

TELESP HOLDING CO  
Form 20-F  
March 01, 2011

As filed with the Securities and Exchange Commission on March 1, 2011

---

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

---

FORM 20-F  
(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
- OR
- ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the fiscal year ended December 31, 2010
- OR
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
- OR
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-14475

---

TELECOMUNICAÇÕES DE SÃO PAULO S.A. – TELESP  
(Exact name of Registrant as specified in its charter)

Telecommunications of São Paulo – Telesp  
(Translation of Registrant's name into English)

Federative Republic of Brazil  
(Jurisdiction of incorporation or organization)

Rua Martiniano de Carvalho, 851  
01321-001 São Paulo, SP, Brasil  
(Address of principal executive offices)

---

Securities registered or to be registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Preferred Shares, without par value	New York Stock Exchange*
American Depositary Shares (as evidenced by American Depositary Receipts), each representing 1 share of Preferred Stock	New York Stock Exchange

Edgar Filing: TELESP HOLDING CO - Form 20-F

\* Not for trading purposes, but only in connection with the registration on the New York Stock Exchange of American Depositary Shares representing those Preferred Shares.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

The number of outstanding shares as of December 31, 2010 was:

Title of Class	Number of Shares Outstanding
Shares of Common Stock	168,609,291
Shares of Preferred Stock	337,232,189

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.  
 Yes  No

Note – Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  
 Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):  
Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:  
International Financial Reporting Standards  
as issued by  
the International Accounting Standards Board  Other   
U.S. GAAP

If "Other" has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow.  
 Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
 Yes  No



TABLE OF CONTENTS

	Page
<u>ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS</u>	5
<u>ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE</u>	5
<u>ITEM 3. KEY INFORMATION</u>	5
<u>ITEM 4. INFORMATION ON THE COMPANY</u>	14
<u>ITEM 4A. UNRESOLVED STAFF COMMENTS</u>	41
<u>ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS</u>	41
<u>ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES</u>	56
<u>ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS</u>	68
<u>ITEM 8. FINANCIAL INFORMATION</u>	69
<u>ITEM 9. THE OFFER AND LISTING</u>	77
<u>ITEM 10. ADDITIONAL INFORMATION</u>	82
<u>ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	94
<u>ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES</u>	95
<u>ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES</u>	97
<u>ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS</u>	97
<u>ITEM 15. CONTROLS AND PROCEDURES</u>	97
<u>ITEM 16. [RESERVED]</u>	98
<u>ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT</u>	98
<u>ITEM 16B. CODE OF ETHICS</u>	98
<u>ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	98
<u>ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES</u>	99
<u>ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS</u>	100
<u>ITEM 16F. CHANGE IN REGISTRANT'S CERTIFYING ACCOUNTANT</u>	100
<u>ITEM 16G. CORPORATE GOVERNANCE</u>	100
<u>ITEM 17. FINANCIAL STATEMENTS</u>	102
<u>ITEM 18. FINANCIAL STATEMENTS</u>	102
<u>ITEM 19. EXHIBITS</u>	102

<u>GLOSSARY OF TELECOMMUNICATIONS TERMS</u>	<u>104</u>
<u>SIGNATURES</u>	<u>106</u>

Table of Contents

INTRODUCTION

References in this annual report to “Telesp,” “we,” “our,” “us” and “the company” are to Telecomunicações de São Paulo S.A. TELESP and its consolidated subsidiaries (unless the context otherwise requires). In addition, all references in this annual report to:

- “ADSs” are to our American Depositary Shares, each representing one share of our non-voting preferred shares;
- “ANATEL” are to Agência Nacional de Telecomunicações – ANATEL, the National Telecommunications Agency of Brazil;
  - “BM&FBOVESPA” are to the Bolsa de Valores, Mercadorias e Futuros;
- “Brazilian Central Bank” or “Central Bank” are to the Banco Central do Brasil, the Central Bank of Brazil;
- “Brazilian Corporate Law” are to the Lei das Sociedades por Ações, Law No. 6,404 of December 1976, as amended;
  - “Brazilian government” are to the federal government of the Federative Republic of Brazil;
  - “CADE” are to Conselho Administrativo de Defesa Econômica, the Brazilian competition authority;
    - “Ceterp” are to Centrais Telefônicas de Ribeirão Preto;
  - “CDI” are to Certificado de Depósito Interbancário, the Certificate for Interbank Deposits;
  - “CMN” are to the Conselho Monetário Nacional, the Monetary Council of Brazil;
  - “Commission” or “SEC” are to the U.S. Securities and Exchange Commission;
- “Corporate Law Method” is the accounting practice to be followed in the preparation of our financial statements for regulatory and statutory purposes prescribed by the Brazilian Corporate Law and accounting standards issued by the CVM;
  - “CTBC Telecom” are to Companhia de Telecomunicações do Brasil Central;
  - “CTBC Borda” are to Companhia Brasileira Borda do Campo – CTBC;
  - “CVM” are to the Comissão de Valores Mobiliários, the Securities Commission of Brazil;
- “General Telecommunications Law” are to Lei Geral de Telecomunicações, as amended, which regulates the telecommunications industry in Brazil;
  - “IASB” are to International Accounting Standards Board;
  - “IFRS” are to International Financial Reporting Standards, as issued by IASB;
  - “IPCA” are to Índice Nacional de Preços ao Consumidor Amplo, the consumer price index;
  - “IST” are to Índice Setorial de Telecomunicações, the inflation index of the telecom sector;

- “JPY” are to Japanese Yen;
- “Number Portability” are to “Portabilidade Numérica,” the service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers;

Table of Contents

- “PTAX rate” are to the weighted average daily buy and sell exchange rates between the real and U.S. dollar that is calculated by the Central Bank;
  - “real,” “reais” or “R\$” are to Brazilian reais, the official currency of Brazil;
- “Speedy” are to broadband services provided by Telesp through asymmetric digital subscriber lines, or ADSL;
  - “TJLP” are to Taxa de Juros de Longo Prazo, or long term interest rate; and
  - “US\$,” “dollars” or “U.S. dollars” are to United States dollars.

Unless otherwise specified, data relating to the Brazilian telecommunications industry included in this annual report were obtained from ANATEL.

The “Glossary of Telecommunications Terms” that begins on page 104 provides the definition of certain technical terms used in this annual report.



Table of Contents

FORWARD-LOOKING STATEMENTS

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Certain statements included in this annual report, principally in “Item 3. Key Information—Risk Factors,” “Item 4—Information on the Company” and “Item 5—Operating and Financial Review and Prospects,” contain information that is forward looking, including, but not limited to:

- statements concerning our operations and prospects;
- the size of the Brazilian telecommunications market;
- estimated demand forecasts;
- our ability to secure and maintain telecommunications infrastructure licenses, rights-of-way and other regulatory approvals;
  - our strategic initiatives and plans for business growth;
  - industry conditions;
  - our funding needs and financing sources;
  - network completion and product development schedules;
  - expected characteristics of competing networks, products and services; and
- other statements of management’s expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts.

Forward-looking statements may also be identified by words such as “believe,” “expect,” “anticipate,” “project,” “intend,” “should,” “seek,” “estimate,” “future” or similar expressions. Forward-looking information involves risks and uncertainties that could significantly affect expected results. The risks and uncertainties include, but are not limited to:

- the short history of our operations as an independent, private-sector entity and the ongoing introduction of greater competition to the Brazilian telecommunications sector;
  - the cost and availability of financing;
- uncertainties relating to political and economic conditions in Brazil as well as those of other emerging markets;
  - inflation and exchange rate risks;
  - the Brazilian government’s telecommunications policy;
  - the Brazilian government’s tax policy;
  - the Brazilian government’s political instability; and
  - the adverse determination of disputes under litigation.

We undertake no obligation to update publicly or revise any forward-looking statements because of new information, future events or otherwise. In light of these risks and uncertainties, the forward-looking information, events and circumstances discussed in this annual report might not occur. Our actual results and performance could differ substantially from those anticipated in our forward-looking statements.

3

---

Table of Contents

PRESENTATION OF FINANCIAL INFORMATION

We maintain our books and records in reais. We prepared our consolidated financial statements included in this annual report in accordance with the IFRS. These consolidated annual financial statements are our first financial statements prepared in accordance with the IFRS, as issued by International Accounting Standards Board (“IASB”). IFRS 1 – “First-time Adoption of International Financial Reporting Standards” has been applied in preparing these financial statements. Until December 31, 2009, our consolidated financial statements were prepared in accordance with accounting practices adopted in Brazil (“Brazilian GAAP”). Brazilian GAAP is based on the Brazilian Corporate Law No. 6,404 of December 15, 1976, as amended, and included the provisions of Law No. 11,638/2007 and Law No. 11,941, dated May 27, 2009; the accounting standards issued by the Brazilian Federal Accounting Council (Conselho Federal de Contabilidade – “CFC”); the accounting standards issued by the Accounting Standards Committee (Comitê de Pronunciamentos Contábeis – “CPC”); and the rules and regulations issued by the Brazilian Securities Commission (Comissão de Valores Mobiliários – “CVM”). After the adoption of CPCs No.15 to 43, Brazilian GAAP does not differ from IFRS, for preparation of consolidated financial statements. The comparative figures with respect to 2009 have been restated to reflect adjustments made as a result of the adoption of IFRS. Reconciliations and descriptions of the effect of the transition from Brazilian GAAP to IFRS are given in Note 3 to our consolidated financial statements included elsewhere in this annual report. These consolidated financial statements have been audited by Ernst & Young Terco Auditores Independentes S.S. (“EY” or “Ernst & Young”). In this annual report we will refer to the set of accounting practices adopted in Brazil, through December 31, 2009, as the “Former Brazilian GAAP”.

We have made rounding adjustments to reach some of the figures included in this annual report. Accordingly, numerical figures shown as totals in some tables may not be an arithmetic aggregation of the figures that preceded them.

Table of Contents

## PART I

## ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

## ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

## ITEM 3. KEY INFORMATION

## A. Selected Financial Data

We maintain our books and records in reais. We prepared our consolidated financial statements included in this annual report in accordance with the IFRS. These consolidated annual financial statements are our first financial statements prepared in accordance with the IFRS, as issued by International Accounting Standards Board (“IASB”). IFRS 1 – “First-time Adoption of International Financial Reporting Standards” has been applied in preparing these financial statements. Until December 31, 2009, our consolidated financial statements were prepared in accordance with accounting practices adopted in Brazil (“Brazilian GAAP”). Brazilian GAAP is based on the Brazilian Corporate Law No. 6,404 of December 15, 1976, as amended, and included the provisions of Law No. 11,638/2007 and Law No. 11,941, dated May 27, 2009; the accounting standards issued by the Brazilian Federal Accounting Council (Conselho Federal de Contabilidade – “CFC”); the accounting standards issued by the Accounting Standards Committee (Comitê de Pronunciamentos Contábeis – “CPC”); and the rules and regulations issued by the Brazilian Securities Commission (Comissão de Valores Mobiliários – “CVM”). After the adoption of CPCs No.15 to 43, Brazilian GAAP does not differ from IFRS, for preparation of consolidated financial statements. The comparative figures with respect to 2009 have been restated to reflect adjustments made as a result of the adoption of IFRS. Reconciliations and descriptions of the effect of the transition from Brazilian GAAP to IFRS are given in Note 3 to our consolidated financial statements included elsewhere in this annual report. These consolidated financial statements have been audited by Ernst & Young Terco Auditores Independentes S.S. (“EY” or “Ernst & Young”). In this annual report we will refer to the set of accounting practices adopted in Brazil, through December 31, 2009, as the “Former Brazilian GAAP”.

The following tables present a summary of our selected financial data at the dates and for each of the periods indicated. You should read the following information together with our audited consolidated financial statements and the notes thereto included elsewhere in this annual report and with “Item 5—Operating and Financial Review and Prospects.”

	Year ended December 31,	
	2010	2009
	(in millions of reais, except for share and per share data)	
Income Statement Data:		
Net operating revenue	15,756	15,806
Cost of goods and services	(8,793 )	(9,092 )
Gross profit	6,963	6,714
Operating expenses, net	(3,417 )	(3,316 )
Operating income before financial expense, net	3,546	3,398

Edgar Filing: TELESP HOLDING CO - Form 20-F

Financial expense, net	(121 )	(189 )
Income before tax and social contribution	3,425	3,209
Income tax and social contribution	(1,027 )	(1,005 )
Net Income	2,398	2,204
Basic and diluted earnings per share:		
Common Shares	4.45	4.08
Preferred Shares	4.89	4.49
Cash Dividends per share in reais, net of withholding tax:		
Common Shares	3.62	2.56
Preferred Shares	3.98	2.81

Table of Contents

	As of December 31, 2010	As of 2009	As of January 1, 2009(1)
	(in millions of reais, except where indicated)		
<b>Balance Sheet Data:</b>			
Property, plant and equipment, net	10,201	9,672	9,869
Total assets	19,966	20,643	20,324
Loans and financing—current portion	420	1,768	502,503
Loans and financing—non-current portion	1,405	1,752	1,717
Shareholders' equity	11,667	11,300	10,382
Capital stock	6,575	6,575	6,575
Number of shares outstanding (in thousands)	505,841	505,841	505,841

(1) Reflecting our retroactive application of changes to the accounting criteria to enable the Former Brazilian GAAP to converge with IFRS.

	December 31, 2010	2009
	(in millions of reais, except where indicated)	
<b>Cash Flow Data:</b>		
<b>Operating activities:</b>		
Net cash provided by operations	4,532	4,449
<b>Investing activities:</b>		
Net cash used in investing activities	(1,659 )	(2,296 )
<b>Financing activities:</b>		
Net cash used in financing activities	(3,594 )	(1,618 )
Increase (decrease) in cash and cash equivalents	(720 )	536
Cash and cash equivalents at beginning of year	2,277	1,741
Cash and cash equivalents at end of year	1,557	2,277

**Exchange Rates**

The Brazilian Central Bank allows the real/U.S. dollar exchange rate to float freely and has intervened occasionally to control the exchange rate volatility. However, the exchange market may continue to be volatile, and the real may depreciate or appreciate substantially in relation to the U.S. dollar. The Brazilian Central Bank or the Brazilian government will intervene in the exchange rate market.

On September 27, 2006, Resolution No. 3,412 absolved existing restrictions on investments in foreign financial and derivative markets by individuals and legal entities. On October 27, 2006, Resolution No. 3,417 increased the liquidation period permitted for exchange transactions from 360 to 750 days.

Since March 17, 2008, Brazilian exporters are allowed to keep 100% of income from exports outside of Brazil. In addition, the foreign exchange mechanism was simplified to provide for the simultaneous purchase and sale of foreign

currency through the same financial institution and using the same exchange rate.

In October 2009, the Brazilian government increased the tax rate related to foreign investments in the Brazilian financial and capital markets from zero to two percent, including investments made pursuant the Brazilian Monetary Council (Conselho Monetário Nacional), or CMN, Resolution No. 2,689, dated January 26, 2000, as amended, or Resolution No. 2,689. The Tax on Financial Transactions (Imposto sobre Operações Financeiras), or IOF tax, applies upon conversion of foreign currency into Brazilian reais related to equity or debt investments by foreign

Table of Contents

investors in the Brazilian stock exchanges or the over-the-counter, or OTC, market, as well as private investment funds, Brazilian treasury notes and other fixed income securities.

On October 5, 2010, the Brazilian government announced measures to respond to the real appreciation by increasing to four percent the IOF tax rate on foreign exchange transactions related to foreign investments in the financial and capital market, except for variable income investments traded on the stock exchange, which remained at two percent. On October 18, 2010, new increases in the IOF tax rate were announced by the Brazilian government which adopted a six percent rate for foreign exchange transactions and for the investments of foreign investors in accordance with the margin requirements for futures transactions on the Brazilian Stock, Commodities and Futures Exchange (BM&FBOVESPA). The IOF tax rate remains at zero on exchange transactions for outflow for these funds as well as over proceeds received as a result of initial public offerings. The conversion of Brazilian currency into foreign currency for purposes of paying dividends for ADS programs is not taxed. On January 6, 2011, the Brazilian Central Bank published Circular 3,520 (Circular 3,520/2011), which imposes a 60% minimum reserve deposit for any financial operations exceeding U.S.\$3 billion.

The following tables set forth the exchange rate (rounded to the nearest tenth of a cent), expressed in reais per U.S. dollar (R\$/US\$) for the periods indicated, as reported by the Central Bank.

Year ended December 31,	Exchange Rate of R\$ per US\$			
	Low	High	Average(1)	Year-End
2006	2.059	2.371	2.168	2.138
2007	1.732	2.156	1.929	1.771
2008	1.559	2.500	1.833	2.337
2009	1.741	2.378	1.990	1.741
2010	1.655	1.880	1.759	1.665

Source: Central Bank of Brazil, PTAX.

(1) Represents the average of the exchange rates (PTAX) on the last day of each month during the relevant period.

Month ended	Exchange Rate of R\$ per US\$			
	Low	High	Average(2)	Period-End
September 30, 2010	1.694	1.744	1.719	1.694
October 29, 2010	1.655	1.711	1.683	1.701
November 30, 2010	1.680	1.734	1.707	1.716
December 31, 2010	1.666	1.712	1.689	1.666
January 31, 2011	1.651	1.691	1.671	1.673
February 28, 2011	1.661	1.678	1.668	1.661

Source: Central Bank of Brazil, PTAX.

(2) Represents the average of the exchange rates (PTAX) of the lowest and highest rates in the month.

## B. Capitalization and Indebtedness



Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

7

---

Table of Contents

D. Risk Factors

This section is intended to be a summary of more detailed discussions contained elsewhere in this annual report. The risks described below are not the only ones we face. Additional risks that we do not presently consider material, or of which we are not currently aware, may also affect us. Our business, results of operations or financial condition could be impacted if any of these risks materializes and, as a result, the market price of our preferred shares and our ADSs could be affected.

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This influence, as well as Brazilian political and economic conditions, could adversely affect us and the trading price of our preferred shares and ADSs.

In the past, the Brazilian government has intervened in the Brazilian economy and made changes in policy and regulations. The Brazilian government's actions to control inflation and affect other policies have often involved wage and price controls, currency devaluations, capital controls, and limits on imports, among other things. Our business, financial condition, results of operations and the market price of our preferred shares and ADSs may be adversely affected by changes in government policies, especially those related to our sector, such as changes in telephone fees and competitive conditions, as well as general economic factors, including:

- currency fluctuations;
- exchange control policies;
- internal economic growth;
  - inflation;
  - energy policy;
  - interest rates;
- liquidity of domestic capital and lending markets;
- tax policies; and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over the possibility of the Brazilian government implementing changes in policy or regulation affecting these or other factors in the future may contribute to economic uncertainty in Brazil and heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian companies. In addition, possible political crises may affect the confidence of investors and the public in general, which may result in economic deceleration and affect the trading prices of shares issued by companies listed on the stock exchange, such as us.

Our business may be vulnerable to the current disruptions and volatility in the global financial markets.

The international economy remains subject to risks and adjustments arising from the international financial crisis from 2008. The international financial system remains susceptible to unfavorable credit and liquidity conditions. Foreign

and national financial institutions, including some of the largest commercial banks, investment banks, mortgage lenders, guarantors and mortgage insurance companies, could continue to experience significant difficulties, including runs on their deposits and inadequate liquidity. Therefore, the prices of financial assets are likely to continue to reflect risk aversion, with increased volatility.

In an attempt to increase liquidity in the financial markets and prevent the failure of the financial system, various governments may continue to intervene in their financial systems, and perform tax adjustments. There is no

Table of Contents

guarantee, however, that these measures will be successful in stabilizing conditions in international financial markets.

Despite the extent of the above-mentioned interventions, global investor confidence could remain low, the global financial markets could remain volatile and access to credit could still be lacking. The continuation or worsening of disruption and volatility in the global financial markets may have a material adverse effect on our ability to access the capital markets under appropriate financial conditions, which may adversely affect our operations. Furthermore, an environment of economic downturn may negatively affect the financial stability of our customers, which could result in a general reduction in Brazil's economic activity and the consequent loss of income for us.

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

Political crisis in Brazil can affect the trust of investors and the public in general, as well as the development of the economy. Political crises may have an adverse impact on the Brazilian economy, our business, financial condition, results of operations and the market price of our preferred shares and ADSs.

Inflation and government efforts to curb inflation may contribute to economic uncertainty in Brazil, adversely affecting our business and results of operations.

Brazil has historically experienced high rates of inflation. Inflation and certain of the government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2010, inflation measured by the Consumer Price Index (Índice de Preços ao Consumidor), or IPCA, published by the Instituto Brasileiro de Geografia e Estatística, reached 5.9%, under the upper limit of 6.5% established by the National Monetary Council, but over the central inflation target of 4.5%. In 2011, the Brazilian monetary policy will continue to use the IPCA for establishing the inflation target. The inflation target for 2011 is set at 4.5%, similar to 2010. If inflation rises beyond this target, the basic interest rates may rise, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2011, factors that may adversely affect consumer inflation are, among others, the international commodities prices, the impact of buoyant domestic economic activity on domestic prices and the indexation of prices and tariffs.

Since 2006, telephone fees for fixed-line services have been indexed to the Index of Telecommunications Service, or IST, reduced by a productivity factor. The IST is a basket of national indexes that reflect the industry's operating costs. As a result, this index serves to reduce potential discrepancies between our industry's revenue and costs, and thus reduce the apparent adverse effects of inflation upon our operations.

The rate increase authorized by ANATEL in 2011, which will reference the IST, will be reduced by a factor of productivity and applied cumulatively after a period of 12 months. This can cause increases in costs and salaries above and below that of our revenue, with adverse impacts on our profitability. Increases in interest rates may have a material adverse effect on our business.

The Monetary Policy Committee of the Brazilian Central Bank (Comitê de Política Monetária do Banco Central do Brasil), or COPOM, sets the target of the basic interest rate for the Brazilian financial system based on an expectation of convergence between the future inflation rate and the central inflation target. On December 31, 2010, the basic interest rate was 10.75% per year, compared to 8.75% per year on December 31, 2009. As of the date of this Form 20-F, market consensus indicates that inflation measured by the IPCA will be higher than the inflation target of 4.5% for 2011. Hence, we expect COPOM to increase interest rates during this year, with adverse effects on our business.

Fluctuations in exchange rates may adversely affect our ability to meet liabilities denominated or linked to foreign currencies or reduce our income in foreign currency, and may have a material adverse effect on the market value of our preferred shares and ADSs.

The exchange rate between the U.S. dollar and the Brazilian real has experienced significant fluctuations in the recent years. Between 2000 and 2003, the real was devalued 68% against the U.S. dollar and gained 32% between 2004 and 2010. Between 2000 and 2010, the real depreciated by 9% against the U.S. dollar.

Table of Contents

As of December 31, 2010, 0.95% of our R\$1.83 billion total financial debt was denominated in U.S. dollars. As of December 31, 2010, we had currency hedges in place to cover all of our financial foreign currency-denominated bank debt.

Part of the costs relating to our network infrastructure and services provided by outside vendors is payable or linked to payment by us in U.S. dollars. By contrast, our revenue is generated in reais, except income derived from hedging transactions, international long distance interconnection and services to customers outside of Brazil.

To the extent that the value of the real decreases relative to the U.S. dollar or euro, our commitments linked to fluctuations in exchange rates or payable in foreign currencies becomes more expensive and in return our accounts receivable denominated in foreign currencies appreciate themselves, which could adversely affect our revenue and expenses. However, 97.0% of the net balance of the transactions denominated in foreign currencies are covered by hedge transactions. Since May 2010, the Company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures generated by invoices issued or received in foreign currencies, substantially reducing the Company's risk to fluctuations in exchange rates. By periodically receiving invoices for the net balance coverage and determining the coverage of exposures, the Company's corporate market risk department monitors its foreign exchange exposure and commitments linked to foreign currencies so as not to achieve a significant amount.

Political, economic and social developments, and the perception of risk in other countries, both emerging and developed market countries, may adversely affect the Brazilian economy, our business, and the market price of Brazilian securities, including our preferred shares and ADSs.

The market for securities issued by Brazilian companies may be influenced, in varying degrees, by economic conditions in both emerging and developed market countries. The reaction of investors to developments in other countries may have an adverse impact on the market value of securities of Brazilian companies. Crises in other emerging countries or the economic policies of other countries may reduce investor demand for securities of Brazilian companies, including our preferred shares. Any of the foregoing developments may adversely affect the market value of our preferred shares and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

Exchange controls and restrictions on remittances abroad may adversely affect holders of our preferred shares and ADSs.

Brazilian law allows that, whenever there is a significant imbalance in Brazil's balance of payments or a significant possibility that such imbalance will exist, the Brazilian government may impose temporary restrictions on capital outflows. Such restrictions could hinder or prevent the holders of our preferred shares or the depositary for the ADSs from remitting dividends abroad. The Brazilian government imposed restrictions on capital outflows for a six-month period at the end of 1989. If similar restrictions are introduced in the future, they would likely have an adverse effect on the market price of our preferred shares and ADSs.

Risks Relating to the Brazilian Telecommunications Industry and Us

Extensive government regulation of the telecommunications industry and our concession may limit our flexibility in responding to market conditions, competition and changes in our cost structure or impact our fees.

Our business is subject to extensive government regulation. ANATEL, which is the primary telecommunications industry regulator in Brazil, is responsible for, among other things:

- industry policies and regulations;



Table of Contents

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

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

Our concession may be terminated by the Brazilian government under certain circumstances.

We operate our business under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, expansion of our network to provide public pay-phone service for all locations with populations in excess of 100, expansion of our network to provide private individual telephone service for all locations with populations in excess of 300, and, with respect to quality of service, targets for the number of call completions. Our ability to satisfy these terms and conditions, as well as others, may be affected by factors beyond our control. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations. Moreover, the concession agreements establish that all assets owned by the Company and which are indispensable to the provision of the services described in such agreements are considered reversible assets and are deemed to be part of the concession assets. The assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time. On December 31, 2010, the net book value of reversible assets is estimated at R\$6.9 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

The expiration date of the original concession agreements was December 31, 2005, but it has since been renewed as of December 22, 2005 for an additional 20-year term. The current concession agreements contain a provision allowing ANATEL to review the concession terms in 2010, 2015 and 2020. This provision permits ANATEL to update the renewed concession agreements with respect to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions. On December 30, 2010, ANATEL amended the Company’s concession agreements to allow further amendments on May 2, 2011, December 31, 2015 and December 31, 2020. These further amendments may establish new conditions and targets for universal access and quality, taking into consideration the conditions prevailing at the



time, including complementary resources.

Important mergers and acquisitions in the market should increase competition in the upcoming years.

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

## Table of Contents

In 2010, important changes occurred in the structure of major companies in the fixed and mobile market, which set a new competitive landscape and are likely to contribute to the acceleration of the convergence of telecommunication technologies and offerings, as well as to geographic expansion. In July 2010, Telefónica S.A. completed the acquisition of a stake in Vivo S.A. from Portugal Telecom, becoming the leader in the Brazilian telecommunications market, considering the number of customers and annual revenue. In the second quarter of 2010, America Movil announced the merger of its fixed (Embratel) and mobile (Claro) Brazilian operations. Throughout 2010, Oi has focused its efforts in integrating its operations with Brasil Telecom and in January 2011, Portugal Telecom completed the acquisition of a minority stake in Oi thus allowing Oi to deleverage its indebtedness and to resume its investments. In May 2010, TIM, a subsidiary of Telecom Italia, announced that they had finished the integration of Intelig, a fixed telephony company acquired in 2009. These corporate movements may cause additional competitive pressures and changes in market share and may potentially impact our business, financial condition and results of operations, especially in combination with a more aggressive number portability strategy that may reduce our customer base.

We face increasing competition from cellular service providers.

Rapid growth of the cellular telecommunications industry and intense competition among cellular service providers have resulted in an expansion of broadband wireless services, lower prices for cellular services, and a greater focus on the market for prepaid lines. Cellular services are increasingly becoming an alternative to fixed telecommunications services and are likely to continue to negatively impact our results of operations. In the long distance business, the aggressive performance of mobile operators, in particular TIM, drove the growth of this market and reduced the participation of fixed-line operator Telefónica. In December 2010, ANATEL held an auction for the last available frequencies for 3G services (third generation mobile phone services), allowing entry of new competitors in the market for wireless broadband communication, further increasing the risk of potential negative impacts on our business. Any loss of market share as a result of competition from cellular service providers could have an adverse effect on our business, financial condition and results of operations.

The industry in which we conduct our business is continually changing and evolving technologically.

The telecommunications industry is subject to rapid and significant technological changes. Our future success depends on our ability to anticipate and adapt in a timely manner to technological changes. We expect that new products and technologies will emerge and that existing products and technologies will be further developed.

The advent of new products and technologies could have a variety of consequences. These new products and technologies may reduce the price of our services by providing lower-cost alternatives, or they may also be superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring investment in new technology.

In August 2010, ANATEL established a new policy regulating the 2.5 GHz spectrum which requires MMDS (Multichannel Multipoint Distribution Service) companies, including us, to return, until 2013, a significant portion of the spectrum they currently own and to offer cable TV on a primary basis. Through this initiative, the ANATEL objects to providing more spectrum availability to mobile operators in Brazil, thus restricting them from increasing service penetration and superior data communication.

We seek to invest in new technology to remain competitive in a rapidly changing market. We have announced the launching of several new products during 2010, including our FTTH program, which intends to offer 3Play services on an industrial scale in the State of São Paulo in the upcoming years.

Risks Relating to the Preferred Shares and the ADSs

Holders of our ADSs may face difficulties in serving process on or enforcing judgments against us and other persons.

We are organized under the laws of Brazil, and all of our executive officers and our independent public accountants reside or are based in Brazil. Also, four of our sixteen directors reside or are based in Brazil. Substantially all of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of the ADSs to effect service of process upon us or these other persons within the United States or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United

Table of Contents

States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain conditions are met, holders may face greater difficulties in protecting their interests due to actions by us, our directors or executive officers than would shareholders of a U.S. corporation.

Holders of Our Preferred Shares and ADSs generally do not have voting rights.

In accordance with Brazilian Corporate Law and our bylaws, holders of our preferred shares, and therefore of our ADSs, are not entitled to vote at meetings of our shareholders, except in limited circumstances set forth in “Item 10. Additional Information—B. Memorandum and Articles of Association.”

