indemnity is based on the terms and conditions of the previous agreement. In addition, we cannot anticipate the effects of this law on the amount of, and enforceability of the right to, compensation and how Brazilian courts will enforce the provisions of Law No. 11,445/07.

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

Our capital expenditure program requires substantial liquidity and capital resources of approximately R\$5.87 billion in the period from 2007 through 2010, of which we spent R\$ 921.1 million in 2007 and we expect to spend R\$1,574.0 million in 2008.

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 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 and 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 entities' 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 national and international financial institutions or development 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, whether denominated in *reais* or foreign currency. Under these covenants, we would have been able to borrow up to an additional R\$3,329.8 million as of December 31, 2007. These contractual limitations may prevent us from completing our capital expenditure program, which could have a material adverse effect on us.

We are subject to cost increases to conform to environmental requirements and potential environmental responsibilities

Our facilities are subject to extensive Brazilian federal, state, local levels, regulatory laws, and environmental covenants relating to the protection of human health and the environment. 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 civil penalties and criminal sanctions, such as fines, indemnification. Since environmental laws and their enforcement by Brazilian authorities are becoming more stringent, our capital expenditures and expenses for environmental compliance may increase substantially. We are 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. For further information on these lawsuits, See "Item 8.A. Consolidated Statements and other Financial Information—Legal Proceedings."

Civil lawsuits and inquiries involving environmental matters are in large part related to the discharge of untreated sewage into waterways and the disposal of sludge from water and sewage treatment stations. However, we are committed to fulfilling environmental obligations, seeking to work proactively and preventively. We have pledged to cooperate with oversight agencies and with the Public Prosecutors' Office, with which it has established commitments and formalized the terms of our compliance.

Our compliance requirements have been implemented with extreme technical and administrative rigor, aiming to conform with environmental requirements. Our compliance with the commitments arising from these agreements and instruments is provided for in the budget.

Given the need to periodically renew licenses and authorizations, We have been enhancing our management instruments used to monitor our operations and facilities in terms of our compliance with the technical requirements of the licenses and authorizations currently in force and the needs related to the regulatory compliance of the existing operational park. Environmental feasibility and compliance analyses are present in all phases of our new projects, including the conception, installation and operational phases.

Due to pending cases in the Brazilian Supreme Court, there is potential instability in the legal framework with respect to which governmental authority has the right to plan and regulate basic sanitation services in metropolitan areas.

We are aware of two lawsuits (Ações de Inconstitucionalidade: ADIN 1842-5 Rio de Janeiro and ADIN 2.077 -3 Bahia) pending in the Brazilian Supreme Court that involve constitutional issues related to the level of public governmental authority (states, municipalities or groups of municipalities) that has the right to plan and regulate basic sanitation services delivered in metropolitan areas, as well as the right to execute concession and program agreements.

Although the State of São Paulo is not party to either of these cases and the decisions in each of these cases will not bind the State of São Paulo, any municipality in the State of São Paulo or their contractual relations with us, the outcome will likely influence future decisions of state and federal courts in the State of São Paulo with respect to similar lawsuits.

We cannot assure you when the lawsuits will be determined nor do we know how we will be affected by the outcome of these lawsuits. If municipalities are granted the right to plan and regulate basic sanitation services in metropolitan areas, they may decide to hold public biddings or even provide basic sanitation services on their own instead of executing a concession or program agreement with us, in which case, we are likely to face a substantial increase in competition from other bidders and municipalities.

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. 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 lawyers, we have provisioned a total aggregate amount of R\$945.3 million as of December 31, 2007 to cover probable losses related to legal proceedings. However, 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 an adverse effect on us. For more information, see “Item 8.A. 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 the United States, and these investments are generally 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 in the United States. 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 in the United States. The ten largest companies in terms of market capitalization represented approximately 54.7% of the aggregate market capitalization of the Bovespa as of December 31, 2007. The top ten stocks in terms of trading volume accounted for approximately 51%, 46.4% and 45.8% of all shares traded on the Bovespa in 2005, 2006 and 2007 respectively.