Holders of Our Preferred Shares might be unable to exercise preemptive rights with respect to the preferred shares unless there is a current registration statement in effect which covers those rights or unless an exemption from registration applies.

Holders of our preferred shares will not be able to exercise the preemptive rights relating to the preferred shares underlying your ADSs unless a registration statement under the U.S. Securities Act of 1933, as amended, or the Securities Act, is effective with respect to the shares underlying those rights, or an exemption from the registration requirements of the Securities Act is available. We are not obligated to file a registration statement. Unless we file a registration statement or an exemption from registration applies, holders of our preferred shares may receive only the net proceeds from the sale of their preemptive rights by the depository, or if the preemptive rights cannot be sold, they will lapse and you will not receive any value for them. For more information on the exercise of these rights, see “Item 10. Additional Information—B. Memorandum and Articles of Association—Preemptive Rights.”

An exchange of ADSs for preferred shares risks the loss of certain foreign currency remittance and Brazilian tax advantages.

The ADSs benefit from the certificate of foreign capital registration, which permits The Bank of New York, as depository, to convert dividends and other distributions with respect to preferred shares into foreign currency, and to remit the proceeds abroad. Holders of ADSs who exchange their ADSs for preferred shares will then be entitled to rely on the depository’s certificate of foreign capital registration for five business days from the date of exchange. Thereafter, they will not be able to remit non-Brazilian currency abroad unless they obtain their own certificate of foreign capital registration, or unless they qualify under Resolution 2,689 of the Central Bank of Brazil, dated January 26, 2000 and issued by BACEN, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration.

If holders of ADSs do not qualify under Resolution 2,689, they will generally be subject to less favorable tax treatment with respect to our preferred shares. There can be no assurance that the depository’s certificate of registration or any certificate of foreign capital registration obtained by holders of ADSs will not be affected by future legislative or regulatory changes, or that additional Brazilian law restrictions applicable to their investment in the ADSs may not be imposed in the future.

Holders of our preferred shares will be subject to, and holders of our ADSs could be subject to, Brazilian income tax on capital gains from sales of preferred shares or ADSs.

Brazilian Law No. 10,833 provides that gains on the disposition of assets located in Brazil by non-residents of Brazil, whether to other non-residents or to Brazilian residents, will be subject to Brazilian taxation. The preferred shares are expected to be treated as assets located in Brazil for purposes of the law, and gains on the disposition of preferred shares, even by non-residents of Brazil, are expected to be subject to Brazilian taxation.

Based on the fact that the ADSs are issued and registered abroad, we believe that gains on the disposition of ADSs made outside of Brazil by non-residents of Brazil to another non-Brazilian resident would not be subject to Brazilian taxation, since it will not fall within the definition of assets located in Brazil for purposes of Law 10,833. However, considering the general and unclear scope of Law No. 10,833 and the absence of judicial court rulings in

## Table of Contents

respect thereto, we cannot be assured that such an interpretation of this law will prevail in the courts of Brazil. If the income tax is deemed to be due, the gains may be subject to income tax in Brazil at a rate of 15.0% (general taxation) or 25.0% (if the non-resident seller is located in a tax haven, a country which does not impose any income tax, which imposes it at a maximum rate lower than 20.0%, or in which the laws impose restrictions on the disclosure of ownership composition or securities ownership or the identification of the effective beneficiary of income attributed to non-resident holders). See “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations.”

### Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

Telefónica Internacional S.A., or Telefónica Internacional, our principal shareholder, currently owns directly and indirectly approximately 85.57% of our voting shares and 87.95% of our total capital. See “Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders” and “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions.” As a result of its share ownership, Telefónica Internacional has the power to control us and our subsidiaries, including the power to elect our directors and officers and to determine the outcome of any action requiring shareholder approval, including transactions with related parties, corporate reorganizations and the timing and payment of our dividends. Given this degree of control over our company, circumstances could arise under which the interests of Telefónica Internacional could be deemed to be in conflict with the interests of our other shareholders.

## ITEM 4. INFORMATION ON THE COMPANY

### A. History and Development of the Company

#### General

Following the restructuring and privatization of Telebrás, discussed below, we were incorporated on May 22, 1998, as a corporation (sociedade anônima) organized under the laws of the Federative Republic of Brazil. We are registered with the CVM, as a publicly held company and our stock is traded on BM&FBOVESPA. We are also registered with the SEC in the United States and our ADSs are traded on the New York Stock Exchange, or the NYSE. Our headquarters are located at Rua Martiniano de Carvalho, 851, 01321-001, São Paulo, SP, Brasil. Our telephone number is 55-11-3549-7200.

As of December 31, 2010, we had 168,609,291 outstanding common shares, with no par value per share, and 337,232,189 preferred shares, with no par value per share. Our shareholders’ equity was in the amount of R\$11.7 billion as presented under IFRS.

We provide fixed-line telecommunications services in the State of São Paulo under concession agreements granted in 1998 by the Brazilian government in connection with the restructuring and privatization of the Telebrás System, as described below. The concession, which was renewed in December 2005, authorizes us to provide fixed-line telecommunications services in a specific region, which includes all of the State of São Paulo except for a small area (Sector 33), where a previously existing fixed-line service provider, CTBC Telecom, which was not part of the Telebrás System, continues to operate independently.

In addition to the services we provide under the concession agreements of 1998, we also provide international and interregional long-distance services, as permitted under Act No. 23,395 of March 1, 2002, under which ANATEL also acknowledged the accomplishment of our network expansion and universal service targets as of September 30, 2001.

We also provide multimedia communication services (“serviços de comunicação multimídia” or “SCM”) such as audio, data, voice and other sounds, images, texts and other information. ANATEL granted the SCM license with Act No. 33,791 of February 14, 2003, which authorized the rendering of the service in all of the State of São Paulo, except for a small area (Sector 33).

## Table of Contents

In March 14, 2007, ANATEL conceded to A.Telecom S.A., one of our wholly-owned subsidiaries, the license to offer Pay TV services through DTH (“Direct to the Home” - a special type of service that uses satellites for the direct distribution of television and audio signals for subscribers). We began offering Pay TV services on August 12, 2007.

On October 31, 2007, the board of ANATEL approved, from a regulatory perspective, the association between Grupo Abril and the Company, which involved, among other transactions, the acquisition of all of the operations of Multichannel Multipoint Distribution Service (MMDS), a special license that allows us to offer Pay TV and broadband services through our subsidiary Telefonica Sistemas de Televisão S.A. The transaction continues to be analyzed by ANATEL, solely with respect to antitrust matters, and will be finally reviewed by CADE.

In 2008, the Company pioneered the launch of internet access through fiber optic cables (“Fiber to the Home” - FTTH) for non-commercial customers. Aside from the offer of an internet connection with high-speed capacities of 30 Mbps and 100 Mbps, various bundles have also been offered, including Wi-Fi, Digital TV, 2,000 minutes of local and intra-state calls, anti-virus protection, call identification, technical assistance and specific call center assistance.

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated to the MMDS in the cities of São Paulo, Curitiba, Rio de Janeiro and Porto Alegre.

As of December 31, 2010, our telephone network included 11.3 million fixed lines in service, 3.3 million broadband clients and 0.5 million Pay TV clients. Of the access lines in service, approximately 70% were residential, 24% were commercial, 2% were public telephone lines and 3% were for our own use and testing.

## Historical Background

### The Restructuring and Privatization

After the incorporation of Telecomunicações Brasileiras S.A. - Telebrás in 1972, Telebrás and its operating subsidiaries, collectively, the “Telebrás System” acquired almost all of the telephone companies in Brazil and monopolized the provision of public telecommunications services in virtually all areas of the country.

In May 1998, just prior to its privatization under the General Telecommunications Law, the Telebrás System was restructured to form, in addition to Telebrás, twelve new holding companies. Virtually all assets and liabilities of Telebrás were transferred to the new holding companies, or the “new holding companies.”

In July 1998, the federal government privatized the Telebrás System, selling substantially all its shares in the new holding companies, including TelesPar and its shares in TSP and CTBC Borda, to private sector buyers. As a result of a subsequent reorganization of SP Telecomunicações on January 10, 1999, one of its subsidiaries, SPT Participações S.A., or SPT, became the controlling shareholder of TelesPar.

### The Reorganization of TelesPar

On November 30, 1999, the shareholders of TelesPar approved a reorganization involving a series of mergers, whereby Telespar became the telecommunications services company operating under our current name, Telecomunicações de São Paulo S.A. - Telesp.

### Ceterp’s Acquisition

On December 20, 1999, we began the acquisition, through a public auction from the municipal government of the City of Ribeirão Preto, in the State of São Paulo, 51.0% of the voting shares and 36.0% of the total share capital of Centrais



Telefônicas de Ribeirão Preto S.A., or Ceterp. Ceterp provided fixed-line and cellular services in the State of São Paulo, outside the Telebrás System, and had been one of our minor competitors.

On December 27, 2000, Ceterp was merged with and into us.

## Table of Contents

### The Spin-off of Certain Data Transmission Operations

On August 3, 2000, the wholly-owned subsidiary Telefônica Empresas S.A. was created with the corporate goal of providing Switched Package Network services, and on January 30, 2001, the independent Brazilian corporation Telefônica Data Brasil Holding S.A. (TDBH) was created through a shareholder-approved spin-off of the data transmission operations performed by Telefônica Empresas S.A. A merger of the company and TDBH was effective July 2006. See “—The SCM Restructuring.”

### Attainment of ANATEL Targets

Telesp’s business, services and tariffs have been regulated by ANATEL since June 16, 1997, in accordance with various decrees, decisions, plans and regulatory measures. We became the first operator to achieve ANATEL’s service targets. As a result, ANATEL granted us a license to offer domestic and international long-distance services to our customers. Accordingly, on May 7, 2002, we began providing international long-distance services and on July 29, 2002, we began providing interregional long-distance service. See “—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies—Network Expansion and Quality of Service” for information relating to ANATEL’s network expansion and universal service targets.

The Board of Directors of ANATEL, at ANATEL’s meeting held on January 29, 2003, granted Telesp the authorization to use the SCM nationwide. The Company may now offer voice and data services through various points of presence composed of networks and telecommunication circuits.

On July 6, 2003, mobile telephony operators started to implement a long-distance carrier selection (CSP) that enables the client to determine the long-distance carrier for each domestic long-distance call (VP2 and VP3) or international call, in accordance with the SMP (Mobile Personal Service) rules. As a result, the Company, having acknowledgement of the revenue from these long distance services, started to pay the mobile telephony operators for the use of their networks.

On September 4, 2004, the rules dictated by Resolution No. 373, dated as of June 03, 2004, were implemented to carry out the reconfiguration of the local areas for the Switched Fixed Telephony Service (STFC). As a consequence, all calls previously billed at domestic long distance rates (DC level – Áreas Conurbadas) are now billed at lower rates as local calls. In São Paulo, this modification involved 53 municipalities, of which 39 are in Grande São Paulo.

### IP Network Asset Acquisition

On December 10, 2002, after receiving approval from ANATEL, our Board of Directors approved a proposal to acquire certain assets from Telefônica Data S.A. (formerly T-Empresas), one of the companies of the Telefônica group, including the following services: (i) an Internet service that allows our customers to access our network through remote dial-up connection and (ii) services that allow customers of Internet Service Providers, or ISPs, to have access to broadband Internet. The purpose of this asset acquisition was to capitalize on synergies that would assist in developing our network and provide a quick response to market competitors.

### Acquisition and Reorganization of Atrium

On December 30, 2004, we acquired indirect control of Atrium Telecomunicações Ltda. from Launceston Partners CV. Atrium provided various types of telecommunications services in Brazil, including internet and intranet services, telecommunications management services and the sale and rental of telecommunications systems and related equipment. The acquisition was carried out through the purchase of the total share capital of Santo Genovese Participações Ltda., which held 99.99% of the representative share capital of Atrium.

On November 21, 2005, we approved the corporate reorganization of our wholly-owned companies A. Telecom S.A. (formerly Assist Telefónica S.A.), Santo Genovese Participações Ltda., or Santo Genovese and Atrium Telecomunicações Ltda., or Atrium, which was implemented and became effective on March 1, 2006.

## Table of Contents

### The SCM Restructuring

On March 9, 2006, our Board of Directors and the Boards of Directors of TDBH and Telefónica Empresas S.A., a wholly-owned subsidiary of TDBH (“T-Empresas” and together with us and TDBH, the “Companies”), approved the restructuring of the Companies’ serviços de comunicação multimídia (“SCM”), or multimedia communications services, and data transmission activities (the “SCM Restructuring”).

The terms and conditions of the SCM Restructuring are set forth in an agreement executed by the Companies on March 9, 2006. The SCM Restructuring consisted of (i) the merger of TDBH into our company (the “Merger”); and (ii) the spin-off of all T-Empresas’ assets and activities except its SCM assets and activities outside Sectors 31, 32 and 34 of Region III of Annex II of the General Concession Plan (the “Spin-off”) and assets and activities related to the data center.

Following the approval of this restructuring: (i) TDBH was dissolved; (ii) its shareholders received shares of our common or preferred stock, or ADSs, as appropriate; (iii) we succeeded TDBH in all of its rights and obligations; and (iv) T-Empresas became our wholly-owned subsidiary. The transfer to Telesp of the spun-off components of T-Empresas did not result in any increase or decrease in the net equity of Telesp, nor in the number of shares that comprise its capital stock.

With respect to TDBH’s Merger into us, certain minority shareholders tried to suspend our General Shareholders Meeting by contesting the appraisal of the share exchange ratio provided by NM Rothschild & Sons (Brasil) Ltda. by obtaining an injunction from the 14th civil chamber of the central forum of the district court of São Paulo. The injunction was lifted on July 28, 2006, and the merger became legally effective. The main action (Ação Ordinária No. 583.00.2006.156920-5) has not yet been resolved in the lower court.

On January 31, 2008, at the 22nd General Shareholders Meeting of Telefónica Empresas S.A., the only shareholder of which is Telesp, it was resolved to change the corporate name of Telefónica Empresas S.A. to Telefónica Data S.A.

### Agreement of Convergence, Purchase and Sale of Operations, Assets, Stock and Other Obligations with the Abril Group

On October 29, 2006, the Company entered into an agreement with Abril Comunicações S.A., TVA Sistema de Televisão S.A., Comercial Cabo TV São Paulo Ltda., TVA Sul Paraná Ltda., and TVA Radioenlaces Ltda. (the “Abril Group”), whereby we combined our telecommunications and broadband services with the broadband and cable services of Tevecap S.A., or TVA, the second largest Brazilian pay TV provider with operations in the states of Paraná, Rio Grande do Sul, São Paulo and Rio de Janeiro. Through this transaction, we broadened our services to meet our users’ increasing demand, combining the Abril Group’s expertise in content and media production and placement with the expertise of the Telefónica Group in the telecommunications segment.

On October 31, 2007, the board of ANATEL concluded the regulatory review of the association between Grupo Abril and the Company, approving the transaction, which involves (i) the acquisition of all of the operations of MMDS (Multichannel Multipoint Distribution Service) and broadband, and (ii) the acquisition of a significant stake, within the limit of the foreseen effective laws and regulations, in the cable television dealers controlled by Grupo Abril within and outside of the State of São Paulo. This decision was published in the Official Gazette of the Federal Executive on November 19, 2007. Antitrust clearance is still pending from ANATEL and CADE competition authorities.

The Telesp stockholders, in the extraordinary general meeting held on November 23, 2007, ratified the entering into of the Agreement, its amendments and annexes, and approved the implementation of the deal and the signature of all

documents necessary for its complete formalization.

As a result of this transaction, Navytree Participações S.A (“Navytree”) became a wholly-owned subsidiary of Telesp, and our provision of broadband services became centralized.

On June 10, 2008, at the General Shareholders Meeting of Navytree, the corporate name of Navytree was changed to Telefônica Televisão Participações S.A (“TTP”).

## Table of Contents

### Corporate Reorganization involving Ajato

On October 14, 2008, Telefonica Sistema de Televisão S.A. (“TST”) and TTP purchased from Abril Comunicações S.A. all shares of Mundial Voip Telecomunicações Ltda., EPP, which had its corporate name changed to Ajato Telecomunicação Ltda. (“Ajato”). Following the merger of TTP into Telesp on November 11, 2008, Ajato’s shares are held by TST and us.

### Corporate Reorganization involving DABR and TTP

On October 21, 2008, Telesp’s Board of Directors and the shareholders of TTP and Telefônica Data Brasil Participações Ltda. (“DABR”) approved a corporate reorganization that consisted of the merger of TTP and DABR into us.

On November 11, 2008, the merger of TTP and DABR was approved by our Extraordinary Shareholders Meeting. As a result of this restructuring, TTP and DABR were dissolved and Telesp assumed all the rights and obligations of TTP and DABR.

The reorganization allowed Telesp to increase synergies, reduce managerial risk, simplify the corporate administrative structure and reduce costs, while also providing tax benefits expected to reduce Telesp’s income tax and other taxes assessed on revenue and income, thereby improving Telesp’s cash flows. The reorganization and the goodwill amortization were structured as to avoid any assumption of indebtedness by Telesp and to minimize any negative impact on the future results of Telesp.

### Corporate Restructuring involving TS Tecnologia

On May 22, 2009, Telefônica Data S.A., our subsidiary, merged with its controlled subsidiary TS Tecnologia da Informação Ltda., or TS Tecnologia, in accordance with the values recorded on the books and an appraisal report. This merger caused TS Tecnologia to be extinguished and Telefônica Data S.A. became the successor of all of the assets and liabilities of TS Tecnologia.

### Corporate Restructuring involving A.TELECOM S.A.

On December 9, 2009, Telesp’s Board of Directors approved the submission to a shareholder vote of the corporate reorganization proposal consisting of the partial spin-off of A.TELECOM S.A. (“A.TELECOM”), and the subsequent merger into Telesp of the spun-off part of A.TELECOM.

On December 30, 2009, A.TELECOM’s shareholders approved the spin-off of part of A.TELECOM and the subsequent merger of the spun off part into Telesp. On the same date, Telesp’s shareholders approved the merger of the spun-off part into us.

This corporate restructuring created synergies for us and A.TELECOM providing both of us with better administrative, operating and regulatory efficiencies regarding telecommunication integrated services, thus benefiting both of us and our respective shareholders.

### Recent Developments

#### Corporate Restructuring involving Vivo Participações S.A.

In July 28, 2010, in accordance with the material fact disclosed to the public by Telefónica S.A., our controlling shareholder, Telefónica S.A. and Portugal Telecom SG SGPS, S.A. (“Portugal Telecom”) executed a purchase agreement for the acquisition by Telefónica S.A. (directly or through any of the companies within its group) of 50% of the capital stock of Brasilcel, N.V. (a company jointly owned by Telefónica and Portugal Telecom, which owns shares representing, approximately, 60% of the capital stock of the Brazilian company Vivo Participações S.A., or Vivo Part) owned by Portugal Telecom.

Table of Contents

On December 27, 2010, the Company and Vivo Part, jointly announced the approval by their respective Boards of Directors of a proposal for corporate restructuring involving the merger of shares of Vivo Part into the Company, aiming for the unification of the shareholding positions of both companies.

Other than the concentration of the shareholding position herein mentioned, the corporate restructuring aims to simplify the current organizational structure of the companies, both of which are publicly-held companies and listed on BM&FBOVESPA and with American Depositary Receipts traded in the United States of America. The restructuring would allow their respective shareholders to participate in one unified company with greater liquidity and with shares traded on Brazilian and foreign stock exchanges. Moreover, the corporate restructuring will provide rationalization of the cost structure of the two companies and will facilitate the integration of businesses and the generation of synergies, thus positively impacting both companies.

The management of each company will follow the recommendations provided by Parecer de Orientação CVM nº 35/08, which seeks to protect the interests of the minority shareholders of both companies and to assure that the transaction observes arm's length conditions for controlling and minority shareholders in the exchange of shares. Therefore, each of Vivo Part and Telesp established independent special committees ("Special Committees") to negotiate the exchange ratio of shares and to present their opinions regarding other conditions of the corporate restructuring that may be proposed, and to subsequently submit their recommendations to the Boards of Directors of each company.

The simplified organization chart below demonstrates the corporate structure of the companies before and after the implementation of this reorganization.

The corporate structure before the merger of shares is as follows:

Vivo Part's management was informed by its controlling shareholder, Telefónica, S.A., that Telefónica, S.A. will hold the shares of the Brazilian holding companies that currently are held indirectly by Telefónica, S.A., through the holding Brasilcel, N.V., as a result of a transaction implemented abroad. The proposed merger of shares will not change the composition of the ultimate control of the involved companies.



Table of Contents

The planned corporate structure after the merger of shares will be as follows:

The totality of shares of Vivo Part will be merged into the Company, and the holders of the merged shares of Vivo Part shall directly receive new shares that they are entitled to in Telesp. In accordance with Brazilian Corporate Law, as well as the bylaws of the two companies, financial advisors and specialized companies will be retained for the preparation of studies regarding the transaction and the subsequent preparation of valuation reports of the companies that will be used as reference for the determination of the exchange ratio of shares and the increase in capital stock resulting from the merger of shares, as well as for the purposes of article 264 of Law No 6,404/76 regarding the exchange ratio between the shares. Once the valuation and the necessary analyses are finalized and the Special Committees created by Vivo Part and the Company, as required by Brazilian Law, have given their recommendation in the transaction to the companies' respective Boards of Directors, the exchange ratio and the other terms and conditions proposed by the respective Boards of Directors will be disclosed by means of a publication of a notice of material fact. The proposals of the Boards of Directors will be subject to the approval of the shareholders in a general shareholders' meeting to be held for this purpose, in accordance with Brazilian Corporate Law, as well as to the necessary regulatory approvals. The restructuring is estimated to take place during the first semester of 2011.

In addition to the notice of material fact to be published reflecting more details on the terms and conditions of the corporate restructuring that will be agreed as mentioned above, the meeting notice of the respective extraordinary shareholders' meetings of the companies for voting on the restructuring will be timely published.

The shareholders holding common and preferred shares of Telesp and common shares of Vivo Part. that disagree with the merger of shares of Vivo Part. into Telesp will have, from the date the general extraordinary shareholders' meetings of the companies that will be called to vote on the corporate restructuring, the right to withdraw from the company, by receiving as reimbursement the amount of shares of which they are legitimate holders on December 27, 2010 (date of the announcement of the restructuring). The value of the reimbursement of the shareholders that dissent from the transaction will be timely disclosed, jointly with the other conditions of the transaction.

Table of Contents

The corporate restructuring will be submitted to ANATEL for approval. Before the corporate restructuring, the Brazilian entities TBS Celular Participações Ltda., Portelcom Participações S.A. and PTelecom Brasil S.A. (jointly, the “Holdings BR”) will be merged into Vivo Part. The Holdings BR currently have as their main asset the shares of Vivo Part and are controlled by Brasilcel, N.V.. The merger of Holdings BR will not result in any change in the number and the composition of classes of shares of Vivo Part, and shall not affect the current participation of the shareholders of Vivo Part.

## Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

## Capital Expenditures

We are permitted to determine our own capital expenditure budget, subject to compliance with certain obligations to expand service under the concession. With this in mind, we were focused in voice services in order to comply with ANATEL’s targets and to provide quality service for clients. Also, in order to achieve a consolidated position in the broadband market, during 2010 the focus of our capital expenditure has been, and continues to be, expanding, modernizing and upgrading our ADSL network and improving our systems and processes of customers relations, marketing and sales.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2010.

	Year ended December 31,		
	2010	2009	2008
	(in millions of reais)		
Traditional Businesses / Maintenance	1,166.1	1,101.2	832.0
New Services / Broadband	1,275.3	1,119.8	1,510.5
Total capital expenditures	2,441.4	2,221.0	2,342.5

We anticipate that our capital expenditures for 2011 will be similar to 2010. We expect to fund these expenditures with funds internally generated from our operations and through debt.

## Table of Contents

### B. Business Overview

#### Our Region

The State of São Paulo covers an area of 248,209 square kilometers, representing approximately 2.9% of Brazil's territory. The population of the State of São Paulo is approximately 41.7 million, representing 21.6% of Brazil's total population. Based on the most recent data available, the gross domestic product, or GDP, of the State of São Paulo in 2008 was an estimated R\$1,003 billion, or approximately US\$429.2 billion, representing approximately 33% of Brazil's GDP for the year. The State of São Paulo's annual per capita income during 2008 was an estimated R\$24.5 thousand, or approximately US\$13.3 thousand.

The concessions granted by the Brazilian government in 1998 and renewed in 2005, with the effective date starting in January 2006, allow us to provide fixed-line telecommunications services to a region that includes most—approximately 95%—of the State of São Paulo. The portion of the State of São Paulo that is excluded from our concession region represents approximately 1.5% of total lines in service and 2.2% of the population in the state. This concession is operated by CTBC Telecom.

Our concession region is Region III, which is comprised of 622 municipalities, including the City of São Paulo, with an aggregate population of approximately 41.7 million. Of the municipalities in Region III, 72 have populations in excess of 100,000. The City of São Paulo has a population of approximately 11 million. According to the plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the State of São Paulo was divided into four sectors, including Sectors 31 (our predecessor company's area prior to the reorganization), 32 (the area corresponding to Ceterp prior to our acquisition), 33 (corresponding to the portion of the State of São Paulo that we do not service) and 34 (CTBC Borda do Campo area prior to the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. According to the Presidential Decree regarding the new General Plan of Grants, published in the Diário Oficial da União on November 21, 2008, the three sectors for which we act as a concessionaire (sectors 31, 32 and 34) were unified into one single sector (sector 31).

On May 7, 2002, we began offering international long distance service and on July 29, 2002, we started offering interregional service. The conditions for the provision of interregional and international long-distance services outside the concession area contemplate that providers already operating services under a selection code (a two-digit code to be input by the caller as a prefix to the number dialed) shall keep such code under the new licenses authorizing operation outside the applicable concession area. Accordingly, we continue using the provider selection code "15" that permits our callers to originate calls using our services even though they are outside our concession area. All interregional and international cellular calls, whether in our concession area or that of another provider, need to dial a carrier selection code using Personal Mobile Service—SMP, through which mobile services users choose the provider for interregional and international long-distance calls, and which requires dialing our code "15" in order to use our services. See "—Services—Network Services."

#### Services

##### Overview

Our services consist of:

- local voice services, including activation, monthly subscription, measured service and public telephones;

- intraregional, interregional and international long-distance voice services;
  - data services, including broadband services;
- Pay TV services through DTH (direct to home), satellite technology and land based wireless technology MMDS (multichannel multipoint distribution service);
  - network services, including interconnection and rental of facilities, as well as other services.

## Table of Contents

In March 2002, ANATEL certified our compliance with the 2003 universal service targets and authorized us in April 2002 to start providing local and intraregional services in certain regions in which we were not operational and interregional and international long-distance services throughout Brazil. See “—Competition” and “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

We provide interconnection services to cellular service providers and other fixed telecommunications companies through the use of our network. In April 1999, we also began to sell handsets and other telephone equipment through A. Telecom S.A. (formerly Assist Telefônica S.A.), our wholly-owned subsidiary. Until January 2001, we provided data transmission services, but spun off our data transmission operations into TDBH. In March 2006, we began the restructuring of our multimedia communications services (serviços de comunicação multimídia) and data transmission activities. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

The monthly and usage fees for our services (local and long-distance) were initially determined in our concession agreements. From March 2007 until July 31, 2007, the billing system was converted to a minute basis and the former measurement based on pulses was discontinued for all customers. Our concession agreements also set forth criteria for annual fee adjustments. We derive a substantial portion of our revenue from services subject to this price adjustment. The method of price adjustment is essentially a price cap. ANATEL annually applies a price index correction that reflects the inflation index of the period and a productivity factor to our local and long-distance fees. Since 2006, the inflation index has been replaced by the IST, which reflects variations in telecommunications companies’ costs and expenses. ANATEL has complied with the fee range set by the concession agreements.

### Local Service

Local service includes activation, monthly subscription, measured service and public telephones. Measured service includes all calls that originate and terminate within the same local area or municipality of our concession region, which we refer to as “local calls.” Excluding the portion of our region that was serviced by Ceterp before our acquisition in December 1999, we were the only supplier of local fixed-line and intraregional long-distance telecommunications services in our region until July 1999. At that time, licenses were auctioned to permit a competitor to provide local fixed-line and intraregional long-distance telecommunications services in our region, including the area formerly served by Ceterp. Vésper São Paulo S.A. received authorization and began operations in December 1999. Embratel, GVT, Oi and Tim also provide local services in our concession region. See “—Competition.”

Telesp became the first telephone service concessionaire in Brazil to offer local services outside its concession region (the State of São Paulo). In May 2003, we achieved the network expansion and universal service targets established by ANATEL, and began providing local services to six other states in Brazil, including Sergipe, Espírito Santo, Rio Grande do Sul, Paraná, Santa Catarina and certain areas in Rio de Janeiro. In May 2004, we began providing local telephone services in seven other states in Brazil, including those in the capitals of Pará, Roraima, Amapá, Rondônia, Maranhão, Tocantins and Acre. In May 2005, we also began to provide local telephone services in the capitals of the following states: Ceará, Amazonas, Pernambuco, Rio de Janeiro, Bahia, Mato Grosso do Sul and Mato Grosso. Since May 2006, we have also been providing local telephone services in Brasília (Distrito Federal) and Goiânia, the capital of the State of Goiás. Currently, our main markets outside our concession region are Rio de Janeiro, Espírito Santo, Minas Gerais, Bahia, Pernambuco, Ceará, DF, Goiás, Rio Grande do Sul, Paraná and Santa Catarina.

### Intraregional Long-Distance Service

Intraregional long-distance service consists of all calls that originate in one local area or municipality and terminate in another local area or municipality of our concession region. We were the sole provider of intraregional long-distance service in our region until July 3, 1999, when the federal government also authorized Embratel and Intelig to provide intraregional long-distance services. Currently, our main competitors in this service are Embratel, Tim, Intelig, Oi and

GVT.

23

---

## Table of Contents

### Interregional and International Long-Distance Service

On March 1, 2002, ANATEL acknowledged that we had satisfied its network expansion and universal service targets two years prior to the scheduled date. As a result, on April 25, 2002, ANATEL published an order that allowed us to be the first fixed-line telephone company to provide the full range of Fixed Telephone Commuted Service (STFC) and granted us a concession to develop interregional long-distance services in Region III and an authorization to develop services in the local, intraregional, interregional and international markets throughout Brazil.

We began operating international long-distance service in May 2002 and interregional long-distance services in July 2002. Interregional long-distance service consists of state-to-state calls within Brazil. International long-distance service consists of calls between a point in Brazil and a point outside Brazil.

### Data Services – Broadband

The broadband service was launched in 1999 with the Speedy brand, initially with ADSL technology, which uses the same copper pair that is used in the provision of voice services, to provide fast internet service. Currently, the product portfolio of broadband speeds on ADSL range from 256kbps (kilobytes per second) up to 8Mbps (mega bits per second). In 2010, Telefonica has 100% coverage of the municipalities in its concession area and is the first operator in Brazil to reach this mark. In addition, throughout 2010, Speedy reached the milestone of 3 million subscribers.

In 2010, Telefonica began selling the product Popular Broadband (Banda Larga Popular), which is an initiative in the State of São Paulo to deliver affordable broadband for low-income populations. This product uses the wi-mesh technology and has a top speed of 256kbps.

We also provide broadband services using coaxial cable at speeds ranging from 8Mbps to 30Mbps through Ajato (allowing for speeds from 2Mbps to 16Mbps) and optical fiber (FTTx). Optical fiber is the most advanced technology currently available and it allows for speeds of up to 1000Mbps.

### Pay TV services

On March 14, 2007, ANATEL has granted A. TELECOM S.A., one of our wholly owned subsidiaries, the license to offer pay TV services via DTH (“Direct to the Home” – a special kind of service that uses satellites to direct distribution of television signals and audio to subscribers). We began offering pay TV services on August 12, 2007.

On October 31, 2007, ANATEL’s council approved, from a regulatory perspective, the association between Grupo Abril and the Company, which involved, among other transactions, the acquisition by the Company of all of Grupo Abril’s Multichannel Multipoint Distribution Service (MMDS) operations, which involve a special license that allows us to offer pay TV through our subsidiary, Telefonica Sistemas de Televisão S.A. The transaction remains under consideration by ANATEL only with respect to antitrust factors, and will ultimately be reviewed by CADE. On December 31, 2010, we reached 486 million pay TV users, including both DTH and MMDS technologies. We currently offer DTH to the whole State of São Paulo, and MMDS in São Paulo, Rio de Janeiro, Curitiba and Porto Alegre areas.

### Network Services

Brazil is divided into four regions in relation to fixed telecommunication services with the following incumbent service providers (which initially received concessions from ANATEL): (i) Region I, that encompasses the North, Northeast and Southeast regions of Brazil, except the State of São Paulo, where concessions are granted to Oi (Telemar) and CTBC Telecom; (ii) Region II, that encompasses the South and Center-West regions of Brazil, where

concessions are granted to Oi (Brasil Telecom), CTBC Telecom, and Sercomtel; (iii) Region III, that encompasses the State of São Paulo, where concessions are granted to Telefonica and CTBC Telecom; and (iv) Region IV, that encompasses the whole country and in which the concession for long distance calls is granted to Embratel.



## Table of Contents

In 2005, after meeting the targets imposed in the concession agreement two years before the expected date, Telefonica started to operate long distance services in every municipality in Brazil. For the operation of local services in Regions I and II, the Company expanded its network to the main Brazilian cities, providing services in these markets with infrastructure based on new generation platforms.

In 2007, the Company developed solutions and invested significant resources to adapt its network to the requirements of number portability determined by ANATEL. Number portability is a service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers. The implementation of number portability in the State of São Paulo was effectively initiated in September 2008 and fully implemented in March 2009.

By the end of 2010, for local services, we were present in the main cities of Regions I and II, namely: Porto Alegre, Curitiba, Brasília, Rio de Janeiro, Vitória, Belo Horizonte, Salvador, Florianópolis, Fortaleza, Recife, Goiânia and Uberlândia. For the provision of data services, Telesp had networks in fourteen cities in these regions.

Telefonica has continuously adapted and expanded its network topology aiming to develop new business opportunities in the State of São Paulo through offering services to other telecommunications companies. The result was a significant increase in the number of providers that use Telefônica's wholesale services.

Other important adaptations have been implemented in the network topology in order to meet the regulatory requirements and to integrate several calling areas of the State of São Paulo, thus allowing customers to make local calls in situations that had previously been categorized as long-distance calls. The integration of new cities into local areas is annually determined by ANATEL and Telefonica is fully complying with ANATEL's determinations.

Competition for long-distance services has continuously increased and by the end of 2010 there were a total of 38 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora - CSP). Satellite services for providing circuits in remote areas for wholesale and large customers have been implemented.

### Other Services

Currently, we also provide a variety of other telecommunications services that extend beyond basic telephone service, including extended maintenance, caller identification, voice mail, cell phone blockers, computer support, antivirus for our internet service subscribers, and posto informático (a solution with a fixed monthly fee consisting of a computer, broadband access and technical support twenty-four hours, seven days a week), among others.

### Interconnection

In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to publish on the internet an interconnection public offer for all types of interconnection services, in addition to the interconnection between fixed-line service providers and mobile service providers; (ii) offers of interconnection for Backbone Internet Providers; (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which new interconnection solicitations are answered. These reforms have facilitated market entry for new operators.

The interconnection public offer (OPI) had been amended following negotiations with providers and changes in the services rendered and regulatory requirements. Telesp has adopted procedures to reduce the time necessary to answer customers' interconnection requests, as well as to monitor and comply with quality levels set by ANATEL for interconnection services with a current availability level of 99.8%.

In 2006, the Company completed the implementation of the interconnection with mobile service providers in the most intensive traffic areas, assuring the proper billing for such calls and reducing interconnection costs.

In 2007, ANATEL published the new version of the Regulation of Fixed Network Compensation Rates, which primarily modified the rules for interconnection rates and calculation methods. Local and long-distance tariffs that were flat at all times became variable according to the rules for public service tariffs. A 20% increase was applied to tariffs of non incumbents.

## Table of Contents

In addition to the necessary adaptations in its network concerning the Number Portability, Telefonica, in conjunction with other operators, implemented a systematic solution including several interoperative processes, which allows the correct forwarding of calls.

According to the Personal Mobile Service (SMP) regulation, the Mobile Network Interconnection Fee (VUM) price is subject to free negotiation between parties and once an agreement is reached it should be homologated by ANATEL to take effect. The agreement currently in effect was executed in 2009.

Starting in November 2009, the licenses of each mobile operator were consolidated by region, resulting in the consolidation of tariffs and in the reduction of interconnection fees for long distance traffic within its network.

At the end of 2010, Telefonica had 106 local and long-distance interconnection agreements and 87 agreements for provision of local traffic and long distance.

### I-Telefónica

I-Telefónica is a free Internet access service provider launched in September 2002 by our subsidiary A. Telecom S.A. (formerly Assist Telefónica). The product is available in 622 cities in the State of São Paulo and over 1,500 cities in all of Brazil. The service delivers high quality, stable Internet access that is structured to ensure that our clients do not encounter a busy signal when connecting to the Internet. I-Telefónica permits us to increase the range of our services and better supply our customers by offering an entry-level option to the Internet market. I-Telefónica also represents a strategic tool to protect us against the possible traffic imbalance that may be generated by Internet access service providers that do not use our network. Traffic imbalance (sumidouro) occurs when a certain telecommunications operator has a higher volume of incoming than outgoing traffic (with another operator). When the incoming/outgoing traffic relationship falls outside the 45%-55% range, the operator with higher outgoing traffic must pay to the other the interconnection fees corresponding to the traffic that exceeds the range. Telecommunications operators that house internet service providers tend to have more incoming than outgoing traffic, and thus receive interconnection revenue from other operators. I-Telefónica helps us keep our dial-up traffic on our own network, and thus reduce unfavorable traffic imbalance, thereby lowering our interconnection expenses.

### Authorization to Provide Multimedia Services

On January 29, 2003, ANATEL granted our SCM license nationwide, allowing A. Telecom S.A. (formerly Assist Telefónica), our wholly-owned subsidiary, to provide voice and data services through points-of-presence (POPs), which are comprised of private telecommunications networks and circuits. In addition to A. Telecom S.A., ANATEL granted SCM licenses to T-Data (formerly T-Empresas) and Emergia.

### Authorizations for pay TV via satellite

On March 14, 2007 ANATEL granted A. Telecom S.A. authorization to provide services of pay TV via satellite (Direct to Home – DTH). DTH is one of the special types of subscription TV services that utilize satellites for the direct distribution of television and audio signals for subscribers. The launching of the commercial transaction occurred on August 12, 2007.

### Authorization for Multichannel Multipoint Distribution Service (MMDS)

On October 31, 2007, the board of ANATEL concluded its regulatory review of the association between Grupo Abril and the Company, approving the transaction from a regulatory perspective, which involved, among other transactions, the acquisition of all of the operations of Multichannel Multipoint Distribution Service (MMDS).

This decision was published in the Official Gazette of the Federal Executive on November 19, 2007. The transaction continues to be analyzed by ANATEL, solely with respect to antitrust matters, and will be ultimately also reviewed by CADE (Conselho Administrativo de Defesa Econômica), the Competition Authority.

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated to the Multichannel Multipoint Distribution Service (MMDS) in São Paulo, Curitiba, Rio de Janeiro and Porto Alegre. ANATEL is currently analyzing the price to be paid for the spectrum usage.

## Table of Contents

### The STFC Concession Agreement

As mentioned above, we are a concessionaire of STFC to render local and domestic long-distance call services originated in Region III, which comprises the State of São Paulo, except for Sector 31, established in the General Concession Plan (PGO).

The current concession agreement, dated December 22, 2005, was renewed on January 1, 2006, and will be valid until December 31, 2025. On December 15, 2010, ANATEL released a public consultation proposing the amendment of clause 3.2 of the concession agreement which resulted in the approval of Resolution 559 published on December 27, 2010. Resolution 559 establishes that the current concession agreement can be reviewed by ANATEL on May 2, 2011, December 31, 2015, and December 31, 2020. Based on the amended clause 3.2, ANATEL may establish new requirements and targets for universal and high quality telecommunication services, according to the conditions present at the time of review.

On November 24, 2010, ANATEL's board held a public session to discuss and approve the amendment of the concession agreement. Although ANATEL has approved the amendments in a public session, it has not yet published the final version of the revised terms. The most relevant modifications discussed by ANATEL's board include: (i) suppression of clause 14.1 which prohibits concessionaires from controlling cable TV operators within their concession area; (ii) amendment of clause 3.2, which provides for a biennial concession fee, to include interconnection revenue in its calculation basis; and (iii) broadening of ANATEL's supervisory powers.

The concession agreement establishes that all assets owned by the Company and which are indispensable to the provision of the services described in such agreement are considered reversible assets and are deemed to be part of the concession assets. These assets will be automatically returned to ANATEL upon expiration of the concession agreement.

Every two years, during the agreement's new 20-year period, publicly held companies will have to pay a renewal fee which will correspond to 2% of the revenue resulting from the application of basic service plans and alternative STFC, net of taxes and social contributions. The first payment of this biennial fee occurred on April 30, 2007, based on 2006 revenue, and the second payment occurred on April 30, 2009, based on 2008 revenue. The next payment is scheduled for April 30, 2011 based on 2010 revenue. See Note 20 to our Consolidated Financial Statements.

On April 8, 2008, Telesp signed an amendment to the concession contracts to substitute the obligation to install telecommunications service posts with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires.

### Corporate Customer Services

We offer our corporate clients comprehensive telecommunications solutions and IT support designed to address specific needs and requirements of companies operating in all types of industry (retail, manufacturing, services, financial institutions, government, etc.).

Our clients are assisted by our highly qualified professionals who are capable of meeting the specific needs of each company with voice, data, broadband and computer services solutions. We work to consistently achieve greater quality and efficiency in our services and increase our level of competitiveness in the market.

### Rates and Taxes

#### Rates

Overview

We generate revenue from (i) activation and monthly subscription charges; (ii) usage charges, which include measured service charges; and (iii) network usage charges and other additional services.

27

---

## Table of Contents

Rates for telecommunications services are subject to comprehensive regulation by ANATEL. See “—Regulation of the Brazilian Telecommunications Industry.” Since the relative stabilization of the Brazilian economy in mid-1994, two major changes in rates for local and long-distance services have occurred: in 1996 to compensate for accumulated effects of inflation and in 1997 to eliminate the cross-subsidy between local and long-distance services.

Concession agreements, which were valid from 1998 until December 31, 2005, and subsequently renewed under a new contract for an additional 20 years until 2025 (all of our relevant concession agreements were renewed), establish a price cap for annual rate adjustments.

According to the new contract, we readjust charges based on a service basket of fees, as follows:

- local services, where rates are established pursuant to a service basket of fees that includes rates for the measured traffic and subscription fees. In the case of a price adjustment, each one of the items within the local fee basket has a different weight and, as long as the total local fee price adjustment does not exceed the rate of increase in the Telecommunication General Price Index, or IST, minus a productivity factor as established in the concession agreements, each individual fee within the basket can exceed the IST variation by up to 5%;
- installation of residential and commercial lines and public telephone services, with adjustments limited to the rate of increase in the IST minus a productivity factor as established in the concession agreements; and
- domestic long-distance services, with rate adjustments divided into intraregional and interregional long-distance services, which are calculated based on the weighted average of the traffic, and taking into account time and distance. For these categories, each fee may individually exceed the rate of increase in the IST by up to 5%; however, the total adjustments in the basket of fees cannot exceed the rate of increase in the IST minus a productivity factor as established in the concession agreements. See “—Regulation of the Brazilian Telecommunications Industry.”

Our rates for international services are not subject to regulation and are not required to follow the price cap for annual rate adjustment described above for other services. Therefore, we are free to negotiate our fees for international calls based on the international telecommunications market, where our main competitor is Embratel.

### Local Rates

As of March 2007, the billing system for local calls was converted to a per-minute system and the previous pulse system was discontinued. The conversion of pulses to minutes occurred gradually, between the months of March and July of 2007. As of August 1, 2007, all of the customers of the Company had their local calls billed in minutes.

Our revenue from local service consists principally of activation charges, monthly subscription charges, measured traffic charges and public telephone charges. Users of measured traffic, both residential and non-residential, paid for local calls depending on usage, which until July 2007, was measured in pulses and from then on has been measured in minutes. The first minute is accounted for at the moment a call is connected to its destination.

Under current ANATEL regulations, residential customers who sign up for the basic plan monthly fee receive an allowance of 200 minutes per month.

Our local concession contracts set forth two mandatory plans for local fixed service, and allow for the concession company to design other alternative pricing plans of its own. Customers will have a choice between the two mandatory plans, any other alternative plan or a combination of basic and alternative plans. The main differences between the two main mandatory plans are as follows:

- Local Basic Plan: for clients that make mostly short duration calls (up to three minutes), during regular hours; and



Table of Contents

- Mandatory Alternative Plan (PASOO): for clients that make mostly longer duration calls (above three minutes), during regular hours and/or that use the line for dial-up service to the Internet.

The following table outlines the basic billing requirements and rates for the local Basic Plan and the Mandatory Alternative Plan:

CHARACTERISTICS OF PLAN	BASIC PLAN	MANDATORY ALTERNATIVE PLAN
<b>Monthly Basic Assignment</b>		
Allowance (minutes included in the Residential Assignment)	200 minutes	400 minutes
<b>Commercial Assignment</b>		
Allowance (minutes included in the Commercial Assignment)	150 minutes	360 minutes
<b>Local Call Charges</b>		
<b>Regular Hours</b>		
Completing the call (minutes deducted from the allotment)	-	4 minutes
Completing the call after the terms of the allotment		
Sector 31	-	R\$0.15698
Sector 34	-	R\$0.15292
Sector 32	-	R\$0.16473
<b>Local Minutes - charges in excess use of the allotment</b>		
Sector 31	R\$0.10224	R\$0.03924
Sector 34	R\$0.10224	R\$0.03822
Sector 32	R\$0.10224	R\$0.04117
Minimum time billing	30 seconds	-
<b>Reduced Hours</b>		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration		
Sector 31	R\$0.20448	R\$0.15698
Sector 34	R\$0.20448	R\$0.15292
Sector 32	R\$0.20448	R\$0.16473

The fees for Local Basic Plan Service were approved by ANATEL's Act No. 6,419 of October 5, 2010. The Alternative Plan under Mandatory Service Provisions (Oferta Obrigatória) (PASOO) was approved by Resolution No. 450, on December 7, 2006, being that the readjustment of the tariffs follows the same rule established for the local basic plan.

In addition, Resolution No. 547, published on November 29, 2010, established that Telesp's fees for both the Local Basic Plan and Mandatory Alternative Plan (PASOO) will be unified following the unification of sectors 31, 32 and 34 into one single sector (sector 31), as defined by the Presidential Decree regarding the new General Plan of Grants published in the Diário Oficial da União on November 21, 2008. Before this unification, ANATEL must publish an

Act with the calculated fees taking into consideration the methodology in Resolution No. 547. This unification also applies to Basic Plan tariffs of fixed-to-mobile calls and long distance calls and presumes the preservation of revenue earned on each item of the Basic Plan.

Besides the Basic Service Plans, Telesp may offer alternative plans with any pricing design it chooses. However, ANATEL must be notified of these alternative plans prior to publishing and implementing of any such plan.

Clause 12.1 of the STFC concession agreement provides that the Local Basic Plan can be readjusted for periods of not less than 12 months taking into consideration the inflation index "IST" reduced by a fraction of the Company's productivity (named "Fator X", which is calculated by ANATEL based on Resolution n° 507/08). The

## Table of Contents

Mandatory Alternative Plan (PASOO) follows the same readjustment formula as the Local Basic Plan. Other alternative service plans are readjusted based on the inflation index “IST.”

On October 5, 2010, ANATEL’s Act No. 6,419 approved new local tariffs for our areas of concession, to take effect as of October 8, 2010. The average readjustment in the local service basket was 0.66%. The tariffs were applied to customers as demonstrated below:

- Residential customers were charged a monthly subscription fee for the provision of service of R\$40.60;
- Commercial clients and non-residential customers (PBX) were charged a monthly subscription fee for the provision of service of R\$69.67 in Sector 31, R\$67.82 in Sector 34 and R\$64.72 in Sector 32;
  - Local minute tariffs were charged R\$0.10224 per minute to Sectors 31, 32 and 34; and
- Activation fees were charged R\$114.28 in Sector 31, R\$94.04 in Sector 34 and R\$61.02 in Sector 32.

## Intraregional and Interregional Long-Distance Rates

Intraregional long-distance service consists of all calls that originate in one local area or municipality of our concession region and terminate in another local area or municipality of our concession region. All other calls are denominated interregional long-distance calls. Rates for intraregional and interregional long-distance calls are computed on the basis of the time of day, day of the week, duration and distance of the call, and also may vary depending on whether special services, including operator assistance, are used.

On July 29, 2002, after we received the concession from ANATEL to provide interregional long-distance services in Region III and authorization to provide interregional long-distance services throughout Brazil, we launched several new options of interregional calling plans relating to consumer “Code 15,” which is the selection code dialed by customers who may choose a long-distance provider with each call and may result in different prices based upon frequency of use and customer calling patterns.

## International Long-Distance Rates

On May 7, 2002, we began operating international long-distance services. International long-distance calls are computed on the basis of the time of day, day of the week, duration and destination of the call, and also may vary depending on whether special services are used or not, including operator assistance.

We have developed alternative rate plans for our residential and corporate customers.

## Network Usage Charges

We earn revenue from any fixed-line or mobile service provider that either originates or terminates a call within our network. We also pay interconnection fees to other service providers when we use their network to place or receive a call. Under the General Telecommunications Law, all fixed-line telecommunications service providers must provide interconnection upon the request of any other fixed-line or mobile telecommunications service provider. The interconnection agreements are freely negotiated among the service providers, subject to a price cap and in compliance with the regulations established by ANATEL, which includes not only the interconnection basic principles covering commercial, technical and legal aspects, but also the traffic capacity and interconnection infrastructure that must be made available to requesting parties. If a service provider offers to any party an interconnection fee below the price cap, it must offer the same fee to any other requesting party on a non-discriminatory basis. If the parties cannot

reach an agreement on the terms of interconnection, including the interconnection fee, ANATEL can establish the terms of the interconnection. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

## Table of Contents

In accordance with ANATEL regulations, we must charge interconnection fees to the other telephone service providers based on the following fees:

- Fee for the use of our local network—We charge long-distance service providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network. We charge local service providers a fee for traffic that exceeds 55% of the total local traffic between the two service providers.
- Fee for the use of our long-distance network—We charge the service providers a network usage charge on a per-minute basis only when the interconnection access to our long-distance network is in use.
- Fee for the rental of certain transmission facilities used by another service provider in order to place a call.

Beginning in 2006, with the 20-year renewal of the concession contracts, the rules in respect of local network fees, or TU-RL, were changed. Beginning on January 1, 2008, local network fees were supposed to be calculated based on a long-term cost model (LRIC—Long Run Incremental Costs).

Through Resolution No. 464, published on April 27, 2007, ANATEL postponed the adoption of the LRIC model to April 30, 2009. Nevertheless, ANATEL is still working on the necessary studies to implement this cost model, as this model is part of its General Plan for Updating the Telecommunications Regulations in Brazil, published on November 12, 2008.

On February 8, 2007, ANATEL published Resolution No. 458, which approved the regulation of payment for interconnection for STFC. Through this regulation, ANATEL established, as the transition rule until the LRIC model becomes effective, that the value TU-RL stays limited to 40% of the local minute value.

In the same way, Resolution No. 458 established that the transition rule for the inter-city network tariff TU-RIU will remain in effect until the LRIC model becomes effective, and further determined that the value of TU-RIU is limited to 30% of the long distance minute value of Class 4, which is the class of calls of the longest distance established by ANATEL.

Cellular telecommunications services in Brazil, unlike those in the United States, are offered on a “calling party pays” basis, under which the subscriber pays only for calls that he or she originates. Additionally, a subscriber pays roaming charges on calls originated and terminated outside his or her home registration area. Calls received by a subscriber are paid for by the party that places the call in accordance with a rate based on per-minute charges. For example, a fixed-line service customer pays a rate based on per-minute charges for calls made to a cellular service subscriber. The lowest base rate per minute, or “VC1,” applies to calls made by a subscriber in a registration area to persons in the same registration area. Calls to mobiles outside the registration area, but within the mobile authorization area, are charged at a higher rate, “VC2.” Calls to mobiles outside the mobile authorization area are billed at the highest rate, “VC3.” When a fixed-line service customer calls a mobile subscriber, we charge the fixed-line service customer per-minute charges based on VC1, VC2 or VC3 rates. In turn, we pay the cellular service provider the cellular network usage charge.

Our revenue from network services also includes payments by other telecommunications service providers for the use of part of our network arranged on a contractual basis. Other telecommunications service providers, including providers of trunking and paging services, may use our network to connect a central switching office to our network. Some cellular service providers use our network to connect cellular central switching offices to the cellular radio-based stations. We also lease transmission lines, certain infrastructure and other equipment to other providers of telecommunications services.

## Data Transmission Rates

We receive revenue from charges for data transmission, which include “Speedy,” the rental of dedicated analog and digital lines for privately leased circuits to corporations and others that were provided by Telesp and Telefonica Data. See “—A. History and Development of the Company—Historical Background—The Spin-off of Certain Data Transmission Operations” and “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

## Table of Contents

### Taxes

The cost of telecommunications services to each customer includes a variety of taxes. The principal tax is a state value-added tax, the Imposto sobre Circulação de Mercadorias e Serviços, or “ICMS,” which the Brazilian states impose at varying rates on revenue from the provision of telecommunications services. The rate in the State of São Paulo is 25% for domestic telecommunications services.

- Federal Social Contributions: Contribuição para o Programa de Integração Social or “PIS,” and Contribuição para o Financiamento da Seguridade Social or “COFINS,” imposed on gross operating revenue at a combined rate of 3.65% for telecommunications services (consisting of the COFINS amounts of 3.0% and PIS amounts of 0.65%) and 9.25% for other services (consisting of the COFINS amounts of 7.6% and PIS amounts of 1.65%). PIS is a tax designed to share business profits with employees through a mandatory national savings program, and is financed by monthly deposits collected as a percentage of gross operating revenue. COFINS is a tax designed to finance special social programs created and administered by the Brazilian government. Revenue related, among other things, with investments, dividends and sales of fixed assets are not subject to PIS and COFINS.
- Contribution for the Fund for Universal Access to Telecommunications Services—“FUST”. FUST was established in 2000 to cover the cost exclusively attributed to fulfilling obligations (including free access to telecommunications services by governmental institutions) of universal access to telecommunications services that cannot be recovered with efficient service exploration or that is not the responsibility of the concessionaire. Contribution to FUST are due at the tax rate of 1% of gross operating telecommunications services revenue (except for interconnection revenue), and it may not be passed on to customers.
- Contribution for the Fund of Telecommunications Technological Development—“FUNTTEL.” FUNTTEL was established in 2000, in order to stimulate, among others, technological innovation and to enhance human resources development so as to increase the competitiveness of the Brazilian telecommunications industry. Contribution to FUNTTEL are due at the tax rate of 0.5% of gross operating telecommunications services revenue (except interconnection revenue), and it may not be passed on to customers.
- Contribution to the Fund for Telecommunications Regulation—“FISTEL.” FISTEL is a fund established to provide financial resources to the Brazilian government for the regulation and inspection of the telecommunications sector. The fees owed to FISTEL, known as the FISTEL Taxes, are: (i) an installation inspection fee assessed on telecommunications central offices upon the issuance of their authorization certificates and (ii) an annual operations inspection fee that is based on the number of authorized central offices in operation at the end of the previous calendar year.

### Billing and Collection

We send each customer a monthly bill covering all of the services provided during the prior period. Telephone service providers are required under Brazilian law to offer their customers the choice of at least six different payment dates for each month. In our case, customers are divided into 35 different groups, and each group receives a bill according to a specific billing date within the monthly billing cycle.

We have a billing and collection system with respect to national and international fixed-line-to-fixed-line and fixed-line-to-mobile for local, long-distance, subscriptions and third party services. Payments of the bills are effected under agreements with various banks and other collection agencies (including lottery-playing facilities, drugstores and supermarkets) either by debiting the customer’s checking account, by direct payment to a bank or through the Internet.

In accordance with the Brazilian telecommunications regulations, we use a billing method called “co-billing.” This method allows billing from other phone service providers to be included within our own invoice. Our customers can receive and subsequently pay all of their bills (including the fees for the use of services of another telephone service provider) by using one invoice. To allow for this method of billing, we provide billing and collection services to other telephone service companies and have developed a special system for such bills. We have co-billing agreements (“co-billing in”) with national and international long distance service providers.



Table of Contents

Similarly, we use the same method of co-billing to bill charges for our services on the invoices of other fixed and mobile providers. We use direct billing through the national registry of clients for customers who use our long distance services through operators that have no joint billing agreement with us.

ANATEL regulations allow us to prevent a customer from making outgoing calls after a receivable has been outstanding for 30 days—a partial block—or prevent a customer from making outgoing or receiving incoming calls—a total block—after 60 days, and to disconnect a customer upon failure to pay after 90 days. During 2010, the monthly average of partial blocks was 849,953 telephone lines and the monthly average of total blocks was 132,912 telephone lines. On December 31, 2010, 8.4% of all receivables had been outstanding between 30 and 90 days, and 38.2% of all receivables had been outstanding for more than 90 days. For a discussion of provisions for past due accounts, see “Item 5—Operating and Financial Review and Prospects.”

We aim to guarantee the non-occurrence of losses in the implementation of new processes and the roll-out of new products through the monitoring of billing, collection and recovery controls. The actions are followed closely by our Revenue Assurance Team, which measures every risk of loss of revenue detected along the billing and collection chain. These risks are managed to minimize revenue losses.

## Network and Facilities

Our network consists of an access layer that connects our clients through our metal or optical networks, which are connected to voice and data centers. These centers are interconnected locally or remotely through transmission equipment connected predominantly with fiber optics and occasionally through a microwave network, which together form a network layer that enables connectivity between the various central aggregate services platforms as well as interconnection with other carriers. Our network strategy is based on the expansion of the Access Network (fiber optics) to allow greater coverage and broadband (high speed) services for our customers, as well as to develop an integrated multiservice network and multimedia applications. As a telecommunication service provider, we do not manufacture equipment for the construction of our networks and facilities. We buy the equipment from qualified suppliers and through this equipment we implement our networks and facilities through which we supply our services. The following table sets forth selected information about our network in aggregate, at the dates and for the years indicated:

	2010	At and for Year ended December 31,			
		2009	2008	2007	2006
Installed access lines (millions)	14.6	14.5	14.7	14.6	14.4
Access lines in service (millions) (1)	11.3	11.3	11.7	12.0	12.1
Average access lines in service (millions)	11.3	11.5	11.8	12.0	12.3
Access lines in service per 100 inhabitants	27.5	27.1	28.7	29.1	29.9
Percentage of installed access lines connected to digital switches	100.0	100.0	100.0	100.0	100.0
Employees per 1,000 access lines installed	0.6	0.5	0.6	0.5	0.6
Number of public telephones (thousands)	250.7	250.5	250.3	250.3	250.3
Registered local call minutes (billions)	50.4	51.5	51.8	54.5	n.a.
Domestic long-distance call billed minutes (billions)	8.7	10.7	11.8	11.9	13.0
International call billed minutes (millions)	61.6	63.8	84.7	88.1	94.7
Broadband services (millions)	3.3	2.6	2.5	2.0	1.6

(1) Data includes public telephone lines.

Technology

In order to offer a greater quantity of integrated services, we have incorporated a series of new technologies in our voice and data networks, the most prominent being IP/MPLS Multiservices networks supported by the IP/MPLS platform. Following the evolution of the Internet, we are also adding the IP/MPLS to the IPv6 technology, and installing a platform for traffic analysis (DPI – Deep Packet Inspection) to optimize the network evolution and delivery of products and services.