Restrictions on the movement of capital out of Brazil may impair the ability of holders to receive dividends and distributions on, and the proceeds of any sale of, the common shares underlying our ADSs.

The Brazilian government may impose temporary restrictions on the conversion of Brazilian currency into foreign currencies and on the remittance to foreign investors of the proceeds of their investments in Brazil. Brazilian law permits the government to impose these restrictions whenever there is a serious imbalance in Brazil's balance of payments or there are reasons to foresee a serious imbalance.

The Brazilian government imposed remittance restrictions in 1990. Similar restrictions, if imposed, would impair or prevent the conversion of dividends, distributions, or the proceeds from any sale of common shares, as the case may be, from *reais* into U.S. dollars and the remittance of the U.S. dollars abroad. We cannot assure you that the Brazilian government will not take similar measures in the future. In such a case, the depository for our ADSs will hold the *reais* it cannot convert for the account of the ADR holders who have not been paid. The depository will not invest the *reais* and it will not be liable for the interest.

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 – for five business days from the date of exchange – on the custodian's certificate of registration. 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, of January 26, 2000, of the Brazilian National Monetary Council, 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 fixed 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.

The protections afforded to minority shareholders in Brazil are different from those in the United States and other jurisdictions and may be more difficult to enforce.

Under Brazilian law, the protections afforded to minority shareholders are different from those in the United States and other jurisdictions. In particular, the case law with respect to shareholder disputes is less developed under Brazilian law than under US law and the laws of other jurisdictions and there are different procedural requirements for bringing shareholder lawsuits, such as shareholder derivative suits. As a result, in practice it may be more difficult for our minority shareholders to enforce their rights against us or our directors or controlling shareholder than it would be for shareholders of a non-Brazilian company.

Actual or anticipated sales of a substantial number of our common shares could decrease the market prices of our common shares and ADSs.

Sales of a substantial number of our common shares – or the anticipation of such sales – could decrease the trading price of our common shares and ADSs. As of December 31, 2007, we had 227,836,623 common shares outstanding, including 114,508,087 shares held by the State. As a consequence of the issuance of common shares or sales by the State or other existing shareholders, the market price of our common shares and, by extension, our ADSs may decrease significantly. As a result, a holder may not be able to sell his or her securities at or above the price he or she paid for them.

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

Under our by-laws, 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 São Paulo Stock Exchange Arbitration Rules in the São Paulo Stock Exchange 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. The State is currently not permitted by law to sell its control shares. 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 by-laws. In that event, a purchaser of ADSs would be effectively precluded from pursuing remedies under the U.S. securities laws in the U.S. courts.

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

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

A holder of our ADSs may find it more difficult than a holder of our common shares to exercise his or her voting rights at our shareholders' meetings.

Holders may exercise voting rights with respect to the common shares represented by our ADSs only in accordance with the deposit agreement relating to our ADSs. There are no provisions under Brazilian law or under our by-laws that limit the exercise by ADR holders of their voting rights through the depositary with respect to the underlying common shares. However, there are practical limitations upon the ability of ADR holders to exercise their voting rights due to the additional procedural steps involved in communicating with these holders. For example, our common shareholders will receive notice of shareholders' meetings through publication of a notice in an official government publication in Brazil and will be able to exercise their voting rights by either attending the meeting in person or voting by proxy. ADR holders, by comparison, will not receive notice directly from us. Instead, in accordance with the deposit agreement, we will provide the notice to the depositary, which will, in turn, as soon as practicable thereafter mail to ADR holders the notice of the meeting and a statement as to the manner in which instructions may be given by holders, but only if we request the depositary to do so. To exercise their voting rights, ADR holders must then instruct the depositary as to voting the common shares represented by their ADSs. Due to these procedural steps involving the depositary, the process for exercising voting rights may take longer for ADR holders than for holders of common shares. ADSs for which the depositary fails to receive timely voting instructions will not be voted at any meeting.