Table of Contents

The IP/MPLS platform allows us to offer internet connection solutions to residential clients (Speedy) and business clients, and for the later, at speeds that vary from 64kbps to 10Gbps.

This platform is connected to the main Brazilian internet providers and telecommunication companies through the network of Telefonica International Wholesale Services, or TIWS, which has redundancy connections. In addition to this connectivity, we plan to install by December 2011 distributed “mirrors” of the main content providers, using innovative resources from the CDN solution (Content Delivery Network). These characteristics provide our clients with high quality services and short delays in their internet connections.

Additionally, we have solution centers named DNS — Domain Name System — strategically positioned in the network which were extended by 25% in 2010 and which guarantee a quick name resolution to our internet services clients. These centers transform the internet addresses typed by residential and business clients into IP addresses guaranteeing the correct transmission of data to the internet.

We provide the IP/MPLS network to our business clients offering advanced connection solutions to small, medium and large companies (Private Virtual Networks — VPN). This network has mechanisms of quality assurance for all applications (QoS – Quality of Service) as well as applications for voice, video and data convergence. We also offer connectivity solutions to business clients through a network based on Frame-Relay, X25, ATM and Metro Ethernet technologies.

In our telephonic segment, due to a new positioning of the fixed services segment after significant media campaigns, supported by a network of the latest generation for transportation of voice traffic, we obtained in 2010 a growth in the fixed telephony base, thus reversing the downward trend in recent years. We were one of the few large operators to grow its base of fixed lines. Other state-of-the-art technologies in the segments of access (fiber-optic cables running to the client’s home, Wi-Fi), transmission (Metro Ethernet) and service platforms (flexible billing plans, prepaid) are being implemented which will allow Telesp to offer, in the short term, voice, video and data services, encompassing all the segments of the market. This convergent network will allow for increased offerings for our clients and a reduction in operational costs centralizing information into fewer elements.

In the residential segment, since 1999, we have been heavily investing in offering broadband access through an asymmetric digital subscriber line, or ADSL, technology under the brand “Speedy.” This technology provides high-speed Internet access through regular telephone lines. In 2007, we initiated the implementation of the FTTx network (available through fiber-optic cables running to the subscriber’s home – GPON technology) with a coverage of 450K Home Passed, offering in 2010 a range of different speeds up to 10 Mbps, and IPTV high definition service (HDTV). In December 2010, we surpassed the mark of 3.2 million broadband clients connected in service, 65% of which had speeds equal to or greater than 2Mbps. To reach this number of clients, we constantly search for market differentials such as new integrated services, speed upgrades and servicing of new localities, among others.

We offer the IPTV service through a partnership with TVA through the FTTx network and Telesp Platform. We made several improvements in the platform, such as the inclusion of FCC (Fast Channel Change) and installing a new version of the software with more interactive navigation, with the aim of providing a better user experience. In 2011, we will continue the improvements started in Telesp’s Platform aiming to increase competitiveness in the ITS market. This platform consists of pay TV with video broadcast offered through the use of the IP protocol. The offering of such technologically advanced services is only made possible due to our partnership with TVA, a recognized provider of pay TV services. Additional services, such as pay-per-view and “video on demand” (“VOD”), are also available. New high definition channels (HD) will be included to increase the quality and option for our customers. Furthermore, Telefônica’s network contains space for the recording of programs or local recordings in the Set Top Box (“STB”), and in the future, third-party content providers will be able to offer games, interactive and connectivity services.

We also offer digital television service via satellite (DTH) to the subscribers in the State of São Paulo (and in the future, all of Brazil) that receive broadcast/PPV content through a Ku band antenna and standard Set Top Box (with Smart Card), also available with a PVR (Personal Video Record) service. As of December 31, 2010, we surpassed the mark of 320,000 subscribers in service. We finished the implementation of the Content Protection system in 2010, aiming to reduce the possibility of undesired access to the distributed content. In 2011, we will

## Table of Contents

include new channels in high definition (HD) to offer premium content to our customers and new local channels to increase penetration of service in some areas of coverage.

Our development plan contemplates the use of the most advanced technology available, focusing on integration with the Internet and an increase in the number of multimedia transmission services, with an emphasis on ADSL, FTTx (GPON), NGN, DWDM, ROADM and re-transmittal technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

Currently, 100% of our network is digital.

## Competition

We have been facing competition in the high value corporate and residential segments in different types of services in previous years. In 2010, this competition increased in the market for small and medium enterprises and in the residential market with lower purchasing power due to an expansion of the coverage area and offers from competitors in both fixed and mobile segments, adding downward pressure to prices and pushing for higher discounts. Our main competitors in the business segment are Oi, TIM, Teléfonos de México, S.A. de C.V. ("Telmex") through Embratel, and GVT. Our competitors employ varying strategies to gain market share. For example, this year, TIM has focused its efforts on the market for long distance calls through aggressive positioning in the market consisting of reduced tariffs and billing "per call." GVT started its operation in some of the major cities in the State of São Paulo with a strategy based on ultra-fast broadband services with low price and high quality service and care, targeted especially to small and medium businesses. Our market strategy in this sector is based on becoming a sole provider of services with converging offers and providing the best customer experience.

In the high-income residential service segment, we compete in fixed voice and long-distance services with TIM (Intelig) and in broadband and pay-TV services with the pay-TV provider Net Servicos de Comunicação SA and in high-speed broadband with GVT. Nevertheless, Telefonica was the wireline operator with the largest growth in the number of broadband customers across the country, adding more than 680 thousand new broadband accesses to its base. In the segment of low income customers, we face competition from Embratel TV services and broadband internet services of NET Communications S.A.

In 2010, we had a growing customer base for our fixed-line services due to the addition of large volumes of new customers, especially in the lower income population, and an improvement of our turnover rate. To achieve this objective, we increased sales of lower-cost alternatives, such as pre-paid fixed lines and offer flat rates called "Talk & Surf at Will," (Fale e Navegue à Vontade), which allows for local network calls and unlimited internet. Additionally, we had marketing campaigns against prepaid mobile services with advertising to demonstrate the economic advantages of using fixed-line services, due to increased competition with post-paid services, which have plans for aggressive in-network minutes.

We continue to develop and expand our product offerings, particularly those with great potential for future growth, such as broadband Internet services, pay-TV, and information technology services.

With respect to our offer of broadband internet, Speedy has maintained its position as market leader in the State of São Paulo with more than 3.3 million customers as of December 31, 2010 and a 19% growth compared with the same date in 2009. We have relaunched the broadband service over high-speed optic fiber and joined the Popular Broadband Plan launched by the government of the State of São Paulo, which will allow the access of lower income customers to broadband internet at a higher rate. For services like pay TV, the focus in 2010 was the improvement of product quality and related services, such as channel programming, installation and billing. We believe that in 2011 this service will be important to enhance the sale of our broadband services and increase fixed-line customer loyalty.

We continue with our strategy in the corporate market as a provider of complete infrastructure solutions for information technology customers, integrating hardware packages, voice, data, Internet and network services. Additionally, we launched the service "OnVideo", a product that allows the client to watch movies directly from a TV with digital video technology on demand. The service "At Home", which provides home automation (a solution that integrates home electrical devices, thus offering improved convenience, comfort, energy efficiency and

## Table of Contents

security), completed its first year in 2010 and exceeded sales expectations. In 2010, we achieved major advances in the relationship with our customers and continue to believe that this is an important foundation of our business. For example, we continued the Telefonica em Ação program of 2009 that consisted of investments in infrastructure improvements, and launched the program "Improving Always" (Melhorar Sempre) with the aim of showing that Telefonica's commitment to improvement of its services is permanent. These programs resulted in the best quality ranking as perceived by customers in the history of Telefonica's services in fixed telephony.

### Sales, Marketing and Customer Service

#### Sales

We bring our solutions to our clients through the following sales channels:

- Person-to-person sales: our business management team offers customized sales services, ensuring high customer loyalty and a strong customer relationship resulting from customized consulting telecommunication and IT services and technical and commercial support;
- Telesales: sales through active and passive telemarketing call centers, employing highly trained sales associates;
- Indirect channels: sales made by certified companies in the telecommunications and data processing segments to provide an adequately sized network for our products and serve the geographic dimensions of these segments;
- Internet: "Portal Telefônica," with on-line information on our products and services specifically targeted toward our corporate clients; we also offer the option of selling services via online chat through highly trained partners and appropriate tools;
- Door-to-Door: in order to approach more corporate clients, we created physical channels of assistance, such as door-to-door sales of services by consultants in the State of São Paulo.

#### Marketing

We continuously monitor market trends and customer needs through research and market analysis in search of business opportunities to develop new products and services as a way of anticipating the future needs of our clients.

We increased the number of packaged products to meet the varied needs of our customer with solutions that combine access services, bundles of voice minutes, broadband internet access and private systems between different branches, and supplies of equipment and computer support, among others. We believe that the trend toward bundled offers will continue to grow, and developing such offers will be important to maintain our competitiveness in the market.

We employ a different approach to marketing using a mix of human and technological resources (specialized teams and business intelligence tools, respectively), in addition to studies that allow us to target each market segment according to the customers' relevant specific needs.

We believe that the brand strength of Telefônica (the brand under which we offer our services), the quality of our services and the skills of our staff are our key differentiators in the market, which guarantees us the ability to innovate and produce new business opportunities .

#### Customer Service

Our principles of corporate operations state that we must always offer our clients innovative and trustworthy products and services of high quality and at reasonable prices. We continually improve the quality of our products and services through the modernization of our telecommunications platform and its management systems, as well as its operational support management systems, and an organizational structure with as few levels as possible, bringing the company closer to the customers.



## Table of Contents

In the first quarter of 2010, rainfall in the city of São Paulo reached a 60-year record with 480 milliliters during the month of January, according to the National Institute of Metrology (Instituto Nacional de Meteorologia). The severe weather conditions resulted in an increase in repair requests for residential phone lines.

Under Brazilian telecommunications regulations, our concession and authorization contracts for providing services (fixed commuted, communication and multimedia telephone and pay TV) contain required targets that must be reached with respect to the quality of services that apply to access times for special service codes, response times for requested information for access codes, national and international call completions, repair requests, fulfillment of repair requests, fulfillment of address change requests and the quality of billing documents.

Service quality improvements were focused in five major strategic projects, with weekly status meetings and an executive officer as sponsor, including multifunctional teams from different departments. We describe below our main strategic projects:

- IT improvements: maintenance and review of quality control systems and objectives, drawn from the client's perspective, with the establishment of service level targets and system availability;
- Network improvement and stabilization: maintenance and review of quality control systems and objectives, drawn from the client's perspective, with the establishment of service level targets and system availability, expansion of network capacity and investments in preventive and corrective maintenance;
- Basic telephony service improvements: review of process and contracts with outsourced companies that render field services to us (installation, repairs and changes of address);
- Broadband service (Speedy) improvements: auditing process in 100% of the sales in all sales channels to assure that our clients will receive full information about the speed and product acquired, in addition to a certifying process of field repairs before completion of the process; and
- Improvement in the billing process: implementation of processes to reduce billing errors and technical problems for fixed-line services and broadband access.

The results were favorable and we registered a decrease of 21.5% in the total number of calls to our customer service department between the first quarter of 2010 and the last quarter of 2010.

In order to continue improving the quality of our services and to guarantee customer satisfaction, our measures include:

- Continued emphasis by the management on product and service quality and on customer satisfaction with weekly meetings attended by our senior officers;
- Use of customer satisfaction surveys focused on the Company's main activities, such as sales, commercial assistance, technical assistance, installation and repairs, retention and back office support. These surveys provide more comprehensive knowledge of our customer evaluation of each of the specific processes;
- Continued analyses of satisfaction surveys with identification of the critical factors for customers and main points for an improved analysis of the correlation of the results with the operational indicators of the company;
- Maintaining an increased emphasis on programs and projects focused on customer satisfaction, oriented toward and prioritized on customer satisfaction survey results together with internal evaluation and evaluation by outside

consultants to help focus on action items of primary importance to customers;

- Implementation of a process for control, approval and promotion of new products, with the goal of releasing products and promotions to customers that have passed all necessary tests and approvals; and

## Table of Contents

- Broad review of the broadband technical assistance processes in order to decrease the repair period and increase the level of successful solutions.

### Seasonality

Our business and results of operations are not materially affected by seasonal fluctuations in the consumption of our services.

### Regulation of the Brazilian Telecommunications Industry

#### General

Our business, including the services we provide and the rates we charge, is materially affected by comprehensive regulation under the General Telecommunications Law and various administrative rules thereunder. Our companies that operate under a concession are authorized to provide specified services and have certain obligations, according to the Plano Geral de Metas de Universalização, or General Plan on Universal Service Targets and the Plano Geral de Metas de Qualidade, or General Plan on Quality Targets.

ANATEL is the regulatory agency established by the General Telecommunications Law. ANATEL is administratively and financially independent of the Brazilian government. Any proposed regulation by ANATEL is subject to a period of public comment and, occasionally, is subject to public hearings, and its decisions may be challenged in the Brazilian courts.

#### Concessions and Authorizations

Concessions are licenses to provide telecommunications services that are granted under the public regime, while authorizations are licenses to provide telecommunications services granted under the private regime.

Companies that provide services under the public regime, known as the concessionary companies, are subject to certain obligations as to quality of service, continuity of service, universality of service, network expansion and modernization.

Companies that provide services under the private regime, known as the authorized companies, are generally not subject to the same requirements regarding continuity or universality of service; however, they may be subject to certain network expansion and quality of service obligations set forth in their authorizations.

Companies that operate under the public regime include us, Embratel, Oi, CTBC Telecom and Sercomtel. The primary public regime companies provide fixed-line telecommunications services in Brazil that include local, intraregional, interregional and international long-distance services. All other telecommunications service providers, including the other companies authorized to provide fixed-line services in our concession region, operate under the private regime.

Public regime companies, including us, can also offer certain telecommunications services in the private regime, of which the most significant are data transmission services.

Fixed-line Services—Public Regime. Our current concession agreements for the local, intraregional and interregional long-distance services, were extended on December 22, 2005, for an additional period of 20 years.

The current concession agreements contain a provision, amended by ANATEL on December 30, 2010, which states that the Concession Agreement may be amended on May 2, 2011 (formerly December 31, 2010), December 31, 2015 and December 31, 2020, to establish new conditions and new targets for universal access and quality, taking into consideration the conditions prevailing at the time, and defining, in the case of universal access targets, complementary resources, as provided by article 81 of Law No. 9,472 of 1997.

Under the renewed concession agreements and during the 20-year renewal period, we are required to pay a biennial fee equal to 2% of the gross revenue of the previous year, net of taxes and social contributions, arising from

## Table of Contents

the rendering of basic service plans and alternative STFC in our concession area . See “—Obligations of Telecommunications Companies.” Each of the foregoing regulatory terms and conditions affecting (or potentially affecting) the current concession agreements, as well as current obligations under the existing concession agreements, may impact our business plan and results of operations.

**Fixed-line Services—Private Regime.** The Brazilian telecommunications regulation delegates to ANATEL the authorization of the private regime companies to provide local and intraregional long-distance service in each of the three fixed-line regions and to provide intraregional, interregional and international long-distance services throughout Brazil. ANATEL has already granted authorizations to private regime operators to operate in Region III, our concession region. ANATEL also granted other private regime companies authorizations to operate in other fixed-line regions and authorizations to provide intraregional, interregional and international long-distance services throughout Brazil in competition with Embratel. Several companies have already applied for the authorization, and ANATEL may authorize additional private regime companies to provide intraregional, interregional and international long-distance services. See “—Competition.”

Since 2002 we provide local and interregional services in Regions I and II and Sector 33 of Region III, and international long distance services in Regions I, II and III.

### Obligations of Telecommunications Companies

We and other telecommunications service providers are subject to obligations concerning quality of service, network expansion and modernization. The concession telecommunication companies are also subject to a set of special restrictions regarding the services they may offer, which are listed in the Plano Geral de Outorgas, or General Plan of Grants, and special obligations regarding network expansion and modernization contained in the General Plan on Universal Service Targets.

In 2008, the presidential decree published with the General Plan of Grants increased the flexibility of telecommunications provider groups as STFC concessionaires by allowing such providers to provide services in up to two General Plan of Grants regions. Prior to this decree, telecommunications provider groups holding STFC concessions could offer STFC services in only one region under the public regime.

### Restrictions on Companies to Provide STFC in the Public Regime

Public regime companies are also subject to certain restrictions on alliances, joint ventures, mergers and acquisitions, including:

- a prohibition on holding more than 20% of the voting shares in any other public regime company, unless previously approved by ANATEL, according to ANATEL’s Resolution 101/99; and
- a prohibition on public regime companies to provide similar services through related companies.

### Network Expansion and Quality of Service

We are subject to the General Plan for Universal Service Targets (Plano Geral de Metas para a Universalização) and the General Plan of Quality Targets (Plano Geral de Metas de Qualidade), each of which respectively requires that we undertake certain network expansion activities with respect to our fixed-line services and meet specified quality of service targets. The timing for network expansion and benchmarks for quality of service are revised by ANATEL from time to time. After two public consultations, ANATEL and the Federal Government are still discussing the new General Plan for Universal Service Targets to be in effect for the period from 2011 to 2015, which shall become part

of the amended concession agreement on May 2, 2011.

The decree altering the General Plan for Universal Service Targets rescinded in 2008 the obligation of telecommunications concessionaires to install telecommunications service centers (providing calling and data access to walk-in customers) and substituted such obligation with an obligation to roll out broadband network infrastructure throughout the municipalities serviced by such concessionaires. In compliance with the decree, in 2010, all municipalities in Brazil had infrastructure for broadband networking . This obligation made us implement an additional network infrastructure in 257 of the 622 municipalities in our concession region.

## Table of Contents

Moreover, we have, as have other telecommunications concessionaires, committed to provide free internet access to public schools during the term of our concession grant (until 2025). This required us to provide internet connections to approximately 9,200 schools in our concession region by the end of 2010. In addition, about 3,000 other schools were included according to the new school census of INEP/MEC.

If a public regime company does not fulfill its obligations under the General Plan for Universal Services and the General Plan for Quality Targets, there are various monetary penalties that may be imposed by ANATEL. A company may lose its license if ANATEL considers it incapable of providing basic services under the two General Plans.

### Interconnection

In compliance with resolution 458 of February 2007, new rules for interconnection fees were introduced. The interconnection fee for off-peak hours was reduced by 30% and it was indicated that the use of the LRIC long-term cost-based model for determining interconnection fee values will be implemented after 2009.

### C. Organizational Structure

On December 31, 2010, our voting shares were controlled by two major shareholders: SP Telecomunicações Participações Ltda. with 50.71% and Telefônica Internacional S/A with 34.87%. Telefônica Internacional is the controlling shareholder of SP Telecomunicações and, consequently, holds directly and indirectly 85.57% of our common shares and 89.13% of our preferred shares. Telefônica Internacional is a wholly-owned subsidiary of Telefônica, S.A. of Spain.

### Subsidiaries

A. Telecom S.A. (formerly Assist Telefônica) is our wholly-owned subsidiary. A. Telecom was formed in Brazil on October 29, 1999, and it is engaged primarily in providing telecommunications and data services and internal telephone network maintenance for customers. The principal services are as follows: (i) digital condominium which is a value-added service for commercial buildings, integrated solution for equipments and services for voice transmission, data and images on commercial buildings under a Building Local Exchange Carrier (“BLEC”) model; (ii) installation, maintenance, exchange and extension of new points of internal telephony wire in companies and dwellings under a basic plan of maintenance (BPM) and (iii) provision of free ISP service under the brand name “I-Telefônica.” In addition, on December 30, 2004, we entered into a transaction to acquire indirect control of Atrium Telecomunicações Ltda. The transaction was approved by our shareholders on January 19, 2005. The acquisition was carried out through the purchase of the total share capital of Santo Genovese Participações Ltda., which held 99.99% of the representative share capital of Atrium. On March 1, 2006 then-subsiary Santo Genovese Participações Ltda., having merged into its subsidiary Atrium Telecomunicações Ltda., was acquired by A. Telecom S.A. and both Santo Genovese Participações Ltda. and Atrium Telecomunicações Ltda. ceased to exist. A. Telecom remained a wholly-owned subsidiary of Telesp, and began carrying out the activities formerly performed by Atrium. See “—B. Business Overview—Services.”

From the second half of 2006, A. Telecom began providing pay TV services, fully focusing on the development of this new product line. In February 2008, A. Telecom became an owned subsidiary of Telefônica Televisão Participações S.A. (TTP). In November 2008, TTP was merged into Telesp and A. Telecom became a wholly owned subsidiary of Telesp. See “—A. History and Development of the Company—Historical Background—Corporate Reorganization involving DABR and TTP.”

Telefônica Data S.A.’s business purpose is to render telecommunications services such as the development, implementation and installation of projects related to integrated business solutions and telecommunications

consulting, as well as activities related to the rendering of technical assistance and equipment and telecommunications network maintenance services. Telefônica Empresas, currently (“Telefônica Data”), became a wholly-owned subsidiary of the Company after the corporate reorganization that was carried out in July 2006. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.” In July 2008, Telefônica Data became a wholly owned subsidiary of TTP. In November 2008, TTP was merged into Telesp and



## Table of Contents

Telefônica Data became a wholly owned subsidiary of Telesp. See “—A. History and Development of the Company—Historical Background—Corporate Reorganization involving DABR and TTP.”

Telefônica Sistema de Televisão S.A. (“TST”) is a company that provides pay television services through the Multipoint Multichannel Distribution Services (“MMDS”) modality.

### Associated Companies

Since June 30, 2000, we have consolidated under the Brazilian Corporate Law Method, and since January 1, 2009, under IFRS, the operations of Aliança Atlântica Holding B.V., an investment company incorporated under the laws of the Netherlands, that had as its main asset a 0.61% interest in the equity capital of Portugal Telecom, which was disposed of in June 2010. As of December 31, 2010, we held a 50% share ownership in Aliança Atlântica Holding B.V. and Telefônica S.A. held the remaining 50%. Aliança Atlântica Holding B.V. is currently in the process of liquidation and, as a result, its remaining assets are being appraised.

Furthermore, since December 31, 2003, we have also consolidated under the Brazilian Corporate Law Method, and since January 1, 2009, under IFRS, our investment under proportional consolidation in Companhia AIX de Participações, or AIX. At December 31, 2010, we held a 50% share ownership in AIX and Telemar Participações S.A. held the remaining 50%. AIX was formed in 2001 to explore, directly and indirectly, activities related to the execution, conclusion and commercial exploitation of underground cables to fiber-optic. See Note 1 to the consolidated financial statements included in this annual report starting at page F-1. We also consolidate on a pro rata basis, as required under the Brazilian Corporate Law Method and under IFRS, Companhia ACT de Participações, in which we hold a 50% interest.

### D. Property, Plants and Equipment

Our main physical properties for providing the Company’s services involve the segments of switching (public switching telephone network-PSTN), transmission (optic and wireless systems), data communication (multiplex devices, IP network), infrastructure (Energy systems and air conditioned) and external Network (fiber-optic and metallic cables), which are distributed in many buildings in the State of São Paulo and in the main cities out of the State of São Paulo. Some of these buildings are also used in administrative and commercial areas.

Our properties are located throughout the State of São Paulo. At December 31, 2010, we used 2,191 properties in our operations, 1,432 of which we own, and we have entered into standard leasing agreements to rent the remaining properties. We own a building in the City of São Paulo where the majority of our management activities are conducted.

As of December 31, 2010, property related to construction in progress represented 7.9% of the net book value of our total fixed assets, automatic switching equipment represented 12.1%, transmission and other equipment represented 36.4%, terminal equipment and modems represented 12.5%, infrastructure represented 27.6%, television equipment and materials represented 1.8%, and other assets represented 1.7% of total fixed assets. As of December 31, 2010, the net book value of our property, plant and equipment was R\$10.2 billion.

Pursuant to Brazilian legal procedures, liens have been attached to several properties pending the outcome of various legal proceedings to which we are a party. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Proceedings.”

### ITEM 4A. UNRESOLVED STAFF COMMENTS

None.

ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

A. Operating Results

The following discussion should be read in conjunction with our consolidated financial statements and accompanying notes and other information appearing elsewhere in this annual report and in conjunction with the

41

---

## Table of Contents

financial information included under “Item 3. Key Information—A. Selected Financial Data.” We prepared our consolidated financial statements included in this annual report in accordance with the IFRS. These consolidated annual financial statements are our first financial statements prepared in accordance with the IFRS, as issued by International Accounting Standards Board (“IASB”). IFRS 1 – “First-time Adoption of International Financial Reporting Standards” has been applied in preparing these financial statements. Until December 31, 2009, our consolidated financial statements were prepared in accordance with accounting practices adopted in Brazil (“Brazilian GAAP”). Brazilian GAAP is based on the Brazilian Corporate Law No. 6,404 of December 15, 1976, as amended, and included the provisions of Law No. 11,638/2007 and Law No. 11,941, dated May 27, 2009; the accounting standards issued by the Brazilian Federal Accounting Council (Conselho Federal de Contabilidade – “CFC”); the accounting standards issued by the Accounting Standards Committee (Comitê de Pronunciamentos Contábeis – “CPC”); and the rules and regulations issued by the Brazilian Securities Commission (Comissão de Valores Mobiliários – “CVM”). After the adoption of CPCs No.15 to 43, Brazilian GAAP does not differ from IFRS, for preparation of consolidated financial statements. The comparative figures with respect to 2009 have been restated to reflect adjustments made as a result of the adoption of IFRS.

### Overview

Our results of operations are principally affected by the following key factors.

### Brazilian Political and Economic Environment

The Brazilian economy has experienced different rates of growth this decade. According to the IBGE which uses the new methodology of national accounts, Brazil’s GDP expanded around 7.5% in 2010, against a retraction of 0.6% in 2009. The average growth of the GDP for the decade was 3.7% per year.

Consumer prices, as measured by the Consumer Price Index, or the IPCA, published by the IBGE, registered a variation of 5.9% in 2010. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank of 4.5%. In 2008 and 2009, the variations of IPCA were 5.9% and 4.3%, respectively. Inflation, as measured by the General Price Index, or the IGP-DI, calculated by the Fundação Getúlio Vargas, which includes wholesale, retail and home-building prices, increased 9.1% and decreased 1.4% in 2008 and 2009, respectively. In 2010, the IGP-DI was 10.77%, the highest rate since 2004.

As a result of the acceleration of inflation and of the economic activity, the Central Bank increased the basic interest rate during 2010. As a result, the Selic rate increased to 10.75% by the end of 2010, against 8.75% per year by the end of 2009.

Brazil finished 2010 with a trade balance surplus of US\$20.3 billion, compared to US\$25.3 billion in 2009. Exports increased by 32% to US\$201.9 billion, and imports increased 42.2% to US\$181.6 billion. Financial inflows into the country increased, with foreign direct investments of US\$48.5 billion, compared to US\$25.9 billion in 2009. Portfolio investments increased by US\$51.1 billion in 2010, in comparison to the increase of US\$46.7 billion in 2009. The positive performance of external accounts allowed international reserves to increase by US\$49.5 billion to the record level of US\$288.6 billion.

The improvement in domestic economic data, such as inflation, external accounts, and interest rates, along with increased liquidity in the international capital markets led to a decrease in country risk in 2010. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI + Brazil), which tracks total returns for traded external debt instruments in the emerging markets, decreased to 180 basis points by the end of 2010 from 197 basis points at the end of 2009.

As a result, the real appreciated against the U.S. dollar by 4.0% in 2010. The exchange rate on December 31, 2010 was R\$1.67/U.S.\$1.00, from R\$1.74/U.S.\$1.00 on December 31, 2009. The real appreciation was also related to the devaluation of the U.S. dollar against other currencies.

Our business is directly affected by trends in the international economy and the Brazilian economy. If the Brazilian economy enters a period of continued recession, then demand for telecommunications services is likely to decline. Similarly, depreciation of the Brazilian real against the U.S. dollar may reduce the purchasing power of

Table of Contents

Brazilian consumers and, as a consequence, negatively affect the ability of our customers to pay for our telecommunications services.

## Impact of Inflation on Our Results of Operations

Prior to 2006, the fees we charged our customers were periodically adjusted by ANATEL based on the inflation rates measured by the General Price Index (IGP-DI).

Starting in 2006, telephone fees were indexed to the IST, which is a basket of national indexes that reflect the telecommunications sector's operating costs. Such indexing will thus reduce inconsistencies between revenue and costs in our industry and therefore reduce the adverse effects of inflation on our business. The IST for the last 12 months is 5.2% according to the last data published by ANATEL with reference to November, 2010.

The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2005 through 2010:

	Inflation Rate (%) as Measured by IGP-DI (1)	Inflation Rate (%) as Measured by IPCA (2)	Inflation Rate (%) as Measured by IST (3)
December 31, 2010	10.8	5.9	5.6
December 31, 2009	(1.4 )	4.3	2.1
December 31, 2008	9.1	5.9	6.6
December 31, 2007	7.9	4.5	3.2
December 31, 2006	3.8	3.1	3.2
December 31, 2005	1.2	5.7	-

(1) Source: IGP-DI, as published by the Fundação Getúlio Vargas.

(2) Source: IPCA, as published by the Instituto Brasileiro de Geografia e Estatística.

(3) Source: IST, as published by the Agência Nacional de Telecomunicações.

## Regulatory and Competitive Factors

Our business, including the services we provide and the rates we charge, is subject to comprehensive regulation under the General Telecommunications Law. As a result, our business, results of operations and financial conditions could be impacted by the actions of the Brazilian authorities, including:

- delays in the granting, or the failure to grant, approvals for rate adjustment;
- the granting of licenses to new competitors in our region; and
- the introduction of new or stricter requirements for our operating concession.

A series of new regulations became effective in 2010. The most important among these regulations were:

- Resolution No. 537 of February 17, 2010, which republished, with amendments, the Regulation on Conditions for Use of Radio Frequency Range 3.5GHz;

- Resolution No. 539 of February 23, 2010, which approved the Regulations of the General Plan for Universal SFTC;
- Resolution No. 544 of August 11, 2010, which approved the Regulations on the Use of Radio Frequencies in the Bands 2170 MHz to 2182 MHz and 2500 MHz to 2690 MHz;
- Resolution No. 548 of November 8, 2010, which approved the Regulation for Evaluating the Efficiency of Use of Radio Spectrum;
- Resolution No. 550 of November 22, 2010, which approved the Regulation on Exploration of SMP through Virtual Network (RRV-SMP);

Table of Contents

- Resolution No. 551 of December 3, 2010, approving the Planning Service for Cable TV and MMDS, replacing Decree No. 399 of August 18, 1997; and
- Resolution No. 553 of December 14, 2010, amending Regulations of Numbering Service of SMP and STFC.

We expect the following issues to become effective as new regulations or to be subject of one or more Public Notices in 2011, with an exact timeline yet to be determined by ANATEL.

- Proposals for new conditions and goals for quality and universal access to be included in the revision of concession contracts of STFC operators;
- Development of a General Competition Plan that would regulate standards for service providers with significant market power;
  - Change in the STFC Regulation;
    - Draft regulation on the provision of STFC out of the Basic Fee Area (Área de Tarifação Básica), or ATB;
      - Proposal to establish a criteria for tariff readjust of phone calls from the STFC;
      - Proposed revision of the rules of usage remuneration of providers of STFC networks;
      - Proposed revision of the rules of the Special Class Individual Access (AICE);
    - Proposal for an Alternative Plan of Compulsory Service Offer (PASOO) for the STFC in the LDN mode;
      - Invitation for bids for 3.5GHz frequencies;
      - Proposed amendment of the Regulation of Multimedia Communication Services (SCM);
        - Proposed rules for industrial exploration of dedicated lines - EILD;
  - Proposed regulations for the Certification of External Telecommunications Networks in regard to power protection;
    - Review of the General Plan on Quality Targets to the STFC (PGMQ-STFC);
    - Proposed rules of quality management for provision of multimedia communication services (RGQ-SCM);
    - Creation of a General Plan on Quality Targets of Television Subscription Services (PGMQ-TV);
  - Proposal for regulation the monitoring and control of goods, rights and services linked to existing concessions;
    - Proposed amendment of the Regulation of Inspection Powers; and
    - Proposal to amend the rules of implementation of administrative sanctions.

Number portability came into effect in Brazil in September 2008. Number portability allows clients within a limited geographic locale to relocate or change their telephone operator without the need to change their telephone number (for either a fixed or mobile line). Number Portability rights for all of our clients became effective in March 2009.

In addition to regulatory considerations, our business is affected by competition from other telecommunications providers. We began to face competition in our region in July 1999, and we anticipate that competition will contribute to declining prices for fixed-line telecommunications services and increasing pressure on operating margins. Our future growth and results of operations will depend significantly on a variety of factors, including:



Table of Contents

- Brazil's economic growth and its impact on the greater demand for services;
- the costs and availability of financing; and
- the exchange rate between the real and other currencies.

Foreign Exchange and Interest Rate Exposure

We face foreign exchange risk due to our foreign currency-denominated indebtedness, accounts payable (including our capital expenditures, particularly equipment) and receivables in foreign currency. A real devaluation may increase our cost of debt and certain commitments in a foreign currency. Our revenue is earned in reais, and we have no material foreign currency-denominated assets, except income from hedging transactions, interconnection of international long-distance services and services rendered to customers outside Brazil. Equity investments in foreign companies also suffer effects with variations in the exchange rate.

On December 31, 2010, 0.95% of our R\$1.83 billion of financial indebtedness was denominated in U.S. dollars. See Note 16 to the Consolidated Financial Statements. Devaluation of the real causes exchange losses on foreign currency-denominated indebtedness and commitments and exchange gain on foreign currency-denominated assets and corporate stakes in foreign companies.

We use derivative instruments to limit our exposure to exchange rate risk. Since September 1999, we have hedged all of our foreign currency-denominated bank debt using swaps. Since May 2010, the Company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures, or assets (issued invoices) minus liabilities (received invoices) for foreign exchange exposures, substantially reducing the Company's risk to fluctuations in exchange rates. However, we remain exposed to market risk resulting from changes in local interest rates, principally the CDI - Certificate for Interbank Deposits (Certificado de Depósito Interbancário), which is an index based upon the average rate of operations transacted among the banks within Brazil). This exposure to the CDI is present in long derivatives positions and financial investments, which are indexed to percentages of the CDI. Substantially, all of our debt is exposed to long term interest rates. On December 31, 2010, R\$1.81 billion of our indebtedness was subject to the variations of the TJLP (a long term interest rate), which remained stable since July 2009, and R\$0.02 billion was subject to the variation of the U.S. dollar . However, the portion in U.S. dollars of our foreign currency debt is swapped under hedging arrangements for variable-rate real-denominated obligations based on CDI. We invest our excess cash mainly in short-term instruments that earn interest based on the CDI. See Note 31 to the Consolidated Financial Statements and "Item 11—Quantitative and Qualitative Disclosures about Market Risk."

Since we have foreign currency derivatives with notional amounts substantially equivalent to our borrowings and invoices issued and received denominated in foreign currency, we do not have material exchange rate exposure with respect to these contracts. However, we could still continue to have exchange rate exposure with respect to our planned capital expenditures, approximately 33% of which are indexed in foreign currencies (mostly U.S. dollars). We systematically monitor the amounts and time of exposure to exchange rate fluctuations and may contract for hedging positions, when appropriate, at our discretion.

Discussion of Critical Accounting Estimates and Policies

The preparation of financial statements included in this annual report in accordance with IFRS involves certain assumptions and estimates that affect the amounts presented for revenue, expenses, assets and liabilities and disclosures of contingent liabilities in the notes to the financial statements. Therefore, the uncertainty relating to these assumptions and estimates could lead to results that require a significant adjustment to the accounting value of assets or liabilities affected in future periods. Although we review these estimates and assumptions in the ordinary course of

business, the presentation of our financial condition and results of operation often requires our management to make judgments regarding the effects on our financial condition and results of operations of matters that are inherently uncertain. Actual results may differ from those estimated under different variables, assumptions or conditions. Note 4 of our Consolidated Financial Statements includes methods used in the preparation of those financial statements and includes a summary of the significant accounting policies. In order to provide an

## Table of Contents

understanding of how we form the foregoing judgments and estimates, we have summarized certain critical accounting policies below.

### Accounting for long-lived assets, including goodwill

Property, plant and equipment and intangible assets, other than goodwill, are recorded at acquisition cost. Property, plant and equipment and intangible assets with definite useful lives are depreciated or amortized on a straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives are not amortized, but are, instead, subject to an impairment test on a yearly basis and whenever there is an indication that such assets may be impaired.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the useful lives of the assets over which they are to be depreciated or amortized. We believe that the estimates we make to determine an asset's useful life are "critical accounting estimates" because they require our management to make estimates about technological evolution and competitive uses of assets.

An impairment loss exists when the accounting value of an asset or cash-generating unit exceeds its recoverable amount, which is the higher between the fair value less selling costs and the value in use. The estimated fair value less selling costs is based on the information available from transactions involving the sale of similar assets or the market price less additional costs regarding the disposition of such asset. The value in use is based on the model of discounted cash flow. Cash flows are derived from the budget for the next 10 years and do not include activities of reorganization for which the Company has not yet been committed or significant future investments that will improve the group of assets of the cash-generating unit subject to the test. The recoverable amount is sensitive to the discount rate used in the method of discounted cash flow as well as to the projected future cash flow and the expected future growth rate used for the purposes of overestimation.

### Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. We record provisions based on reasonable estimates for possible auditing by tax authorities from the jurisdictions in which we operate. The value of these provisions is based on several factors such as experience from previous tax audits and different interpretations of tax regulations by the taxable entity and the competent tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the prevailing conditions in the domicile of the Company. As a result, we may be required to pay more than our provisions or to recover less than the assets recognized.

### Pension plan benefits

The cost of pension plans with determined benefits and other post-employment medical care benefits and the present value of pension obligations are determined using actuarial valuation methods. The actuarial valuation involves the use of assumptions about discount rates, expected return rates of assets, expected future salary increases, mortality rates, health care costs trend rates and future increases in retirement benefits and pensions. The obligation of a defined benefit is highly sensitive to changes in these assumptions. All assumptions are reviewed at each data-base. The mortality rate is based on mortality tables available in the country. Future increases in wages and retirement benefits and pensions are based on expected future inflation rates for the country and could significantly impact the value of the obligations to provide these benefits.

### Fair value of financial instruments

When the fair value of financial assets and liabilities presented on the balance sheet cannot be obtained in active markets, it is determined using valuation techniques, including the method of discounted cash flow. The data obtained for the use of these methods are based on the information prevailing in the market as possible. However, when it is not feasible to obtain such information in the market, a certain assumption level is required to establish the fair value. The assumption includes consideration of the data that was used, such as the liquidity risk, credit risk and

Table of Contents

volatility. Changes in the assumptions regarding these factors could affect the presented fair value of financial instruments.

## Provisions for civil and labor contingencies

We record provisions for civil and labor actions. The assessment of the likelihood of loss includes assessing the available evidence, the hierarchy of laws, the available jurisprudence, the most recent court decisions and its materiality in the legal system as well as the evaluation of the case by external counsels. Provisions are reviewed and adjusted to take into account changes in circumstances such as the applicable prescriptive period, results from tax inspections or additional exposure identified based on newly issued court decisions. A significant change in these circumstances or assumptions could result in a corresponding increase or decrease into the amount of our provisions.

## Sources of Revenue

The breakdown of our gross operating revenue is presented net of discounts granted. In addition, we categorized our revenue according to the following groups:

- Local: includes the sum of revenues from monthly subscription fees, installation fees, local services, public telephony and fixed-to-mobile revenues (VC1);
- Domestic long distance: includes the sum of fixed-to-mobile revenues (VC2 and VC3), public long distance telephony and domestic long distance;
- International long distance: includes the sum of revenues from international public telephony and international long distance; and
  - Data Transmission: includes the sum of infrastructure rental revenues and data transmission.

## Results of Operations

The following table sets forth certain components of our net income for each period ended December 31, 2010 and December 31, 2009, as well as the percentage change of each component.

	Year ended December 31,		% Change 2010 - 2009
	2010	2009	
	(in millions of reais, except percentages)		
Net Operating Revenue	15,756.1	15,806.0	(0.3 )
Operating Expenses, including cost of services and goods	(12,212.3 )	(12,426.8 )	(1.7 )
Equity in earnings of associates	2.9	18.8	(84.6 )
Financial Result	(120.7 )	(188.8 )	(36.0 )
Income and social contribution taxes	(1,027.2 )	(1,005.1 )	2.2
Net Income	2,398.8	2,204.1	8.8
Capex	2,441.4	2,220.9	9.9
Capex/Net Operating Revenue	15.5 %	14.1 %	% 1.4 p.p.

## Net Operating Revenue

Net operating revenue in 2010 was R\$15,756.1 million, remaining virtually stable in relation to 2009. This effect is mainly due to an increase in broadband revenue and corporate data in the amount of R\$372.5 million, beyond the increase of domestic long distance revenue of R\$105.8 million, explained by higher mobile incoming traffic with the “15” use (indicating our selection code of operator). These variations were offset by a decrease in revenue from local fixed telephony of R\$642.3 million, which was due to a decrease in VC1 and fixed-to-fixed traffics, despite the increase by 39,000 in the number of lines in service.

Table of Contents

## Capital Expenditures (Capex)

The capital expenditures in 2010 were R\$2,441.4 million, representing an increase of 9.9% compared to 2009. The investments in broadband and new businesses were intensified through the expansion and modernization of our network, the improvement of our systems and the processes of customer relationships, such as call centers, customer retaining programs and others. As a percentage over net operating revenues, the ratio was from 14.1% in 2009 to 15.5% in 2010.

## Results of Operations for the Year Ended December 31, 2010 Compared to the Year Ended December 31, 2009

## Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue in 2010 totaled R\$21,359.0 million, registering a decrease of 1.0% in relation to 2009. The components of our gross operating revenue are presented in the following table:

	Year ended December 31,		% Change 2010 - 2009
	2010	2009	
	(in millions of reais, except percentages)		
Gross operating revenue (1)	21,359.0	21,584.4	(1.0 )
Fixed Telephony	15,005.6	15,547.1	(3.5 )
Local	10,033.0	10,675.3	(6.0 )
Domestic long distance	4,876.4	4,770.6	2.2
International Long Distance	96.2	101.2	(5.0 )
Data Transmission	4,304.4	3,931.9	9.5
Interconnection	524.7	487.1	7.7
Pay TV	478.1	492.5	(2.9 )
Others	1,046.2	1,125.6	(7.1 )

(1) Gross operating revenue, but net of discounts granted.

## Fixed Telephony

Local. Revenue from local services reached R\$10,033.0 million in 2010, a decrease of 6.0% in relation to R\$10,675.3 million registered in 2009. The decrease is due to lower local fixed telephony revenue in 2010, explained by a decrease of VC1 and fixed-to-fixed traffics, offset by the increase in the monthly fee revenue, due to the positive net additions of 39,000 lines in service registered in the year, in addition to the tariff readjustment of most alternative plans as of August 2010.

Domestic long distance. Revenue from domestic long distance services in 2010 totaled R\$4,876.4 million, an increase of 2.2% in relation to R\$4,770.6 million in 2009. These effects are mainly explained by higher mobile incoming traffic with the "15" use (indicating our selection code of operator) and by the tariff readjustment of 0.66%, effective from October 8, 2010, and are partially offset by a reduction of fixed incoming traffic.

International long distance. Revenue from international long distance services reached R\$96.2 million in 2010, a decrease of 5.0% in comparison with R\$101.2 million in 2009. This evolution is justified by a decrease of traffic in

the period.

48

---



Table of Contents

## Data Transmission

Data transmission revenue reached R\$4,304.4 million in 2010, an increase of 9.5% when compared to R\$3,931.9 million in 2009. This growth is justified by increased hiring the actions of sales personnel and the Company's commitment to quality, reflected in an increase of the customer satisfaction index and larger customer base. There were 680,401 net additions of broadband, the highest gain of our history. Additionally, data revenue in the corporate segment increased in 2010.

## Interconnection revenue

Interconnection revenue totaled R\$524.7 million in 2010, an increase of 7.7% when compared to R\$487.1 million in 2009. This change is due to higher mobile incoming traffic. Additionally, we recorded a tariff readjustment for local, domestic long distance and interconnection services of 0.66%, effective as of October 8, 2010.

## Pay TV

Pay TV revenue totaled R\$478.1 million in 2010, representing a decrease of 2.9% in relation to R\$492.5 million in 2009. This decrease is mainly related to the lower average customer base in 2010. However, the trend changed in the last quarter of 2010, with 21,000 net additions of new customers, due to the Company's repositioning in relation to this product and the significant churn reduction in the period.

## Others

Other revenue registered R\$1,046.2 million in 2010, a decrease of 7.1% when compared to R1,125.6 million 2009. This decrease occurred because of lower revenue from resale of goods and value added services, but was partially offset by a revenue increase in our providing integrated solutions in the corporate segment.

## Operating Expenses

Operating expenses totaled R\$12,212.3 million in 2010, a decrease of 1.7% when compared to R\$12,426.8 million in 2009. The following table sets forth the components of operating expenses:

	Year ended December 31,		% Change 2010 - 2009
	2010	2009	
	(in millions of reais, except percentages)		
Operating Expenses	(12,212.3 )	(12,426.8 )	1.7
Interconnection expenses	(4,521.0 )	(4,386.3 )	3.1
Personnel expenses	(1,030.5 )	(722.6 )	42.6
Outsourcing expenses	(4,101.5 )	(3,630.0 )	13.0
Bad debt provision	(386.3 )	(564.6 )	(31.6 )
Taxes	(353.7 )	(382.4 )	(7.5 )
Other operating revenue (expenses)	94.2	(235.4 )	(140 )
Depreciation and amortization	(1,913.5 )	(2,505.5 )	(23.6 )

## Interconnection expenses

Interconnection expenses totaled R\$4,521.0 million in 2010, an increase of 3.1% when compared to R\$4,386.3 million in 2009. Such effect is mainly explained by higher expenses with total unbundled loops, an increase in mobile incoming traffic with the “15” use (indicating our selection code of operator) and Mobile Network Interconnection Fee (VUM) readjustment of 0.67% in February, 2010.

#### Personnel expenses

Personnel expenses reached R\$1,030.5 million in 2010, a growth of 42.6% in relation to R\$722.6 million in 2009. This increase is mainly due to a reversal of labor contingencies in the second quarter of 2009 in the amount of R\$159 million and to the non-recurring expenses related to personnel reorganization in the amount of R\$74.8 million, accounted for in the fourth quarter of 2010.

## Table of Contents

### Outsourcing expenses

Outsourcing expenses reached R\$4,101.5 million in 2010, an increase of 13.0% when compared to R\$3,630.0 million in 2009. This increase is related to an increase of commercial expenses, mainly in customer service, as a result of our commitment to quality and customers satisfaction, a higher concentration of advertising campaigns in 2010, and higher expenses with regard to network maintenance.

### Bad debt provisions

Bad debt provisions registered R\$386.3 million in 2010 from R\$564.6 million in 2009, representing a decrease of 31.6%. As a percentage of the net operating revenue, the ratio decreased from 3.6% in 2009 to 2.5% in 2010. This effect is explained by an improvement in the customer base profile through our strong performance in our commercial debt collection. Our 1.8% bad debt provision percentage on net operating revenue registered in the fourth quarter of 2010 is one of the lowest levels we have ever reached.

### Taxes

Taxes reached R\$353.7 million in 2010, a decrease of 7.5% when compared to R\$382.4 million in 2009. This variation is justified by the decrease in taxes due to services provided between us and our subsidiaries. This effect was partially offset by an increase in FUST and FUNTEL in the period.

### Other operating revenue (expenses)

Other operating revenues (expenses) reached R\$94.2 million in 2010, mainly justified by the sale and assignment of the right of use of non-strategic assets during 2010 in the total amount of R\$320.6 million, partially offset by the cost of goods sold to the corporate segment.

### Depreciation and amortization

Depreciation and amortization reached R\$1,913.5 million in 2010 compared to R\$2,505.5 million in 2009, a decrease of 23.6% explained by the adoption of new terms for certain categories of assets, which resulted in changes in those assets' useful life time when compared to those in 2009. Because this was a change in accounting estimates, the effects of this change were recorded prospectively from the year of 2010. This movement generated a decrease of R\$399.6 million in the depreciation expense in the year.

### Equity in earnings of associates

Equity in earnings of associates in 2010 reached R\$2.9 million, compared to R\$18.8 million in 2009, representing a decrease of 84.6%. This decrease is explained by the effect of applying equity accounting of the shareholding of Cable TV operators.

### Financial Result

For the year-end period ended on December 31, 2010, the financial result reached R\$120.7 million, increasing by R\$68.1 million or 36.0% when compared to the period ended December 31, 2009, mainly due to lower net debt. In relation to the last quarter of the previous year, the result was increased by R\$19.2 or 37.1% due to the same effect.

### B. Liquidity and Capital Resources

## General

We have funded our operations and capital expenditures mainly from operating cash flows and loans obtained from financial institutions. As of December 31, 2010, we had R\$1.5 billion in cash and cash equivalents. Our principal cash requirements include:

- the servicing of our indebtedness,
- capital expenditures, and
- the payment of dividends.

## Sources of Funds

Our cash flow from operations was R\$4.5 billion in 2010 compared to R\$4.4 billion in 2009. The increase in cash flow from operating activities of 3.0% in 2010 compared to 2009 was due primarily to (i) an increase in our net

Table of Contents

income, (ii) a decrease in our net accounts receivable from customers due to a better collection performance accompanied with lower billings, and (iii) a decrease in certain current liabilities due to the payment of ANATEL's concession in 2009 that happened on a biennial basis.

## Uses of Funds

Our cash flow used in investing activities was R\$1.7 billion in 2010 compared to R\$2.3 billion in 2009. The decrease in the cash flow used in investing activities of 26% in 2010 compared to 2009 was primarily due to the sale of the shares of Portugal Telecom in the net amount of R\$127.2 million and the assignment of rights to use existing space in transmission towers in the net amount of R\$292.7 million.

Our cash flow used in financing activities was R\$3.6 billion in 2010 compared to R\$1.6 billion in 2009. The increase in cash flow used in financing activities of 125% in 2010 compared to 2009 was due primarily to the prepayment of our debentures in the amount of R\$1.502.4 million and related interests in June 2010, and to an increase in our dividend payments in 2010.

## Indebtedness

As of December 31, 2010, our total debt was as follows:

Debt	Currency	Annual interest rate payable	Maturity	Principal amount outstanding (in thousands of reais)
Loan and Financing		TJLP + 1.73%		
BNDES	R\$	to 3.73%	2015	1,808,422
Mediocrédito	US\$	1.75%	2014	17,304
<b>Total debt</b>				<b>1,825,726</b>
Current				420,412
Long-term				1,405,314

Interest and principal payments on our indebtedness as of December 31, 2010 due in 2011 and 2012 total R\$420 million and R\$413 million, respectively.

The agreements that govern the majority of our outstanding loans and financings contain certain standard restrictive covenants, which may provide for the acceleration of the full balance of our obligations in the event of any default. As of December 31, 2010, we were not in default of any of our obligations and therefore none of our liabilities were subject to acceleration.

## Capital Expenditures and Payment of Dividends

Our principal capital requirements are for capital expenditures and payments of dividends to shareholders. Additions to property, plant and equipment totaled R\$2.4 billion and R\$2.2 billion for the years ended December 31, 2010 and 2009, respectively. Our capital expenditures for the year 2011 are expected to be similar to 2010. These expenditures relate primarily to the expansion of our network. We may seek financing for part of our capital expenditures and cash management assistance from the Brazilian government, in particular from Banco Nacional de Desenvolvimento Econômico e Social (Bank for Economical and Social Development), or BNDES, which is the main government financing agent in Brazil, as well as from the local or foreign capital markets or from local and foreign financial institutions. See "Item 4. Information on the Company—A. History and Development of the Company—Capital Expenditures."

Pursuant to our bylaws and Brazilian Corporate Law, we are required to distribute a mandatory minimum dividend of 25% of “adjusted net income” (as defined below) in respect of each fiscal year, to the extent earnings are available for distribution. Holders of preferred shares are assured priority in the reimbursement of capital, without a premium, and entitled to receive cash dividends that are 10% higher than those attributable to common shares.

## Table of Contents

Adjusted net income, as determined by Brazilian Corporate Law, is an amount equal to our net income adjusted to reflect allocations to or from (i) legal reserve, (ii) statutory reserve and (iii) a contingency reserve for anticipated losses, if any.

We may also make additional distributions to the extent that we have available profits and reserves to distribute. All of the above distributions may be made as dividends or as tax-deductible interest on shareholders' equity. We paid dividends of R\$1.9 billion, R\$1.5 billion and R\$2.2 billion in 2010, 2009 and 2008, respectively.

Our management expects to meet 2011 capital requirements primarily from cash provided from our operations. Net cash provided by operations was R\$4.5 billion, and R\$4.4 billion in 2010 and 2009, respectively.

As determined by the Brazilian Corporate Law and our by-laws, we must generally pay dividends to all shareholders equal to at least 25% of our annual net income. These adjustments to net income for purposes of calculating the basis for dividends include allocations to various reserves that effectively reduce the amount available for the payment of dividends. For the fiscal year ended December 31, 2010, the Board of Directors Meeting held on February 7, 2011 decided to submit to the shareholders meeting a proposal to pay dividends in the amount of R\$1.7 billion, which, together with the interim dividend and interest on own capital payments made in 2010, would be more than sufficient to meet the minimum dividend required by Brazilian law. The proposal to pay dividends will be approved by a General Shareholders Meeting to be held in 2011. See "Item 3. Key Information—D. Risk Factors—Risks Relating to the Preferred Shares and the ADSs—Holders of our preferred shares and our ADSs generally do not have voting rights" and "Item 10. Additional Information—B. Memorandum and Articles of Association—Voting Rights."

## New Accounting Pronouncements

### Recently Adopted Standards

The consolidated financial statements were prepared and are being presented in accordance with the IFRS.

We adopted IFRS for the first time in our consolidated financial statements for the fiscal year ended December 31, 2010, which includes the comparative financial statements for the fiscal year ended December 31, 2009.

IFRS 1 (First-time Adoption of International Financial Reporting Standards) requires an entity to develop its accounting policies based on the standards and related interpretations effective on the closing date of its first consolidated IFRS financial statements (December 31, 2010), at the date of transition to IFRS (January 1, 2009) and for the comparative period shown in the first IFRS financial statements (December 31, 2009).

We adopted all the standards, revisions of standards and interpretations issued by IASB effective as of December 31, 2010.

### Recently Issued Standards

New IFRS standards and interpretations of the IFRIC (International Financial Reporting Interpretations Committee of the IASB):

Some new IASB accounting procedures and IFRIC interpretations have been published and/or revised, the adoption of which is optional or mandatory for the years beginning January 1, 2010. Management of the Company and its subsidiary has analyzed the impacts of these new pronouncements and interpretations and do not expect their adoption to cause a material impact on the yearly information of the Company and its subsidiary for the year of first-time application, as follows:

- IAS 24 Disclosure Requirements for Government-Related Entities and Related Party Definition  
(Revised): Simplifies the disclosure requirements for government-related entities and defines related parties. This



Table of Contents

revised rule addresses aspects that, according to previous disclosure requirements and the prior definition of related party, were extremely complex and difficult to be applied in practice, particularly in environments where government control is pervasive, and now provides a partial exemption for government-related entities as well as a revised definition of a related party. This amendment was issued in November 2009, and became effective for fiscal years beginning in January 1, 2011. This amendment will have no impact on the consolidated financial statements of the Company.

- IFRS 9 Financial Instruments – Classification and Measurement: IFRS 9 closes the first part of the project to replace “IAS 39 Financial Instruments: Recognition and Measurement” IFRS 9 uses a simple approach to determine if a financial asset is measured at amortized cost or fair value, based on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets. The standard also requires that only one method be adopted for the determination of impairment losses. This standard will become effective for fiscal years beginning in January 1, 2013. Management is assessing the potential impact on the consolidated financial statements of the Company.
- IFRIC 14 Prepayments of a Minimum Funding Requirement: This amendment only applies to situation where an entity is subject to minimum funding requirements and advances its contributions in order to meet such requirements. This amendment allows for the entity to account for the benefit of such prepayment as an asset. This amendment will become effective for fiscal years beginning in January 1, 2011. This amendment will have no impact on the consolidated financial statements of the Company.
- IFRIC 19 Extinguishing Financial Liabilities with Equity Instruments: IFRIC 19 was issued on November 2009 and became effective for annual period beginning July 1, 2010, and earlier application is permitted. This interpretation clarifies the requirements of IFRS standards when an entity renegotiates the terms and conditions of a financial liability with its creditor and the latter agrees to accept entity stock or other equity instruments to settle the financial liability in full or in part. The Company does not expect IFRIC 19 to have any impact on its consolidated financial statements.
- Improvements to the IFRS: The IASB has issued improvements to the rules and amendments to the IFRS in May 2010, and the amendments will be effective as of January 1, 2011:
  - IFRS 3 – Business combinations.
  - IFRS 7 – Financial Instruments: Disclosures.
  - IAS 1 – Presentation of Financial Statements.
  - IFRIC 13 – Customer Loyalty Programs.

The Company does not expect the changes to have any impact on its consolidated financial statements.

Other rules and interpretations that have been issued but not adopted yet are not expected, based on Management’s opinion, to have a significant impact on the Company’s reported results or equity.

C. Research and Development, Patents and Licenses

Research and Development

Telefónica operates in a fast-paced, dynamic and convergent industry, which demands that its products and services be continuously revamped in order to keep up with growth expectations. Accordingly, since 2005, Telefónica created a new Strategic Innovation Unit that aims to develop new products and services to be tested or launched by Telefónica in the near future.

Also, in order to keep pace with constant innovation, Telefónica created a business incubator that helps the organization to easily handle emerging business opportunities of large sizes or risks that otherwise would be difficult to manage in the context of current business units.

Table of Contents

The table below presents the Telefónica investments in development, update and modernization of systems to support the launch of new products, improve the external plant inventory quality and take advantage of the new rules for technology businesses. Seeking to continually improve and modernize its services, Telefónica partnered with partners specialized in R&D such as the CPqD and TPD.

R&D investments	2010	2009	2008
		(in millions of reais)	
Centro de Pesquisa e Desenvolvimento (CPqD)	7.2	6.2	6.3
Telefônica Pesquisa e Desenvolvimento (TPD)	5.3	4.8	4.5
Innovation (business incubator and tests)	6.8	4.1	4.2
Total	19.3	15.1	15.0

The partnership between Telefônica and CPqD allows Telefônica to keep informed of technical research services, development of new features in current systems, and services in the areas of consulting and training. Telefônica can benefit from the use of a specific tool that monitors and manages data of cables, optical fiber and the level of use of its external network.

The partnership between Telefônica and TPD allows Telefônica to transfer to an automatic model of management of the planning and operation network focused on performance.

#### Patents and Licenses

Our principal intellectual property assets include:

- permission to use the trademark name “Telefônica” and all names derived from “Telefônica”;
- our name “Telecomunicações de São Paulo S.A. - Telesp”; and
- our commercial brands, “Super 15” for long-distance services and “Speedy” for broadband products, “Telefônica TV Digital” for pay television service, “DUO” for telephone and broadband service and “TRIO” for telephone, broadband and Digital TV service.

#### D. Trend Information

From a business and strategy perspective, one of the most important factors in the development of the telecommunications industry in the future is technological convergence represented by the integration of networks and services about which debates have arisen with respect to the technological, as well as legal, regulatory and commercial aspects.

Looking at the more mature markets like Europe, America and Asia, and the latest movements of the major telecommunications companies in Brazil, there is a clear trend of developing integrated and comprehensive offers and greater market presence. The broadband market will likely continue to grow strongly, as it will be the main platform for development of convergent products and services. We continue with our strategy to increase the speed of our broadband connection in São Paulo by expanding fiber optic and cable connections, and to provide better quality services and new products, especially TV and video on demand over IP protocol.

The Brazilian economy had a solid growth in recent years, with its expansion concentrated in the middle class population. We believe the same will occur in the telecommunications market, especially in the markets for broadband

and paid-TV, which should be the main drivers of the industry and should accelerate the expansion of geographical coverage and development of convergent offers. Moreover, welfare programs for digital inclusion and incentives for the IT industry should have greater importance in 2011. Telefonica will likely continue to invest in these markets through its various technological alternatives and their partners. The appreciation of the real against the U.S. dollar is likely to continue to favor us by reducing the cost of imported equipment.

Due to the increase in fixed lines obtained by Telesp in 2010, we will continue to explore opportunities in 2011 with lower-income customers and in physical presence channels for even greater growth. Currently, our portfolio

Table of Contents

includes voice packets of fixed tariffs for services (offering unlimited local calls to other fixed line phones), bundles of minutes (Meus Minutos), controlled and economic lines (a cheaper package of minutes for local calls to fixed lines and use of pre-paid credits for long distance calls and calls to mobile phones). Our competitors also offer different plans to capture the lower income segment of the market, including offering flexible billing packages, free calls to other customers with the same service provider or call packages with significantly reduced prices. For the long distance market, we expect that competition from VoIP (Voice over Internet Protocol - technology to transmit voice using the Internet) will increase due to the increase of broadband connections, both fixed and 3G. We are taking several actions to keep up with market trends and to compete by taking advantage of new technologies. We will increase our presence to capture the growth in the market through appreciation of fixed lines, proposals combining broadband and data, and a differentiated experience for the client compared to our competitors.

We will continue to monitor the development of products and services based on broadband products such as IPTV, video on demand, data and video, in order to prepare the Company to benefit in areas where our conventional network coverage is limited. We also will monitor the fiber optic products, including a portfolio of competitive high-speed and new value-added products such as Wi-Fi modem and service support, installation and configuration (Tec Total), packet voice services, interactive TV and high-definition, customized content and on demand. This strategy is in line with trends in more developed markets where there is greater integration between the operations of fixed voice, broadband and pay TV. Telefonica will continue to invest towards improving the quality of our services and developing new products to remain competitive technologically. Finally, we will continue our efforts to improve our relationship with customers. The improvements in customer experience will be supported by the quality improvement actions initiated in 2009 and by disseminating a culture of service and continuous improvement.

## E. Off-balance-Sheet Arrangements

None.

## F. Tabular Disclosure of Contractual Obligations

Our contractual obligations and commercial commitments as of December 31, 2010 are as follows:

	Total	Less than 1 year	1 - 3 years	4 - 5 years	After 5 years
	(In thousands of reais, as of December 31, 2010)				
<b>Contractual obligations</b>					
Long-term debt	1,825,726	420,412	825,352	579,962	—
Pension and other post retirement benefits	219,000	3,016	5,217	4,292	206,475
Other long-term obligations including leases	77,860	22,300	55,560	—	—
Total contractual cash obligations	2,122,586	445,728	886,129	584,254	206,475
<b>Commercial commitments</b>					
Suppliers	2,780,672	2,780,672	—	—	—
Other commercial commitments	—	—	—	—	—
Total commercial commitments	2,780,672	2,780,672	—	—	—

## Long-Term Debt

Year ending December 31,	Amount (in thousands of reais, as of December 31,
--------------------------	--

	2010)
2012	412,808
2013	412,544
2014	410,051
2015	169,911
Total	1,405,314

Table of Contents

## ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES

## A. Directors and Senior Management

We are managed by a Board of Directors (Conselho de Administração) and an Executive Committee (Diretoria).

## Board of Directors

Our Board of Directors is comprised of a minimum of five and a maximum of 17 members, all shareholders, serving for a term of three years. The following is a list of the current members of the Board of Directors, their respective positions and dates of their election.

Name	Position	Date of Appointment
Antonio Carlos Valente da Silva	Chairman	April 07, 2010
José María Álvarez-Pallete López	Vice-Chairman	April 07, 2010
Antonio Viana-Baptista	Director	April 07, 2010
Fernando Abril-Martorell Hernández	Director	April 07, 2010
Fernando Xavier Ferreira	Director	April 07, 2010
Francisco Javier de Paz Mancho	Director	April 07, 2010
Guillermo Fernández Vidal	Director	April 07, 2010
Iñaki Urdangarin	Director	April 07, 2010
José Fernando de Almansa Moreno-Barreda	Director	April 07, 2010
José Manuel Fernandez Norriella	Director	May 19, 2010 (*)
Luciano Carvalho Ventura	Director	April 07, 2010
Luis Bastida Iburguen	Director	April 07, 2010
Luis Fernando Furlan	Director	April 07, 2010
Luis Miguel Gilperez Lopez	Director	November 17, 2010 (**)
Miguel Ángel Gutiérrez Méndez	Director	April 07, 2010
Narcís Serra Serra	Director	April 07, 2010

\*The members of the Board of Directors have the mandate until the ordinary general meeting of 2013.

(\*) The Board member José Manuel Fernandez Norriella was appointed by the Board of Directors in May 19, 2010, as provided by Article 150 of Law 6,404/76, replacing Mr. Juan Carlos Ros Brugueras. His election was ratified at the General Shareholders' Meeting of August 12, 2010.

(\*\*) The Board member Luis Miguel Gilpérez Lopez was appointed by the Board of Directors at a meeting dated November 17, 2010, as provided by Article 150 of Law 6,404/76.

Table of Contents

Set forth below are brief biographies of our directors:

Antonio Carlos Valente da Silva is 58 years old and acts as President of the Board of Directors and serves as Chief Executive Officer. Mr. Valente is an Electrical Engineer, with vast experience in business development and telecommunications regulation. Mr. Valente served as Chief Executive Officer of Telefónica del Perú S.A.A., Telefónica Móviles S.A., Telefónica Móviles Perú Holding S.A.C., Telefónica Perú Holding S.A.C and of Telefónica Multimedia S.A.C and is a member of the Board of Directors. In addition, Mr. Valente is First Vice-President of the Association of Private Enterprises of Public Services (ADEPSEP) and is a Director of the Official Chamber of Commerce of Spain in Perú (COCEP). Prior to his appointment as Chief Executive Officer of Telefónica del Perú, Mr. Valente was responsible for the regulation of the Telefónica Group for Latin America. From 2002-2003, Mr. Valente acted as Vice-President of the National Agency of Telecommunications (ANATEL) of Brazil and presided over the Latin American Telecommunications Regulators Forum (Regulatel) institute, which unites nineteen Latin American countries and the Caribbean. Mr. Valente obtained a postgraduate degree in Business and Administration, with a specialization in Systems and Business Management including Entrepreneurial Strategy, from MIT/Sloan School of Management. Mr. Valente has taught and published numerous articles regarding regulation and telecommunications in Brazilian and international magazines. Since May 2007, he has been President of “AHCET – Asociación Iberoamericana de Centros de Investigación y Empresas de Telecomunicaciones.” Since July 2008, he has been President of “Telebrasil” (Associação Brasileira de Telecomunicações). He is also a Board Member of CPQD (Centro de Pesquisas e Desenvolvimento), a member of the Strategic Committee of “FIESP” (Federação das Indústrias do Estado de São Paulo), the Vice-President of “ABDIB” (Associação Brasileira da Industria de Base), a member of the “CDES” (Conselho de Desenvolvimento Econômico e Social da Presidência da República) and President of “FEBRATEL”(Federação Brasileira de Telecomunicações).

José María Álvarez-Pallete López is 47 years old and was appointed Chairman and Chief Executive Officer of Telefónica Internacional in July 2002, Managing Director Latin America and member of the Board of Telefónica, S.A. in July 2006, and Chairman and CEO of Telefonica Latin America in March 2009. He began his career at Arthur Young Auditors in 1987 and joined Benito & Monjardin/Kidder, Peabody & Co. in 1988, where he held positions in the research and corporate finance departments. In 1995, he joined Valenciana de Cementos Portland (CEMEX) as head of the Investor Relations and Studies department. He was appointed Financial Manager for CEMEX in Spain in 1996 and General Manager for Administration and Financial Affairs for CEMEX Group's interests in Indonesia in 1998, headquartered in Jakarta. He joined Telefónica in February 1999 as CFO of Telefónica Internacional. In September of the same year, he became CFO of Telefónica, S.A. Mr. Álvarez-Pallete holds a graduate degree in Economics from the Complutense University of Madrid. He also studied Economics at the Université Libre de Belgique. In 2000, he was named CFO of the Year in the M&A chapter by CFO Europe Magazine (The Economist Group). He holds a post graduate degree in the International Management Program by the Instituto Panamericano de Alta Dirección de Empresa (IPADE). He also obtained the Advanced Research Certificate from the Accounting, Financial Administration and Economy Department of the Universidad Complutense de Madrid. He is President of the Board of Directors of Telefónica Internacional, S.A.U. and is also a member of the following Boards of Directors: Telecomunicações de Sao Paulo, S.A., Telefónica DataCorp, S.A.U., Colombia Telecomunicaciones, S.A. ESP, Telefónica Móviles México, S.A. de C.V., Telefónica Larga Distancia de Puerto Rico, Telefónica del Perú, S.A., and alternate director of Telefónica Móviles Colombia, S.A., Telefónica de Argentina, S.A., Telefonica Chile, S.A. and Telefónica Móviles Chile, S.A. He has been Chairman of Antares, Fonditel, Telfisa and Telefónica North América; Vice Chairman of T.Perú; a member of the Board of Directors of CEMEX Singapur, Admira Media, Inmobiliaria Telefónica, TPI, Telefónica Móviles, Telefónica de España, Telefónica Holding Argentina, Telefonica Datacorp, Telefónica O2 Europe, China Netcom, Portugal Telecom, and SGPS SA; a member of the Supervisory Board of Cesky Telecom; and President of the Supervisory Board of Brasilcel N.V.

Antonio Viana-Baptista is 53 years old and is a member of our Board of Directors. He was the General Director of Telefónica de Espanha, member of the Executive Committee and of the Board of Directors of Telefônica S.A. holding



of Telefônica Group. He is also a member of the Board of Directors of O2 PLC, Telefónica Móviles México as well as a non-Executive Board Member of Research in Motion (RIM), NH Hoteles, Semapa, S.A., Jeronimo Martins, S.A. and Jasper Wireless. Since arriving at Telefônica in 1998, he has been involved with many companies in the group. He was the Executive President of Telefónica Móviles, S.A. In the period between December 1998 and

Table of Contents

July 2002, he was President of Telefônica International and Executive President of Telefónica Latinoamérica. He was Executive Director of BPI (Banco Português de Investimento) during the period from 1991 to 1998. During the period from 1985 to 1991, he was partner of McKinsey & Co. in Madrid and Lisbon. He holds a degree in economics from Universidad Católica Portuguesa in 1981 and also holds an MBA from INSEAD, Fontainebleau, in 1983.

Fernando Abril-Martorell Hernández is 48 years old and serves on our Board of Directors. He is a member of the Board of Directors of ENCE (the Spanish pulp producer). From 1987 to 1997, Mr. Abril-Martorell Hernández performed several functions at JP Morgan, in New York, London and Madrid, including treasury department manager and member of the managing committee. Mr. Abril-Martorell Hernández joined the Telefónica group in January of 1997, as corporate finance general manager, having represented the group's interests in the Brazilian telecommunications industry privatization process. From December 1998 to June 2000, he served as chief executive officer and chief financial officer of Telefónica Publicidad e Información (TPI). He was COO and a member of the Board of Directors of the Telefónica Group from August 2000 to September 2003. In 2005, he joined Credit Suisse Group in Spain as Managing Director and Chief Executive Officer. Mr. Abril-Martorell Hernández holds a degree in law and business sciences from ICAI-ICADE (Instituto de Postgrado y Formación Continua), Spain.

Fernando Xavier Ferreira is 62 years old and acts as a member of our Board of Directors. Mr. Ferreira served as our chief executive officer and of SP Telecomunicações Participações Ltda. He was president of the Supervisory Board of Brasilcel N.V., president of the Boards of Directors of Vivo Participações S/A, and Fundação Telefônica. He is also a member of the Board of Directors of Telefónica Internacional S.A. Mr. Ferreira has served as president of Telecomunicações Brasileiras S.A. - Telebrás, executive secretary in the Brazilian Ministry of Communications, chairman of the Board of Directors of Embratel S.A., president of Nortel do Brasil S.A., Brazilian General Director of Itaipu Binacional, president of Telecomunicações do Paraná S.A. - Telepar and as member of ANATEL's consulting committee and member of the Board of Directors of Empresa Brasileira de Correios e Telégrafos - ECT and Portugal Telecom. He holds a degree in electrical engineering from Faculdade de Engenharia Elétrica da Universidade Católica do Rio de Janeiro, the Electric Engineering Faculty of the Catholic University of Rio de Janeiro, Brazil, which he received in 1971. He attended a business administration course at Western Ontario University, Canada, in 1982.

Francisco Javier de Paz Mancho is 52 years old and serves as a member of our Board of Directors. Currently Mr. Mancho is the Chief Executive Officer of Atento Inversiones y Teleservicios, S.A.U., an advocate of MAZ management registry, serves as a member of the Board of Directors of Telefônica Internacional, is a member of the Board of Advisers of Telefônica LATAM and is the Honored President of PREALSA, member of the Advisory Council of Telefonica Espanha, President of the Regulation Commission of the Advisory Council of Telefonica Espanha (October 2009 to date); executive officer and member of the Board of Directors of Telefônica Argentina S.A. (2008-2009), member of the Advisory Council of Telefonica Andalucía (September 2008 to date); member of the Board of Directors of Telefónica S.A, President of the Human Resources, Reputation and Corporate Responsibility Commission, member of the Regulation Commission and member of the International Matters Commission (December 2007 to date); vocal of the Executive Committee of the Superior Board of Councils (since 2006). From June 2004 until December 2007, he was the President of Mercasa. He was Counselor deputy to President and Director of the Strategic Corporate area of Donuts Panrico Donuts Multinacional (1996-2004), General Director of the Ministry of Commerce and Tourism (1993-1996), General Secretary of Unión de Consumidores de España (UCE) (1990-1993), Delegate Counselor of Ciudadano magazine (1990-1993) and General Secretary of Juventudes Socialistas and executive member of PSOE (1984-1993). Also, he has acted in the following capacities: executive officer and member of the Board of Directors of Telefónica Argentina S.A. (2008-2009), counsel of Túnel del Cadí (2004-2006), President of Patronal Pan and Bollería Marca (COE) (2003-2004), Vice-president of Patronal Pan y Bollería Marca (COE) (2001-2002), counsel of Mutua de Accidents of Zaragoza (MAZ) (1998-2004), counsel of Panrico Group (1998-2004), President of Observatorio de la Distribución Comercial del Ministerio de Comercio e Turismo (1994-1996), Vice-president of Mercasa (1993-1996); Member of Social and Economic Council and Permanent Commission (1991-1993 and 1996-2000) and counsel of Tabacalera, S.A. (1993-1996). Mr. Javier holds degrees in

Information and Publicity and Law.

Guillermo Fernández Vidal is 64 years old and serves as a member of the Board of Directors. Mr Vidal began his career as a Systems Technician at NCR. In 1972, he joined ENTEL as a Systems Officer. In 1982, Mr. Vidal was

58

---

Table of Contents

appointed as President of ECOTEL, a position he occupied until 1987. After that, Mr. Vidal joined Telefónica Group, where he occupied several high-level administrative positions. Currently, he is an Advisor of Telefónica and member of the Board of Directors of Telefónica O2 - Chequia. Along his career path, Mr. Vidal was a member of the Boards of Directors of the following companies: ECOTEL, Ibermática, Amper, Telefónica de Peru, Telefónica CTC, TPI, Terra, Telefónica Móviles, Via Digital, Telefónica de España SAL and Telefónica Móviles España. Mr. Vidal holds a degree of industrial engineering.

Iñaki Urdangarín is 43 years old and serves as a member of our Board of Directors. He is President of the Commission for Public Affairs for the Board of Telefónica (Latin America). He has been assigned to Washington, D.C. as Telefonica Internacional USA Chairman, where his main role is to promote the institutional presence of Telefónica in North, Central and South America and to contribute toward facilitating the dialogue between the company and interest groups among regulators of the industry within the United States, Europe and Latin America. He has previously managed numerous projects connected to corporate social responsibility both in Europe and Latin America. Sustainable development and social integration have been areas of priority in which Mr. Urdangarín has developed his professional activity for Telefónica. Mr. Urdangarín is a graduate in Business Administration from ESADE, where he also gave classes in Business Policy, and also has a Master's degree in Business Science from Barcelona University. He has researched, and published on, sponsorship, corporate social responsibility and regional economic development. He was an elite athlete, winning two Olympic medals in handball in 1996 and 2000 and amassing numerous sporting distinctions, as well as earning the affection of the sporting public from all over Europe.

José Fernando de Almansa Moreno-Barreda is 62 years old. He is a member of the Board of Directors of Telefónica and President of the Board's International Affairs Committee. He is also a member of the Board of Directors of Telefónica de Peru S.A., Telecomunicações de São Paulo S.A., Telefónica de Argentina S.A., Telefónica Latinoamérica S.A., Telefónica Moviles México S.A. de CV, and BBVA Bancomer Mexico. Mr. Almansa joined the Spanish Diplomatic Corps in 1974 and served from 1976 to 1992 as Embassy Secretary of the Spanish Embassy in Brussels, Cultural Counselor of the Spanish Representation to Mexico; Chief Director for Eastern European Affairs and Atlantic Affairs Director in the Spanish Foreign Affairs Ministry; Press and Political Counselor to the Spanish Permanent Representation to the North Atlantic Council in Brussels; Minister-Counsellor of the Spanish Embassy in the Soviet Union; General Director of the National Commission for the 5th Centennial of the Discovery of the Americas and Deputy General Director for Eastern Europe Affairs in the Spanish Foreign Affairs Ministry. In January 1993, Mr. Almansa was appointed Chief of the Royal Household by His Majesty King Juan Carlos I. He held this post until December 2002 and is currently Personal Adviser to His Majesty King Juan Carlos I. Mr. Almansa holds a law degree from the Universidad de Deusto, Bilbao, Spain. He is a sponsor, among other affiliations, of the Foundations Reina Sofia, Conde de Barcelona, Diputacion de San Andrés de los Flamencos - Carlos de Amberes Foundation, Padre Arrupe - Activa, Principe de Asturias and Euroamérica.

José Manuel Fernandez Norniella is 65 years old and he is a member of our Board of Directors. Mr. Norniella has held or currently holds the following positions: Gran Cruz Isabel La Católica, Grand Officer of the Order of Bernardo O'Higgins Republic of Chile, Official Great Verdienstkreuz mit stern German Federal Republic and Order of Merit of the Polish Republic. He was Commercial Officer of G.G.SA (Electromecanique) from 1969 to 1974; Head of the Purchasing Department of ALFA-LAVAL SA. from 1974 to 1979; Factory Executive Officer of MSA (BLACKTONE Sw.g.) from 1979 to 1980; Vice President of DIRNA SA. from 1980 to 1981; Purchasing and Importation of BBC from 1981 to 1985; Procurement and Risk Executive Officer of ABB. from 1985 to 1989; General Managing Officer of ABB from 1989 to 1993; Vice President of ALDEASA from 1998 to 2000; Chief Officer of AZUCARERA EBRO from 2000 to 2001; Chief Officer of EBRO-PULEVA from 2001 to 2005; Honorary Chief Officer of EBRO-PULEVA since 2005; Vice President of CHILECTRA (Cl.) from 2001 to 2006; Director of EDESUR (Arg.) from 1999 to 2000; Director of IANSA (Cl.) from 2001 to 2005; Director of ENAGAS from 2001 to 2005; Director of ENDESA from 1998 to 2006; Secondary Director of ABENGOA from 1999 to 2006; Director of TELVENT from 2007 to present; Director of IBERIA from 2003 to 2011; Director of Caja Madrid from 2007 to the

present; Vice-president of Caja-Madrid from 2010 to the present; Director of Banco BFA from 2010 to the present; Director of IAG from 2010 to the present; Director of R.T.V.E from 1990 to 1993; National Congressman representing Madrid in the V and VI legislature from 1993 to 1996; Vice-president of Industry Commission from 1993 to 1996; Member of the Congress Common Management Group from 1993 to 1996; State Secretary of Tourism and Small and Medium Businesses from 1996 to 1998; Chief Officer of Turespaña from 1996

Table of Contents

to 1998; Chief Officer of ICEX from 1996 to 1998; Associate Director of BID, BERD and BM from 1996 to 1998; Chairman of the Board of Governors of the Chamber of Commerce of Spain from 1998 to 2005; Vice President of CEOE from 1999 to 2000; and Member of the International Chamber of Commerce (CCI) from 1999 to 2002; Vice President of W.S.R from 2002 to 2003; Vice President of Caja Madrid (2010 to date); Member of the Board of Directors of IAG (International Airlines Group) (2011 to date) and Member of the Board of Directors of BFA (Banco Financiero y de Ahorro) (2011 to date). Mr. Norniella holds a degree in Energetic Sciences Engineering from U. P. M., and is licensed in Foreign Commerce, Logistics and Procurement, Projects and Risks Management and Trademarks and Patents.

Luciano Carvalho Ventura is 63 years old. He is a member of our Board of Directors and is the officer responsible for LCV Governança Corporativa. He serves as a member of the Board of Directors of the Jose Alves Group and of the Lojas Salfer. Since 1980, he has been dedicated to corporate governance consulting and serving as an independent member of corporate boards. He is a founding member of the Instituto Brasileiro de Governança Corporativa - IBGC – Brasil (Brazilian Corporate Governance Institute) and he was a member of its Board of Directors. He was a member of the International Corporate Governance Network - England. He is professor of the course for formation of directors of Brazilian Corporate Governance Institute and a speaker at various masters courses and seminars. He holds an MBA from Escola de Administração de Empresas de São Paulo—Fundação Getúlio Vargas, a post-graduate degree in finance from Escola de Administração de Empresas de São Paulo da Fundação Getúlio Vargas, a degree in business management from Escola de Administração de Empresas da Universidade Federal de Pernambuco, and a degree in economics from Faculdade de Ciências Econômicas da Universidade Federal de Pernambuco.

Luis Bastida Ibarquen is 65 years old and is a member of our Board of Directors. Since 2002, he has acted as an independent consultant, author and lecturer on business economics and serves as director for different companies and foundations. During 2000 and 2001, he was Managing-Director of Banco Bilbao Viscaya Argentaria, where he was a member of the Steering Committee and head of the Global Asset Management Division. From 1988 to 2000, he worked for Banco Bilbao Viscaya. In the period 1994 to 2000, he was Chief Financial Officer (CFO), reporting directly to the Chairman. From 1976 to 1987, he worked at Banco Bilbao, where he had different responsibilities, mainly in areas related with the finance function. From 1970 to 1976, he worked for General Electric in New York and Spain. At General Electric, he was a member of the Finance Management Program and the International Management Program and worked in various capacities in the Finance and Strategic Planning Functions. He holds degrees in Business at the E.S.T.E. University in San Sebastián - Spain and holds an MBA from Columbia University in New York.

Luiz Fernando Furlan is 64 years old and is Co-Chairman of the Board of BRF Brasil Foods S.A, Chairman of the Amazonas Sustainable Foundation, and Director on the Boards of Amil Participações S.A., Telecomunicações de São Paulo S.A – Telesp in Brazil as well as Telefónica S.A. and Telefónica Internacional (Spain), AGCO Corporation (USA) and a member of the International Advisory Board of Panasonic (Japan) and McLarty Associates (USA). From 2003 until 2007, he was Minister of Development, Industry and Foreign Trade of Brazil. Previously, he was Chairman of the Board of Directors of Sadia S.A., and served on the boards of international corporations such as Panamco (Pan American Beverages, Inc. - USA). He also joined the advisory councils of IBM - Latin America, Embraco S.A. (Brasrotor - Brazil), ABN Amro Bank (Brazil), Maersk Group (Denmark) and was President of ABEF (Brazilian Chicken Exporters Association), ABIOVE (Vegetal Oil Industries Association), ABRASCA (Brazilian Association of Public Owned Companies), Co-President of the MEBF (Mercosur-European Union Business Forum), Vice President of FIESP (São Paulo Entrepreneurs Association) and board member of Bovespa (São Paulo State Stock Exchange). He holds a degree in Chemical Engineering from FEI (Industrial Engineering Faculty) and in Business Administration from University of Santana - São Paulo, with extension and specialization courses in Brazil and abroad.

Luis Miguel Gilperez Lopez is 51 years old and serves as a member of our Board of Directors. He currently holds the position of Officer Brasil. Mr. Lopez started his professional career at an insurance company, where he worked for 6

years in different departments. From 1981 onward, he has worked at Telefónica Group. From 1987 to 1993, he was responsible for the commercial activities of the mobile telephone service, but in 1993, following the creation of Telefónica Móviles, he has held different managing positions in practically all departments. From 2006

Table of Contents

to September 2010, he was responsible for the mobile telephone department in Telefónica Latinoamérica. He is an Industrial Engineer and holds a Master in Business Planning and Administration.

Miguel Ángel Gutiérrez Méndez is 52 years old and is a Board member of Telefónica Internacional S.A., where he was previously responsible for Institutional and Public Policy for Grupo Telefónica in Latin America. He is also a Board member of ABERTIS (Barcelona, Spain). He is also a Board and Audit Committee member of Telesp. From March 2002 to October 2004, Mr. Gutiérrez was Chairman of the Board of Directors of Autopistas del Oeste S.A. (a subsidiary of ABERTIS). From February 2002 until July 2003, he was Chairman and CEO of Telefónica Group in Argentina. He was a founding partner of The Rohatyn Group, an asset management company that focused on emerging markets with \$ 3 billion under management. He manages their Private Investment Business with teams in New York, Hong Kong, Lima, Sao Paulo, Johannesburg and Buenos Aires. For a period of 21 years, Mr. Gutiérrez occupied several posts at J.P. Morgan, reaching the position of Managing Director for Global Emerging Markets, covering Latin America, Eastern Europe, Africa and Asia, London and New York emerging market activities from 1995-2001. Mr. Gutiérrez was also President of ADESPA (Association of Companies and Public Utilities of Argentina); Vice-President of the Fundación Cámara Española de Comercio; a Board member of the Cámara Argentina de Comercio; and a Board member of the Institute for Business Development of Argentina - IDEA. He is currently a member of the advisory council of CIPPEC (Center of Implementation of Politics for Equity and Growth), a Board member of Fundación Cruzada Argentina, a Board member of the Center for Financial Stability "CEF", and a Board member of Universidad Torcuato Di Tella. He holds an MBA from IAE Universidad Austral (Argentina).

Narcís Serra Serra is 67 years old and serves as a member of our Board of Directors. From 1991 to 1995, he was Vice President of the Government of Spain, and from 1982 to 1991, served as Minister of Defense. From 1979 to 1982, he was the Mayor of Barcelona. Mr. Serra holds a doctorate in economics from the Universidad Autónoma de Barcelona and is President of CIDOB Foundation and Barcelona Institute for International Studies (IBEI).

## Executive Committee

The executive committee consists of at least three and no more than fifteen members, who may or may not be our shareholders, all of them appointed by our Board of Directors for a period of three years and may remain in office until reappointed or replaced. Any of our executive officers may be removed at any time by a decision of the Board of Directors.

The following are the current members of the executive committee, their respective positions and the date of their appointment.

Name	Position	Date of Appointment
Antonio Carlos Valente da Silva	Chief Executive Officer	May 19, 2010
	Chief Financial Officer and Investor	
Gilmar Roberto Pereira Camurra	Relations Officer	May 19, 2010
Mariano Sebastian de Beer	General Manager of Fixed Telephony	May 19, 2010
Gustavo Fleichman	General Counsel	May 19, 2010

Set forth below are brief biographies of our executive officers:

Gilmar Roberto Pereira Camurra is 55 years old and serves as Chief Financial Officer and Investor Relations Officer (CFO). He has 29 years of working experience in the financial system. He served for a year as member of the executive board of Grupo Paranapanema (tin exporter). Among his experiences in the banking system, he was



vice-president of Citibank N.A., performing various activities for 18 years with a focus on the international and treasury areas; founding partner of Banco ABC Roma, performing activities relating to treasury, international and controlling areas; and executive officer of BCN-Barclays, performing activities relating to treasury, asset management and corporate finance in the last three years before the transfer to the Telefónica Group and served as foreign exchange director and deputy treasurer for HSBC Bank. He has been Chief Financial Officer of Telefónica Group in Brazil since November 1999. He also serves as member of the decision-making body of Fundação Sistel,

Table of Contents

President of the decision-making body of Visão Prev Sociedade de Previdência Complementar, and Vice President of the Board of Directors of Telefónica Factoring. He holds a business administration and accounting science degree with a specialization course in finance from University of California, Berkeley.

Gustavo Fleichman is 51 years old and serves as General Secretary and secretary of the Board of Directors of Telecomunicações de São Paulo S.A. -Telesp since April 2006. From 2004 to 2006, he worked in Bulhões Pedreira Lawyers, a law firm located in Rio de Janeiro. He worked as a Legal Director of Tele Norte Leste S/A - Telemar, a telecommunications company located in Brazil, from 2002 to 2004. During this period, he was also a Board member of the Brazilian Bar association in the State of Rio de Janeiro (OAB/RJ). He was Vice President of Shell Brasil S/A from 1998 to 2002. During this period, he was also Vice President of the Brazilian National Union of Distributors of Fuels and Lubricants (SINDICOM). Since 2009, he has been a Board member of the Brazilian Bar association in the State of São Paulo (OAB/SP). He holds a law degree from and holds a post-graduate degree in management and tax.

Mariano Sebastian de Beer is 40 years old and serves as General Manager of Fixed Telephony of Telecomunicações de São Paulo S.A. – TELESP since February 2010. He served from December 1999 to August 2001 as our Vice-President for Special Clients and Small Business (a position that has changed in June 2001 to Vice-President of Residential Sales). From August 2001 to November 2002, Mr. de Beer served as our Vice-President of Strategic Planning. In November 2002, he was elected as our Vice-President for Corporate Sales. In 2006, he was elected as Managing Director of Telefônica Negócios at TISA – Telefonica Internacional in Madrid and in October 2008 he was elected as our Executive Vice-President. Previously, he was a consultant at McKinsey in Brazil. He holds a degree in Universidade Argentina de La Empresa, Buenos Aires, Argentina. He also holds an MBA degree from Georgetown University.

For the biography of Antonio Carlos Valente da Silva, see “—Board of Directors.”

**B. Compensation**

For the year ended December 31, 2010, the aggregate amount of compensation paid to all our Directors and Executive Officers was approximately R\$13.0 million, of which R\$9.5 million corresponded to salaries and R\$3.4 million corresponded to bonuses. Telesp also paid R\$2.5 million in connection with its distribution under the Performance Share Plan – PSP, a long-term incentive plan. See “Item 6.—Directors, Senior Management and Employees—E. Share Ownership” for a discussion of the PSP plan.

For the year ended December 31, 2010, our Directors and Officers did not receive any pension, retirement or similar benefits.

**C. Board Practices**

**Board of Directors**

Our Board of Directors typically meet once every three months and the Chairman may call special meetings. Our Board takes action by majority vote, provided the majority of its members in office are present, with the Chairman having, in addition to his or her regular vote, the deciding vote in the event of a tie. The specific responsibilities of the Chairman include representing the Board in the General Shareholders Meetings, chairing the General Shareholders Meetings, selecting the Secretary from among those present, and calling and chairing meetings of the Board.

Our Board of Directors is responsible, among other things, for:

- establishing our general business policies;
- electing and removing the members of our executive committee, and establishing their responsibilities with due regard for legal and statutory provisions;
  - supervising our management and examining our corporate records;
  - calling General Shareholders Meetings;

Table of Contents

- approving the financial statements, management reports, proposals for allocation of the company’s results and the submission of such documents to the General Shareholders Meeting;
  - appointing and deposing external auditors;
  - determining the distribution of interim dividends;
- determining the payment of interest on equity “ad referendum” of the General Shareholders Meeting;
  - authorizing the purchase of our shares to be cancelled or kept in treasury;
  - appointing and removing the person responsible for internal auditing;
  - approving the budget and annual business plan;
- deliberating on the issuance of new shares by increasing the corporate capital within the limits authorized by the bylaws;
  - approving the issuance of commercial paper and depositary receipts;
  - authorizing the sale of fixed and concession-related assets;
- approving agreements, investments and obligations in an amount greater than R\$250 million that have not been approved in the budget;
- approving employment and compensation plans, incentive policies and professional development, regulation and staffing of the Company, and the terms and conditions of collective bargaining agreements to be executed with unions representing various categories of the Company’s employees and adhesion or disassociation from pension plans, all with respect to employees of the Company; the Board of Directors can, at its own discretion, assign to the Company’s officers limits to deliberate on these matters;
- authorizing the acquisition of interest in other companies on a definitive basis and the encumbrance and creation of lien on or sale of an equity interest;
  - authorizing the offering of ordinary non-convertible unsecured debentures;
- approving the organizational structure of the Company; the Board of Directors can assign to the officers limits to the exercise of such powers, subject to legal and bylaws provisions;
  - approving and modifying the internal regulations of the Board of Directors;
  - deliberating as to the issuance of warrants;
- deliberating, by delegation of the General Shareholders Meeting, about the following aspects related to company debentures: (i) opportunity to issue, (ii) time and conditions of expiration, amortization or redemption, (iii) time and conditions of the payment of interest, of the participation in the profits and of the premium of repayment, if any, (iv) method of subscription or placement, and (v) the type of debentures;
-

approving the establishment of technical and advisory committees for advice on matters of interest to them, to elect members of such committees and approve the committees internal regulations, which shall contain specific rules concerning their organization, functions, powers, and compensation of members;

- authorizing the sale of property, the creation of in rem guarantees and the provision of guarantees on behalf of third parties, and setting limits on the practice of such acts by the officers;
- establishing, as an internal regulation, the limits for the officers to authorize the disposition or encumbrance of permanent assets, including those related to public telecommunications services which are disabled or inoperable;

Table of Contents

- approving the Company's participation in consortia in general, and the terms of such participation; the Board of Directors may delegate such powers to the officers and establish limits, as it seeks to develop activities in line with the Company's purpose;
- setting the limits for the officers to authorize the practice of reasonable gratuitous acts for the benefit of employees or the community of which the Company is a part of, including the donation of unserviceable assets to the Company; and
  - approving the creation and closure of subsidiaries of the Company, in Brazil or abroad.

The members of our Board of Directors are all shareholders, one of them being elected by the preferred shareholders in a separate voting process and the others being elected by the holders of common shares. The members of the Board of Directors are elected for a period of three years and may be reelected.

Executive Committee

Our Executive Committee is responsible for our day-to-day management and for representing us in our business with third parties. Each of our current Executive Officers has been appointed by our Board of Directors for a three-year term and may remain in office until reappointed or replaced.

Fiscal Board

Brazilian Corporate Law and our bylaws each require that we maintain a statutory Fiscal Board (Conselho Fiscal). Our statutory Fiscal Board, which is a separate and distinct entity from our outside auditors, is primarily charged with certain advisory, reporting, oversight and review functions with respect to the company's financial statements. Our statutory Fiscal Board is also responsible for rendering opinions on management's annual report and management proposals, including financial statements, to be submitted at shareholders meetings relating to a change in the company's capital composition, investment plans, budget, debenture issuances or subscription bonuses, payment of dividends and consolidations, mergers and spin-offs. However, the statutory Fiscal Board, as required by Brazilian Corporate Law and our bylaws, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law.

In accordance with Brazilian Corporate Law and our bylaws, the Fiscal Board consists of a minimum of three and a maximum of five active members and an equal number of alternates.

One member of the Fiscal Board and his or her alternate must be elected by holders of preferred shares in a separate voting process. The following are the current members of the Fiscal Board:

Members	Alternates	Date Appointed
Flavio Stamm	Gilberto Lerio	April 07, 2010
Patrícia Maria de Arruda Franco	Stael Prata Silva Filho	April 07, 2010
Carlos Raimar Schoeninger	João Orlando Lima Cordeiro	April 07, 2010

Committees

Brazilian Corporate Law does not require a corporation to maintain committees responsible for ethics, corporate governance or compensation. Nevertheless, our Board of Directors has created the following committees:

- Control and Audit Committee;
- Nominations, Compensation and Corporate Governance Committee; and
- Service Quality and Marketing Committee.

Table of Contents

Control and Audit Committee

Our Control and Audit Committee was created by our Board of Directors in December 2002 and is comprised of a minimum of three and a maximum of five directors, who are not members of our executive committee, and who are appointed by the Board of Directors to serve as members of the Control and Audit Committee for the duration of their respective terms as members of the Board of Directors. The Committee has its own charter, which was approved by the Board of Directors. The Committee provides support to the Board of Directors.

According to its charter, the Control and Audit Committee shall meet four times per year and report its conclusions to the Board of Directors. We anticipate that there will be some similar functions between the Control and Audit Committee and our statutory Fiscal Board (Conselho Fiscal).

The Control and Audit Committee, among other responsibilities that may be required by the Board of Directors, is charged with informing and providing recommendations to the Board of Directors regarding the following:

- the appointment, termination and renewal of the independent auditors, as well as the terms and conditions of the contract with the independent auditors;
- the analysis of the company's accounts, compliance with certain legal requirements and the adoption of generally accepted accounting principles;
- the results of each internal and independent audit and management's response to the auditor's recommendations;
  - the quality and integrity of the company's internal control systems;
- the performance of the independent auditors, requesting opinions on the annual reports and that the main audit reports be clear and precise; and
- any communications with the internal auditors about any significant deficiencies in our control systems and identified financial conditions.

The following are the current members of the Control and Audit Committee:

Members	Date Appointed
Luis Bastida Ibarguen	May 19, 2010
Luiz Fernando Furlan	October 20, 2010
Miguel Ángel Gutiérrez Méndez	May 19, 2010

Nominations, Compensation and Corporate Governance Committee

Our Nominations, Compensation and Corporate Governance Committee was established in November 1998, and was restructured in October 2004, and consists of three to five directors appointed by the Board of Directors to serve for the duration of their respective terms as members of the Board of Directors. The Nominations, Compensation and Corporate Governance Committee, among other responsibilities that may be required by the Board of Directors, is charged with informing and providing recommendations to the Board of Directors regarding the following:

- the appointment of executive officers for our company and our subsidiaries;



- the parameters on compensation for our executive officers and administrators;
- the terms and conditions of executive officers employment agreements;
- the review of the Board's compensation plan and any amendments;
- the incentive plans related to compensation;

Table of Contents

- the compensation policy for directors and executive officers of the company; and
- the annual corporate governance report.

The following individuals are the current members of the Nominations, Compensation and Corporate Governance Committee:

Members	Date Appointed
José Fernando de Almansa Moreno-Barreda	May 19, 2010
Antonio Carlos Valente da Silva	May 19, 2010
Iñaki Urdangarin	May 19, 2010
José Manuel Fernandez Normiella	May 19, 2010

Service Quality and Marketing Committee

The Service Quality and Marketing Committee was created on December 16, 2004 and provides assistance to our Board of Directors. The Committee consists of at least three, and at most five, members of our Board selected periodically. The Committee meets from time to time, depending on the availability of its members and when called by its chair. The Committee is responsible for review and analysis of quality indices measuring our principal services and to ensure that the requisite degree of commercial assistance is furnished to our clients.

Members	Date Appointed
Antonio Viana Baptista	May 19, 2010
Fernando Xavier Ferreira	May 19, 2010
Luciano Carvalho Ventura	May 19, 2010

D. Employees

As of December 31, 2010, we had 6,768 employees. All of our employees are full-time, and are divided into the following categories: 58% in our network plant operation, maintenance, expansion and modernization; 30% in sales and marketing; and 12% in administration, finance and investor relations, human resources, inventory, technology, legal and strategic planning and management control.

We, in conjunction with other sponsors (the companies resulting from the breakup of Telebrás), sponsored private pension benefits and health care plans for retirees in order to supplement the salaries of retired employees. The plans PBS Telesp, Visão Telesp, Visão Telefônica Empresas, Visão Assist and Visão Tgestiona, previously managed by Fundação Sistel de Seguridade Social, or the Sistel, were transferred to another closed social security entity called Visão Prev Sociedade de Previdência Complementar on February 18, 2005. The Visão Prev Sociedade de Previdência Complementar manages the following pension plans: Visão Telesp, Visão Telefônica Empresas, Visão Assist, Visão Tgestiona, Visão Atelecom, Visão Terra, Visão Telerj Celular, Visão Telebahia Celular, Visão Telergipe Celular, Visão Telest Celular, Visão Celular CRT, TCO Prev, TCP Prev, PBS-Tele Leste Celular, PBS-Tele Sudeste Celular, PBS-TCO, PBS-Telesp Celular, PBS Telesp and Vivo Prev. In May 12, 2009, the benefit plan-Visão Multi was created by the sponsors Telefonica Internacional Wholesale Brasil Ltda “TIWS” and Telefonica Pesquisa e Desenvolvimento do Brasil Ltda, or “TPD”; the benefit plan Atento was created in December 2010 and is sponsored by Atento Brasil S.A., and both are managed by Visãoprev. The plans, Planos de Assistência Médica aos Aposentados -

PAMA, or the PAMA, and PBS-A - Plano de Benefícios Sistel Assistidos, or the PBS-A, are still managed by Fundação Sistel de Seguridade Social. Until December 1999, all sponsors of the plans managed by Sistel were jointly and severally liable for all existing benefit plans. After December 1999, a single employer-sponsored pension plan for active employees was created, the PBS Telesp Plan, or PBS plan. See Note 30 to our consolidated financial statements for a more detailed description of the PBS plan. Retired employees (PBS-A) and post-retirement health care benefits, or PAMA, remained as multi-employer benefit plans. The restructuring of the benefit plans took place in January 2000.

Due to the withdrawal of other active participants in December 1999, we individually sponsored the PBS plan, which covers 0.50% of our employees. In addition to the PBS plan, the multi-sponsored health care plan, or PAMA,

## Table of Contents

is provided to retired employees and their dependents. Contributions to the PBS plan are determined based on actuarial valuations prepared by independent actuaries, in accordance with standards applicable in Brazil.

In August 2000, we established the Visão plan, offered to participants in our PBS plan, as well as to employees who did not qualify for participation. Unlike the PBS plan, which is a defined benefits plan, the Visão plan is financed for contributions by participating employees, as well as by us as sponsor, which are credited to the individual accounts of the participants. We are responsible for all management and maintenance expenses of the Visão plan, including the risks of death and permanent injury of the participants. The employees participating in the plan were granted the option to migrate to the Visão plan, which was also offered to those who did not participate in the PBS plan and to all newly hired employees. Our contributions to the Visão plan are equal to those of the individual participants, ranging from 2% to 9% of the participant's salary, depending on the percentage chosen by the participant. The aggregate costs under the Visão plan equal approximately 7.1% of the total amount of salaries paid to participating employees. Currently 84.5% of our employees are covered under the Visão plan.

In 2010, we had 3,259 retirees and beneficiaries, of which 21 were covered by PAMA and 3,238 were covered by PAMA-PCE. At the end of 2010, PAMA remained as a multi-financed plan.

Approximately 14% of our employees are members of the main telecommunications industry labor union, Sindicato dos Trabalhadores em Empresas de Telecomunicações e Operadores de Mesas Telefônicas no Estado de São Paulo, the Labor Union of Employees of Telecommunications Companies and Telecommunications Desk Operators in the State of São Paulo, or SINTETEL, which is associated with the Federação Nacional dos Trabalhadores em Telecomunicações, the National Federation of Telecommunications Workers or FENATTEL. The collective labor agreement was renewed on September 1, 2010 and will expire on August 31, 2011. Our management considers relations with our work force to be satisfactory. We have never experienced a work stoppage that had a material effect on our operations.

### E. Share Ownership

None of our directors or executive officers beneficially owns, on an individual basis, 1% or more of our common or preferred shares (including ADSs representing preferred shares) or of our total equity share capital.

At the General Shareholders Meeting of Telefónica S.A. (our indirect controlling shareholder), held on June 21, 2006, the application of a long-term incentive plan – “Performance Share Plan” (PSP) - for executives of Telefónica S.A. and of other entities within the Telefónica Group, which includes Telesp was approved. The plan grants a determined number of shares of Telefónica S.A. to selected participants who fulfill the necessary requirements.

The PSP is divided into five cycles, each of three year duration. The eligible executives, who must remain with the Telefónica Group for a minimum period of three years commencing on the date of their eligibility, will have the right to receive stipulated shares based upon their performance in achieving targeted pre-defined results. Shares will be received at the end of each cycle. Each cycle is independent of the others, with the first cycle starting on July 1, 2006 (with distribution of shares of Telefónica S.A. starting on July 1, 2009) and each subsequent cycle commencing on July 1 of each subsequent year, up to and including, the fifth cycle, which commences on July 1, 2010 (with delivery of shares of Telefónica S.A. starting on July 1, 2013).

The first distribution under the PSP took place in July 2009, with 56 executives (including 4 executives appointed pursuant to the bylaws) from Telesp given the right to 239,867 shares of Telefónica S.A.

The second distribution under the PSP took place in July 2010, with 57 executives (including 4 executives appointed pursuant to the bylaws) from Telesp potentially having the right to 175,534 shares of Telefónica S.A.

The third distribution under the PSP will take place in July 2011, with 58 executives (including 4 executives appointed pursuant to the bylaws) from Telesp potentially having the right to receive 186,186 shares of Telefónica S.A., for which, on December 31, 2010, we have made a provision of R\$6.0 million.

The fourth distribution under the PSP will take place in July 2012, with 63 executives (including 4 executives appointed pursuant to the bylaws) from Telesp potentially having the right to receive 245,240 shares of Telefónica S.A., for which, on December 31, 2010, we have made a provision of R\$3.6 million.

Table of Contents

The fifth provision related to PSP will take place in July 2013, with 65 executives (including 4 executives appointed pursuant to the bylaws) from Telesp potentially having the right to receive 260,611 shares of Telefónica S.A., for which, on December 31, 2010, we have made a provision of R\$1.5 million.

## ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

## A. Major Shareholders

In accordance with our bylaws, we have two classes of capital stock authorized and outstanding: common shares (ações ordinárias) and preferred shares (ações preferenciais). Our common shares have full voting rights. Our preferred shares have voting rights only under limited circumstances. At December 31, 2010, Telefónica Internacional owned 34.87% of our common shares and SP Telecomunicações, a wholly-owned subsidiary of Telefónica Internacional, owned 50.71% of our common shares. Since Telefónica Internacional owns 100% of the equity share capital of SP Telecomunicações, it has effective control over 85.57% of our outstanding common shares. Accordingly, Telefónica Internacional has the ability to control the election of our Board of Directors and to determine the direction of our strategic and corporate policies. Neither Telefónica Internacional, nor SP Telecomunicações, has any special voting rights beyond those ordinarily accompanying the ownership of our common or preferred shares.

The following tables set forth information relating to the ownership of common and preferred shares by SP Telecomunicações, Telefónica Internacional and our officers and directors. We are not aware of any other shareholder that beneficially owns more than 5% of our common shares.

Shareholder's Name	Number of common shares owned	Percentage of outstanding common shares	
SP Telecomunicações	85,603,079	50.71	%
Telefónica Internacional	58,859,918	34.87	%
All directors and executive officers as a group	21	—	

Shareholder's Name	Number of preferred shares owned	Percentage of outstanding preferred shares	
SP Telecomunicações	29,042,853	8.61	%
Telefónica Internacional	271,707,098	80.53	%
All directors and executive officers as a group	1	—	

Telefónica Internacional is a wholly-owned subsidiary of Telefónica S.A., or Telefónica. Telefónica's shares are traded on various stock exchanges, including exchanges in Madrid, Barcelona, Bilbao, Valencia, London, Tokyo, New York, Lima, Buenos Aires and São Paulo. Telefónica's business operations are concentrated in a number of sectors, including fixed and mobile telecommunications services, data communications, pay TV, integrated business solutions, e-commerce, market information and services, media content creation, production, distribution and marketing and call center services.

## B. Related Party Transactions

Note 28 to our consolidated financial statements presents, in tabular format, more detailed financial information with respect to transactions and balances with related parties. We provide below a summary description of transactions with related parties.

We entered into a consulting service agreement, known as the Consulting Agreement, with Telefónica Internacional, on May 17, 1999, pursuant to which Telefónica Internacional provides advice regarding our management, operations and business. The expiration of this contract was originally August 3, 2003, but it was automatically extended for a five-year term and renewed for an additional five years in December 2008. Since January 2006, the percentage of net revenue applicable to this contract was 0.1%, pursuant to our concession contracts with ANATEL entered into in December 2005. In December 2010, this agreement was terminated and the outstanding amount of R\$23.9 million was paid to Telefónica Internacional.

## Table of Contents

In addition, in July 2010, we registered with the Brazilian Intellectual Property Agency (INPI), and entered into an agreement with Telefónica S.A. for the exploitation of the trademark “Telefónica” by us upon the payment of the equivalent of 1.0% of our net operating revenue, excluding intercompany transactions. The aggregate amount disbursed in 2010 under this agreement was R\$89 million.

In 1999, we entered into a service agreement with Atento Brasil S.A. (an indirect majority-owned subsidiary of Telefónica S.A.), or Atento, that is automatically extended every three years, for the provision of certain customer services, principally services related to our call center. Transactions under this service agreement with Atento Brasil involved approximately R\$705 million in 2010 (compared to R\$656 million in 2009).

In April 2001, we entered into a service agreement for the provision of administrative, accounting and other services with Telefónica Serviços Empresariais do Brasil Ltda., or TGestiona, an indirect wholly-owned subsidiary of Telefónica. Transactions with TGestiona under this service agreement involved approximately R\$89 million in 2010 (compared to R\$80 million in 2009).

We also entered into certain agreements for the provision of telecommunications services to several of our affiliates, each under the indirect or joint control of Telefónica, including Vivo, TIWS Brasil Ltda. and others listed in Note 28 to our consolidated financial statements. Transactions pursuant to these various service agreements, in the aggregate, involved approximately R\$2.0 billion in 2010 (compared to R\$2.0 billion in 2009).

### C. Interests of Experts and Counsel

Not applicable.

## ITEM 8. FINANCIAL INFORMATION

### A. Consolidated Statements and Other Financial Information

See Note 19 of our Consolidated Financial Statements.

### Legal Proceedings

We are party to legal proceedings incidental to the normal course of our business. The main categories of such proceedings include:

- administrative and judicial litigation with Instituto Nacional da Seguridade Social, the National Institute of Social Security, or INSS;
- administrative and judicial proceedings relating to tax payments;
- lawsuits brought by employees, former employees and trade unions relating to alleged infringements of labor rights; and
- other civil suits, including litigation arising out of the breakup of Telebrás and events preceding the breakup.

Our policy with respect to provisioning for contingencies classifies the various legal proceedings to which we are party as “probable,” “possible” and “remote.” In general, 100% of the total claim value for legal proceedings classified as “probable” are provisioned. Our senior management classifies each legal proceeding into one of these three categories (probable, possible and remote) based upon the advice of internal and external counsel and specialized technical



advisors in charge of each matter. Due to the level of provisioning and based on its analysis of the individual cases, our management believes that no additional liabilities related to any legal proceedings will have a material effect on our financial condition or results of operations.

Provision for Tax Matters

On December 31, 2010, we have filed lawsuits to obtain recognition of the unconstitutionality of the collection of taxes as detailed below:

## Table of Contents

- CIDE. Intervention on the Economic Domain Contribution (Contribuição de Intervenção sobre o Domínio Econômico), the CIDE tax, is collected by the Federal Government on remittances made abroad rising from contracts related to technology transfers, licensing of trademarks and software agreements, among others. On December 31, 2010, we made a reserve in the amount of R\$25.9 million.
- FGTS. Contributions to the Unemployment Guarantee Fund (Fundo de Garantia por Tempo de Serviço – FGTS) are collected by the Brazilian federal social security program on the deposits made by employers for their employees. The amount involved is R\$61.2 million. The lawsuit is at the highest level of appeal. According to the legal opinion of our legal counsel, we made a provision and deposit in the full amount. This lawsuit does not result in reducing the share of the deposits in the FGTS made by us on behalf of employees.

## Other Provisions

There are other contingencies to which we registered provision in the total amount of R\$6.4 million related to FINSOCIAL and PIS/PASEP compensation that were declared unconstitutional as well as certain proceedings related to municipal taxes such as ISS, IPTU and others. In the opinion of our management, the chance of loss in these cases is “probable.”

## Tax Proceedings

The following tax proceedings were pending as of December 31, 2010, and, in the opinion of our management and our legal advisors, the chance of loss in these cases is “possible”.

- Federal Jurisdiction. As of December 31, 2010, the Company and its subsidiaries are involved in various lawsuits on the federal level, both administrative and judicial proceedings, which are awaiting trial in various court levels, in the total amount of R\$1.3 billion. Such lawsuits concern: (a) claims of dissatisfaction due to non-approval of applications for compensation made by us; (b) debts declared and allegedly unpaid; (c) fines for the distribution of dividends with an alleged existence of Federal debt outstanding; (d) social security contributions on the payment of compensation arising from the salary losses resulting from "Plano Verão" and "Plano Bresser", SAT (Workers Accident Insurance), Social Security and amounts owed to third parties (INCRA and SEBRAE); (e) income tax and contributions on awards; (f) withheld income tax on the remittance of money abroad for technical services and administrative assistance as well as royalties; (g) various offsets; (h) an operation and inspection fee; and (i) an increase in the tax calculation basis for the PIS/COFINS tax (Law No. 9718/98). We describe below proceedings in which the opposing party is the ANATEL.

Contribution for the Fund for Universal Access to Telecommunications Services—“FUST”: A Writ of Mandamus was filed by fixed telecommunication operators to enforce a right to exclude the costs of interconnection (ITX) and commercial exploration of dedicated lines (EILD) expenses in the calculation base of the FUST tax, as provided by the Precedent No. 7, dated as of December 15, 2005, grounded on the article 6 of Law No. 9,998, dated as of August 17, 2000. A partially favorable lower court decision was obtained and currently we are awaiting the decision of the appellate court. The total amount involved is R\$594.4 million. Part of this amount (R\$75.8 million) relates to differences between ITX and EILD due to the adoption of a non-cumulative calculation method in the retroactive period from 2001 to 2005 and the remaining part (R\$241.1 million) relates to the differences between ITX and EILD found for the period from 2006 to the present that was registered in the item “taxes” and is being deposited monthly in court. Also, the remaining amounts involved are related to ANATEL’s notification to us of debt in the amount of R\$277.5 million for the amounts under discussion in the Writ of Mandamus, for which we believe the chance of loss is possible.

Contribution for the Fund of Telecommunications Technological Development—"FUNTTEL": Contrary to the regulation currently in effect, the ANATEL notified us and our subsidiaries of owing to ANATEL the contribution to FUNTEL on other revenue (which are not from telecommunications) as well as costs transferred to other operators (interconnection and EILD expenses) for the period between 2001 and 2005.

## Table of Contents

The lawsuits are waiting for a decision by the lower administrative court. The total amount involved is R\$109.9 million.

Contribution to the Fund for Telecommunications Regulation—"FISTEL": As a result of the extension of the terms of our licenses for the use of telephone exchanges associated with the operation of the "switched fixed telephone service," the ANATEL charged us a rate for installation inspection (TFI) concerning the extension of such licenses. This charge results from the ANATEL's position that article 9, section III of Resolution No. 255 is applicable in this case, so that the extension would be a taxable event of TFI. Considering that the recovery of TFI on renewal of licenses is unwarranted under current regulations, we are discussing such charge in court. A favorable decision was obtained in the lower court and currently is awaiting decision of the appellate court. The total amount involved is R\$31.3 million.

- **State Jurisdiction.** As of December 31, 2010, we were a defendant in various administrative proceedings (arising from tax delinquency notices related to the matters described below) and judicial proceedings under state jurisdiction, related to the ICMS tax, in the total amount of R\$1.9 billion, for which we are awaiting decision in various court levels. Such lawsuits concern: (a) provision of additional facilities and services (pursuant to Convention 69/98); (b) lease of Speedy's Modem; (c) International Calls (International Direct Dial); (d) debts declared and allegedly not paid; (e) undue credit for the acquisition of goods for fixed assets; (f) lack of proportional devolution of credit for acquisition of fixed assets; (g) amounts misappropriated by way of extemporaneous ICMS credits; (h) rendering of service outside of São Paulo and ICMS payed to the State of São Paulo; and (i) co-billing.
- **Municipal Jurisdiction.** As of December 31, 2010, we were a defendant in various administrative proceedings (arising from tax delinquency notices) and judicial proceedings, for which we are awaiting decisions in different court levels, in the total amount of R\$280.4 million. Such lawsuits concern: (a) the ISS tax; (b) a property tax; (c) a fee for land use; (d) services provided by third parties; and (e) miscellaneous municipal fees.

Based on the opinion of our tax advisors, our management believes that the resolution of the above-mentioned matters will not have any material impact on our financial condition.

## Labor Litigation

We are also a defendant in several legal proceedings filed by former employees and outsourced employees (alleging joint or several liability), who claim, among other things, deficient overtime payment, unequal compensation, retirement wage supplements, health and security hazard compensation; free extension of health plan benefits to retirees of Telesp; and, some proceedings regarding our outsourcing practices.

In addition, we are also defendant in a public civil action filed by the Federal Ministry of Labor which concerns our retaining of third party companies to perform our core business. Although the likelihood of loss in this action is "possible," no value amount has been attributed to this action because currently we are not able to calculate the total amount to be paid by us in the event we lose and, as a result, we have not recorded any amounts.

## Civil Claims

There are several civil claims against us. We have recorded R\$446.1 million in provisions for these proceedings where the risks are deemed probable, including the civil proceedings described below and the regulatory and antitrust proceedings that follow:

- "0900 Service" Claims. On June 9, 2000, WCR do Brasil Serviços Ltda. proposed enforcement proceedings against the Company, claiming the collection of the alleged difference in amounts calculated by Telesp regarding the use

of the “0900 Service” and the amounts transferred to that company. In 2010, we appealed to the supreme court and the decision was unfavorable to us. In November 2010, a litigation settlement was reached and approved by the judge. Proceeding archiving is awaited.

- Expansion Plan - PEX. We are defendants in proceedings related to the possible right of individuals that purchased our shares in connection with our network expansion plan after 1996, to receive additional shares from us. These claims are in different levels of the court system. The chance of loss in such

Table of Contents

proceedings is classified on a case-by-case basis according to the facts presented in each proceeding. For the proceedings in which the chance of loss was classified as “probable,” we recorded a provision of R\$21.9 million.

- **Service Complaints.** We and our subsidiaries are defendants in certain civil actions, in different court levels, regarding claims related to our services and our ordinary course of business initiated by individual costumers, civil associations on behalf of costumers or by the PROCON foundation, as well as by the Federal and State Public Prosecutor’s Offices. We recorded a provision of R\$153.3 million for these claims. We are also defendants to such civil actions in which the risk of loss is classified as “possible” in the amount of R\$309.8 million.
- **Consumer Relations Claims.** We are defendant in several civil actions initiated by individual customers in which the claims are the same or very similar from each other and when considered individually are not material, to which we recorded a provision of R\$100.5 million, calculated based on the statistical analysis of our historical losses in such proceedings.

There are several civil claims against us, for which we have not recorded provisions, though which we deem to be notable, including:

- **Pension Benefit Plan Spin-Off.** Sistel Participants Association in São Paulo (ASTEL) filed a public civil action against the Company, Sistel Foundation and others, claiming the annulment of the spin-off of the PBS pension benefit plan that occurred in 2000 which caused the creation of the specific Telesp-PBS pension benefit plan, and corresponding allocation of resources resulted from the technical superavit and fiscal contingencies existing at that time. The chance of loss is possible based on the opinion of our legal advisors. The amount value of this public civil action cannot yet be determined once it depends on an expert appraisal report since it includes the spun-off portion of Sistel related to the telecommunication operators from the former “Telebrás System”.
- **Community Telephone Plan -PCT.** We are subject to civil public action proposals claiming the possible right for indemnity of associates and entities hired for the construction of community networks connected to the network of fixed telephony operators and did not receive shares for their financial investment in the municipality of Mogi das Cruzes, involving a total amount of approximately R\$160.8 million. The chance of loss is possible based on the opinion of our legal advisors. The appellate court decided in our favor and changed the lower court decision. The plaintiff filed an appeal to the supreme court which is awaiting to be resolved.
- **Services Quality Class Action.** The Public Prosecutor Office of the State of São Paulo commenced a class action claiming moral and property damages suffered by all consumers of telecommunication services from 2004 to 2009 due to the bad quality of services and failures of the communications system. The Public Prosecutor Office suggested an total award against the Company of R\$1 billion. A judgment was rendered on April 20, 2010 imposing the payment of damages caused to all consumers who proved to be eligible for the award. Alternatively, if clients do not prove themselves eligible in a number compatible with the severity of the damage after a period of one year, the judgment establishes that R\$60 million should be deposited in a special fund for protection of diffuse customer interests (Fundo Especial de Defesa de Reparação de Interesses Difusos Lesados). It is not possible to estimate how many consumers may present themselves in this procedure nor the values to be claimed by them. The parties filled an appeal. The effects of the sentence were suspended. Despite of the degree of risk considered as “possible”, no value amount was atributed to this action because currently we are not able to calculate the total amount to be paid by us in the event we lose and, as a result, we have not recorded any provisions.

Table of Contents

- Inclusion of PIS and COFINS in Service Rates. The federal district attorney's office believes that the amounts collected by us as COFINS and PIS are being improperly included in the fixed telecommunications service rates, and therefore has filed a public civil action in order to exclude those amounts from those charged to our customers and to demand that the amounts improperly charged be returned in double. There are other seven public civil actions and several individual actions based on the same claim. The supreme court has decided in our favor stating that the amount charged to our customers is legal. This decision was a leading case covered by the law of repetitive appeals against telephone service concessionaires and, as a result, the risk of loss of such proceedings was changed from possible to remote. We have not made any provisions for these lawsuits.

Regulatory and Antitrust Litigation

ANATEL

Administrative Proceedings for Noncompliance with Regulatory Obligations Brought by ANATEL – PADOs. As of December 31, 2010, the Company was involved in several administrative proceedings brought on grounds of alleged breach of obligation established by federal regulation, involving risk of loss that is classified as probable. The amount involved and the provision recorded for the proceedings involving a risk of loss classified as probable was, in December 31, 2010, R\$170.4 million. We are also defendants to such administrative proceedings in which the risk of loss classified as possible in the amount of R\$337.4 million.

Dividends and Dividend Distribution Policy

Priority and Amount of Preferred Dividends

The Brazilian Corporate Law generally requires that the bylaws of each Brazilian corporation specify a minimum percentage of the distributable profits comprising dividends and/or interest on shareholders' equity, or distributable amount, of the corporation for each fiscal year that must be distributed to shareholders as dividends. See "Item 10. Additional Information—B. Memorandum and Articles of Association." Moreover, each Brazilian

Table of Contents

company may issue new preferred shares for public distribution only if one of the following terms applies to the preferred shares: (i) the right to receive dividends equivalent to at least 25% of the net profit for the fiscal year, to be calculated in accordance with Article 202 of the Brazilian Corporate Law as follows: (a) priority in the receipt of dividends corresponding to at least 3% of the book value per share and (b) the right to an equal share of the profits attributable to the holders of common shares, after the holders of common shares have received a dividend equal to a minimum of 3% of the book value per share; or (ii) the right to receive dividends, at least 10% higher than those paid for each common shares; or (iii) tag-along rights of at least 80% of the price paid in the sale of control to be paid by the controlling shareholder and also including the right to receive dividends at least equal to the dividend paid to common shares.

According to our bylaws, we are required to distribute as dividends of each fiscal year ending on December 31, to the extent amounts are available, an aggregate amount equal to at least 25% of adjusted net income as a mandatory dividend. The annual dividend distributed to holders of our preferred shares is 10% higher than the dividend distributed to our common shareholders.

Under the Brazilian Corporate Law, a company is allowed to withhold payment of the mandatory dividend in respect of common shares and preferred shares if:

- management and the fiscal board report to the shareholders meeting that the distribution would be incompatible with the financial circumstances of the company; and
  - the shareholders ratify this decision at the shareholder's meeting. In this case:
- management must forward to the CVM within five days of the shareholders meeting an explanation justifying the decision at the shareholders meeting; and
- the profits that were not distributed are to be recorded as a special reserve and, if not absorbed by losses in subsequent fiscal years, are to be paid as dividends as soon as the company's financial situation permits.

For the purposes of the Brazilian Corporate Law, net profits are defined as net income after income tax and social contribution for the fiscal year, net of any accumulated losses from prior fiscal years and any amounts allocated to beneficiary parties', employees' and management's participation in a company's profits and founders' shares.

Under Brazilian Corporate Law, and in accordance with our bylaws, adjusted net income is an amount equal to our net income adjusted to reflect allocations to or from (i) legal reserves, (ii) statutory reserves, and (iii) contingency reserves for anticipated losses, if any.

At each annual shareholders meeting, the Board of Directors is required to suggest the allocation of net profits obtained during the preceding fiscal year. Under Brazilian Corporate Law, we are required to maintain a legal reserve, to which 5% of our net profits must be allocated for each fiscal year, until the reserve amounts to 20% of our paid-in capital. Net losses, if any, shall be charged against the accumulated profits, profit reserves and legal reserve, following this order.

Brazilian Corporate Law also provides for an additional allocation of net profits to special accounts, which is also recommended by management and subject to approval by shareholders at the annual shareholders meeting, including the amount of net profits that may be allocated to the contingency reserve for anticipated losses that are deemed probable in future years. Any amount so allocated in a previous year must be either:

- reversed in the fiscal year in which the loss was anticipated, if the loss does not in fact occur; or



- written-off in the event that the anticipated loss occurs.

Net profits may also be allocated to the unrealized income reserve in case the total amount of mandatory dividends exceeds the amount of realized income. Such allocation should also be suggested by management and

## Table of Contents

subject to approval by shareholders at the shareholders meeting. For such purpose, realized income is the balance of net profits exceeding the sum of:

- the positive net result of equity adjustment; and
- earnings net from transactions or the accounting of assets and liabilities at market value which must be realized after the end of the subsequent fiscal year.

The amounts available for distribution are determined on the basis of financial statements prepared in accordance with the accounting practices adopted in Brazil.

If the minimum dividend to be paid to the holders of preferred shares is not paid for the period set forth in our bylaws, which in no event shall be longer than three years, the holders of preferred shares will be entitled to full voting rights until such dividend is paid in full.

### Payment of Dividends

We are required by law and our bylaws to hold an annual shareholders meeting until April 30 of each year at which, among other issues, the allocation of net profits obtained during the preceding fiscal year and the declaration of dividends by decision of common shareholders are decided, acting on the recommendation of the executive officers, as approved by the Board of Directors. The payment of annual dividends is based on the financial statements prepared for each fiscal year ending December 31. Under the Brazilian Corporate Law, dividends are required to be paid within 60 days following the date the dividend is declared to shareholders of record on the declaration date, unless a resolution by the shareholders sets forth another date of payment, which must occur prior to the end of the fiscal year.

A shareholder has a three-year period from the dividend payment date to claim dividends in respect of its shares, after which we have no liability for the payment. Because our shares are issued in book-entry form, dividends with respect to any share are automatically credited to the account holding the share and no action is required on part of the shareholder. We are not required to adjust the amount of paid-in capital for inflation.

If a shareholder is not a resident of Brazil, he or she must register with the Central Bank of Brazil in order to be eligible to receive dividends, sales proceeds or other amounts with respect to his or her shares outside of Brazil. Our preferred shares underlying ADSs are held in Brazil by a Brazilian custodian, Banco Itaú S.A., as the agent for the depositary, which is the registered owner of our shares.

Payments of cash dividends and distributions, if any, will be made in Brazilian currency to the custodian on behalf of the depositary, which will then convert those proceeds into U.S. dollars and will provide for U.S. dollars to be delivered to the depositary for distribution to holders of ADSs. In the event that the custodian is unable to immediately convert the Brazilian currency received as dividends into U.S. dollars, the amount of U.S. dollars payable to holders of ADSs may be adversely affected by devaluations of the Brazilian currency that occur before dividends are converted and remitted. Dividends in respect of the preferred shares paid to resident and non-resident shareholders, including holders of ADSs, are not currently subject to Brazilian withholding tax.

### Additional Payments on Shareholders' Equity

Law No. 9,249, dated December 26, 1995, as amended, provides for distribution to shareholders of interest on shareholders' equity, which may be computed against the amount of dividends to be distributed to the shareholders. A company may treat these payments as financial expenses for income tax and social contribution purposes. This interest is limited to the daily pro rata variation of the Taxa de Juros de Longo Prazo, or TJLP, a nominal long-term interest

rate determined by the federal government that includes an inflation factor and cannot exceed the greater of:

- 50% of net income (before deducting income taxes and the interest on shareholders' equity) for the period in respect of which the payment is made, or
  - 50% of the sum of retained earnings and profit reserves.

Table of Contents

Any payment of interest in respect to preferred shares to shareholders (including the holders of ADSs) is subject to Brazilian withholding tax at a rate of 15%, or 25% in the case of a shareholder domiciled in a tax haven, and these payments may be included, at their net value, as part of any mandatory dividend. If payment of interest on shareholders equity is made for a beneficiary located outside of Brazil, the Tax on Exchange Transactions (“IOF”) triggers at a rate of zero. See “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations—Distributions of Interest on Capital.”

We declare and pay dividends and/or interest on shareholders’ equity as required by Brazilian Corporate Law and our bylaws. The declaration of annual dividends, including dividends in excess of the mandatory distribution, requires approval by the vote of a majority of the holders of common shares, and depends on many factors. These factors include our results of operations, financial condition, cash requirements, future prospects and other factors deemed relevant by shareholders. Our shareholders have historically acted on these matters based on recommendations by the Board of Directors. Within the context of tax planning, we may determine in the future that it is to our benefit to distribute interest on shareholders’ equity.

The following table sets forth the dividends or interest on shareholders’ equity paid to holders of our common and preferred shares since 2006 in reais.

Year	Description (Dividends or Interest on Shareholders’ Equity)(1)	Common Shares (per share/in R\$)	Preferred Shares
2010	Div/Int	3.616248	3.977873
2009	Div/Int	2.556431	2.812074
2008	Div/Int	4.539838	4.993823
2007	Div/Int	5.247437	5.772180
2006	Div/Int	5.581383	6.139521

(1) Interest on shareholders’ equity is net of withholding taxes.

#### Dividends and Interest on Shareholders’ Equity

On December 9, 2009, the Board of Directors approved, subject to the shareholders approval, a payment of interest on shareholders’ equity for our common and preferred shares in the amount of R\$174.3 million. The actual payment occurred on April 26, 2010.

On April 7, 2010, at the General Shareholders Meeting, the shareholders approved the distribution of dividends to the common and preferred shares in the total amount of R\$1,252 million declared on the basis of the closing balance sheet on December 31, 2009. The Company’s management proposed the payment of the approved dividends would be made in two installments as follows:

- An initial installment of R\$800 million, with the payment to be made until June 30, 2010. The actual payment occurred on April 26, 2010.
- The remaining portion of R\$451.6 million, with payment until December 21, 2010. The actual payment occurred on December 13, 2010.

On September 29, 2010, the Board of Directors approved the distribution of interim dividends of R\$196.4 million based on earnings accumulated in our existing balance sheet as of June 30, 2010. The actual payment occurred on December 13, 2010.

On September 29, 2010, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$ 331.5 million. The actual payment occurred on December 13, 2010.

Table of Contents

On December 14, 2010, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$ 171.7 million. The Board of Directors has proposed at the annual shareholders meeting that the payment of such interest on shareholders equity should be initiated before December 21, 2011 on a date still to be determined by the management of the Company and properly announced to the market and shareholders.

## Reverse Stock Split

In a special General Shareholders Meeting held on May 11, 2005, our shareholders approved the reverse stock split of all of our shares, under the terms of Article 12 of the Brazilian Corporate Law, at the ratio of 1,000 existing shares per one share of the same type and class. When the shares began trading on BM&FBOVESPA in unitary form on June 27, 2005, each of our ADRs, which previously represented 1,000 preferred shares, became one preferred share.

## Cancellation of Treasury Stock

On March 9, 2006, a special meeting of the shareholders approved the cancellation of 1,562,387 shares of treasury stock, consisting of 1,258,508 common shares and 303,879 preferred shares. These treasury shares had been acquired as a result of a reverse stock split.

## B. Significant Changes

None.

## ITEM 9. THE OFFER AND LISTING

## A. Offer and Listing Details

The trading market for our common and preferred shares is BM&FBOVESPA.

Our preferred shares began trading on BM&FBOVESPA, on September 21, 1998 and are traded on BM&FBOVESPA under the symbol "TLPP4". Our common shares trade under the symbol "TLPP3". At December 31, 2010, we had approximately 506.2 million common and preferred shares held by approximately 1.9 million common and preferred shareholders. The following table sets forth the reported high and low closing sale prices for the common and preferred shares on BM&FBOVESPA, for the periods indicated.

	Prices of common shares of the company	
	High	Low
	(in reais)	
January 1, 2005 through March 31, 2005	48.90	39.17
April 1, 2005 through June 30, 2005 (1)	40.50	35.70
July 1, 2005 through September 30, 2005	37.48	32.10
October 1, 2005 through December 31, 2005	37.49	31.90
January 1, 2006 through January 31, 2006	43.80	36.17
April 1, 2006 through June 30, 2006	43.39	36.40
July 1, 2006 through September 30, 2006	42.69	37.10
October 1, 2006 through December 31, 2006	47.49	40.50
January 1, 2007 through March 31, 2007	50.30	43.00
April 1, 2007 through June 30, 2007	58.99	44.30

Edgar Filing: TELESP HOLDING CO - Form 20-F

July 1, 2007 through September 30, 2007	66.98	51.80
October 1, 2007 through December 31, 2007	59.80	44.00
January 1, 2008 through March 31, 2008	47.00	39.00
April 1, 2008 through June 30, 2008	41.95	37.80
July 1, 2008 through September 30, 2008	40.00	35.00
October 1, 2008 through December 31, 2008	40.44	33.84
January 1, 2009 through March 31, 2009	38.64	34.48

Table of Contents

	Prices of common shares of the company	
	High	Low
	(in reais)	
April 1, 2009 through June 30, 2009	42.00	37.50
July 1, 2009 through September 30, 2009	41.00	36.00
October 1, 2009 through December 31, 2009	40.64	36.00
January 1, 2010 through March 31, 2010	37.78	32.57
April 1, 2010 through June 30, 2010	33.59	29.00
July 1, 2010 through September 30, 2010	39.00	33.20
October 1, 2010 through October 31, 2010	39.50	36.41
November 1, 2010 through November 30, 2010	39.10	36.89
December 1, 2010 through December 31, 2010	39.30	36.22
January 1, 2011 through January 31, 2011	39.50	37.80
February 1, 2011 through February 24, 2011	40.98	38.41

(1) Before June 27, 2005, our ADRs were traded in the proportion of 1000 per 1. Since that date, ADRs have been traded in the proportion of one to one.



Table of Contents

	Prices of preferred shares of the company	
	High	Low
	(in reais)	
January 1, 2005 through March 31, 2005	58.38	43.81
April 1, 2005 through June 30, 2005 (2)	52.95	45.20
July 1, 2005 through September 30, 2005	49.00	41.91
October 1, 2005 through December 31, 2005	48.20	41.50
January 1, 2006 through March 31, 2006	54.00	46.16
April 1, 2006 through June 30, 2006	53.41	42.41
July 1, 2006 through September 30, 2006	51.90	43.50
October 1, 2006 through December 31, 2006	55.00	48.11
January 1, 2007 through March 31, 2007	56.30	49.40
April 1, 2007 through June 30, 2007	62.80	50.75
July 1, 2007 through September 30, 2007	69.50	53.50
October 1, 2007 through December 31, 2007	63.19	45.20
January 1, 2008 through March 31, 2008	50.99	41.97
April 1, 2008 through June 30, 2008	48.84	42.37
July 1, 2008 through September 30, 2008	48.37	38.69
October 1, 2008 through December 31, 2008	53.30	43.99
January 1, 2009 through March 31, 2009	48.19	40.55
April 1, 2009 through June 30, 2009	49.25	43.10
July 1, 2009 through September 30, 2009	45.68	41.30
October 1, 2009 through December 31, 2009	45.83	42.12
January 1, 2010 through March 31, 2010	43.29	37.84
April 1, 2010 through June 30, 2010	39.37	33.08
July 1, 2010 through September 30, 2010	41.80	36.12
October 1, 2010 through October 31, 2010	41.98	40.00
November 1, 2010 through November 30, 2010	41.77	39.59
December 1, 2010 through December 31, 2010	42.03	38.60
January 1, 2011 through January 31, 2011	42.60	40.46
February 1, 2011 through February 24, 2011	40.75	38.80

(2) Before June 27, 2005, our ADRs were traded in the proportion of 1000 per 1. Since that date, ADRs have been traded in the proportion of one to one.

In the United States, the preferred shares trade in the form of ADRs, each representing one preferred share, issued by The Bank of New York, as depositary, pursuant to a Deposit Agreement, among us, the depositary and the registered holders and beneficial owners from time to time of ADRs. The ADRs commenced trading on the NYSE on November 16, 1998 under the symbol "TSP". The following table sets forth the reported high and low closing sales prices for ADRs on the NYSE for the periods indicated.

	U.S. dollars per ADR	
	High	Low
January 1, 2005 through March 31, 2005	21.97	16.16
April 1, 2005 through June 30, 2005 (3)	20.43	18.38
July 1, 2005 through September 30, 2005	20.80	17.54
October 1, 2005 through December 31, 2005	21.74	18.34
January 1, 2006 through March 31, 2006	25.50	20.58

Edgar Filing: TELES P HOLDING CO - Form 20-F

April 1, 2006 through June 30, 2006	25.14	18.84
July 1, 2006 through September 30, 2006	24.22	19.95
October 1, 2006 through December 31, 2006	25.50	22.27
January 1, 2007 through March 31, 2007	27.14	23.62

Table of Contents

	U.S. dollars per ADR	
	High	Low
April 1, 2007 through June 30, 2007	32.99	25.30
July 1, 2007 through September 30, 2007	37.15	26.71
October 1, 2007 through December 31, 2007	35.16	25.45
January 1, 2008 through March 31, 2008	29.83	24.08
April 1, 2008 through June 30, 2008	29.52	25.17
July 1, 2008 through September 30, 2008	30.42	20.65
October 1, 2008 through December 31, 2008	26.09	18.62
January 1, 2009 through March 31, 2009	21.30	17.12
April 1, 2009 through June 30, 2009	24.55	20.95
July 1, 2009 through September 30, 2009	25.56	21.17
October 1, 2009 through December 31, 2009	27.38	23.74
January 1, 2010 through March 31, 2010	25.42	21.02
April 1, 2010 through June 30, 2010	22.18	18.01
July 1, 2010 through September 30, 2010	24.58	20.84
October 1, 2010 through October 31, 2010	25.35	24.00
November 1, 2010 through November 30, 2010	25.20	23.30
December 1, 2010 through December 31, 2010	24.53	22.70
January 1, 2011 through January 31, 2011	25.34	24.27
February 1, 2011 through February 24 2011	24.25	23.20

(3) Before June 27, 2005, our ADRs were traded in the proportion of 1000 per 1. Since that date, ADRs have been traded in the proportion of one-to-one.

## B. Plan of Distribution

Not applicable.

## C. Markets

## Trading on the BM&amp;FBOVESPA

The Brazilian Securities, Commodities and Futures Exchange (BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros), or BM&FBOVESPA, is a Brazilian publicly traded company formed in 2008 through the integration between the São Paulo Stock Exchange (Bolsa de Valores de São Paulo) and the Brazilian Mercantile and Futures Exchange (Bolsa de Mercadorias & Futuros). BM&FBOVESPA is one of the largest exchanges in the world in market capitalization, the second in the Americas and the leader in Latin America.

Trading on the exchange is conducted by authorized members. Trading sessions take place every business day, from 10:00 a.m. to 5:00 p.m. or from 11:00 a.m. to 6:00 p.m. during daylight savings time in the U.S., on an electronic trading system called Megabolsa. Trading is also conducted between 5:45 p.m. and 7:00 p.m., or between 6:45 p.m. and 8:00 p.m. during daylight savings time in Brazil, in an after-market system connected to both traditional brokerage firms and brokerage firms operating on the Internet. This after-market trading is subject to regulatory limits on price volatility of securities traded by investors operating on the Internet.

In order to better control the excess of volatility in market conditions, BM&FBOVESPA has adopted a “circuit breaker” system pursuant to which trading sessions may be suspended for a period of 30 minutes or one hour whenever the indices of these stock exchanges fall below the limits of 10% and 15%, respectively, relative to the index of the

previous trading day. In the event the stock exchange index falls by 20% in comparison to the previous trading day, BM&FBOVESPA may determine the suspension of trading sessions for a certain period which will be at its sole discretion.

At December 31, 2010, the aggregate market capitalization of the 381 companies listed on BM&FBOVESPA was approximately US\$1,542 billion. Although all the outstanding shares of an exchange-listed company may trade on a Brazilian stock exchange, in most cases, less than half of the listed shares are actually available for trading by

## Table of Contents

the public, the remainder being held by small groups of controlling entities or persons that rarely trade their shares. For this reason, data showing the total market capitalization of Brazilian stock exchanges tends to overstate the liquidity of the Brazilian equity securities market.

### Regulation of Brazilian Securities Markets

The Brazilian securities market is regulated by the CVM, as provided for by the Brazilian Securities Exchange Act and Corporate Law. The National Monetary Council is responsible for supervising the CVM's activities, granting licenses to brokerage firms to govern their incorporation and operation, and regulating foreign investment and exchange transactions, as provided for by the Brazilian Securities Exchange Act and Law No. 4595 of December 31, 1964. These laws and regulations provide for, among other things, disclosure requirements, criminal sanctions for insider trading and price manipulation, protection of minority shareholders, the procedures for licensing and supervising brokerage firms and the governance of Brazilian stock exchanges.

Under Brazilian Corporate Law, a company is either publicly held and listed, a *companhia aberta*, or privately held and unlisted, a *companhia fechada*. All listed companies are registered with the CVM and are subject to reporting requirements to periodically disclose information and material facts. A company registered with the CVM may trade its securities either on the Brazilian exchange markets, including the BM&FBOVESPA, or in the Brazilian over-the-counter market. Shares of companies listed on BM&FBOVESPA may not simultaneously trade on the Brazilian over-the-counter market. The over-the-counter market consists of direct trades between persons in which a financial institution registered with the CVM serves as an intermediary. No special application, other than registration with the CVM (and, in case of organized over-the-counter markets, in the applicable one), is necessary for securities of a public company to be traded in this market. To be listed on the BM&FBOVESPA, a company must apply for registration with the BM&FBOVESPA and the CVM.

Trading in securities on the BM&FBOVESPA may be suspended under a request from a company in anticipation of a material announcement. Trading in the securities of a particular company may also be suspended under the initiative of BM&FBOVESPA or the CVM, among other reasons, due to the belief that the company has provided inadequate information regarding a material event or has provided inadequate responses to inquiries by the CVM or the BM&FBOVESPA.

Brazilian securities law, the Brazilian Corporate Law and the regulations issued by CVM, CMN and the Central Bank provide, among other things, disclosure requirements and restrictions on insider trading, price manipulation and protection of minority shareholders.

### Corporate Governance Practices

We are a *sociedade anônima*, a corporation incorporated under the laws of Brazil, and are subject to the corporate governance provisions of the Brazilian Corporate Law. We comply with the regulatory requirements of the Brazilian Corporate Law regarding the independence of our Board of Directors, the establishment and composition of certain board committees and the adoption and disclosure of corporate governance guidelines.

We comply with several requirements of Brazilian and international laws in order to promote strong corporate governance, reduce investor uncertainties and enhance disclosure of material and other information.

With the approval of our Board of Directors and/or Officers, we implemented several measures over the last few years designed to improve our transparency and disclosure practices. We believe these measures will benefit our shareholders, and current and future investors as well as the marketplace in general. Among the measures we have implemented, we have:

- created a disclosure policy for material facts and corporate actions;
- created a policy for internal controls related to financial information;
- created a Service Quality and Marketing committee;
- created a Control and Audit committee;

Table of Contents

- created a Nominations, Compensation and Corporate Governance committee;
- developed and published a company Corporate Governance Report (Informe de Governança Corporativa) with information regarding the corporate governance principles we follow, our shareholder structure and characteristics, the composition and competence of administrative entities, the obligations and responsibilities of administrators and equity interests held by corporate officers and administrators;
- created a policy to denounce fraud within the Company (Canal de Denúncias);
- created a policy for prior approval of contracting audit services;
- created an internal rule of conduct relating to the securities market;
- created an Ethics Code in respect of handling financial information; and
- created a policy regarding communication of information to the securities market.

As determined by the Brazilian Corporate Law, the compensation of senior management is approved by our shareholders at an annual shareholders meeting. The Nominations, Compensation and Corporate Governance Committee provides information and recommendations to the Board of Directors regarding the criterion for compensation.

Our rules relating to insider trading are determined in our internal rules and the corporate laws. Senior management and members of our Board of Directors and any other employee exposed to sensitive information are subject to the restrictions imposed by such charter. In addition to the prohibition on trading of our shares by such individuals when in possession of insider information, the charter establishes blackout trading periods for those periods when insider information is available. As an example, the month before the formulation and approval of our annual financial statements by our Board of Directors is considered a blackout period under the charter. In addition, the charter sets forth instructions for dealing with conflicts of interest and mandates disclosure of any such situation.

Code of Business Conduct and Ethics

Although adoption of a code of ethics is not required by Brazilian Corporate Law, we implemented a code of ethics regulating the conduct of our managers in connection with the registration and control of financial and accounting information and their access to privileged and non-public information and data in order to comply with the requirements of the Sarbanes-Oxley Act and NYSE rules. See “Item 16B. Code of Ethics.”

In addition to complying with the rules of corporate governance applicable to us under Brazilian law, we intend to gradually comply with substantially all of the new rules established by the NYSE and the SEC applicable to domestic U.S. companies.

D. Selling Shareholders

Not applicable.

E. Dilution

Not applicable.

F. Expenses of the Issue

Not applicable.

ITEM 10. ADDITIONAL INFORMATION

A. Share Capital

Not applicable.

82

---



Table of Contents

B. Memorandum and Articles of Association

Set forth below is certain information relating to our capital stock and a summary of certain significant provisions of our bylaws and the Brazilian Corporate Law.

General

We are registered with the Junta Comercial de São Paulo, the Board of Trade of São Paulo, or JUCESP, under No. 35.3.001588-14. According to Section 2 of our bylaws, our main corporate purpose is to provide telecommunications services and to develop those activities necessary or useful for the performance of these services, in accordance with the concessions, authorizations and permits granted to us.

There are no provisions in our bylaws with respect to:

- an officer's power to vote on proposals in which the officer has a personal interest;
- an officer's power to vote on his own compensation, even in the absence of an independent quorum;
- age limits for retirement of officers;
- required shareholding to qualify as a manager (officer); or
- anti-takeover mechanisms or other procedures designed to delay, defer or prevent changes in our control.

Brazilian Corporate Law forbids a director to interfere in any business of the company when there is any conflicting interest between him and the Company.

Brazilian Corporate Law requires ownership of shares in order for a person to qualify as a member of the Board of Directors (conselho de administração) of a corporation (sociedade por ações).

Issuance of commercial paper and incurrence of certain debt shall be preceded by approval from our Board of Directors, according to the provisions set forth in section 17 of our bylaws.

Our capital stock is comprised of preferred shares and common shares, all without par value. At December 31, 2010, there were 337,232,189 outstanding preferred shares and 168,609,291 outstanding common shares. Our share capital may be increased by resolution of the Board of Directors, up to the limit authorized by our bylaws. Any increase above the authorized capital must be approved by a general shareholders meeting.

The preferred shares are non-voting, except under limited circumstances. They are given priority in the reimbursement of capital, without premium, and are entitled to receive a dividend 10% higher than that attributable to common shares.

Pursuant to Law No. 10,303/01, the following changes were introduced to the Brazilian Corporate Law:

- preferred shares representing 10% of our total number of outstanding shares would be entitled to appoint a representative to our Board of Directors;
- disputes among our shareholders would be subject to arbitration, if provided for in our bylaws;

- a tender offer at a purchase price equal to fair value for all outstanding shares would be required upon a delisting or a substantial reduction in liquidity of our shares as a result of purchases by the controlling shareholders;
- any sale of control would require the shareholders to tender for the minority shareholders' common shares and, if provided for in our charter, for the minority shareholders' preferred shares, at a purchase price at least equal to 80% of the price per share with voting rights paid to the controlling shareholder;

## Table of Contents

- shareholders would be entitled to withdraw from us upon a spin-off only if it entailed a change in the corporate purpose, a reduction in mandatory dividends or the participation in a centralized group of companies;
- the controlling shareholders, the shareholders that elect members to our Board of Directors and Fiscal Board, the members of our Board of Directors and Fiscal Board and our Executive Officers would be required to disclose any purchase or sale of our shares to the CVM and BM&FBOVESPA; and
  - we would be permitted to satisfy our information disclosure requirements through the Internet.

## Voting Rights

Each common share entitles the holder to one vote at general shareholders meetings. Preferred shares do not entitle the holder to vote at shareholders meetings, except under specific circumstances and with respect to certain matters, as specified below. Holders of preferred shares are only entitled to attend and to discuss, but not to vote on, the issues discussed at our general shareholders meetings.

The appointment of one member of our statutory Fiscal Board, including the alternate member, takes place at the annual ordinary general shareholders meeting, upon separate vote of the holders of preferred shares, for the position available at the Fiscal Board. The election of a member of the Board of Directors by preferred shareholders also occurs on a separate vote, with no participation of the controlling shareholder.

Brazilian Corporate Law provides that certain non-voting shares, such as our preferred shares, shall be entitled to voting rights in the event a corporation fails for three consecutive fiscal years to pay any fixed or minimum dividends to which non-voting shares are entitled. In this case, the voting rights of these shares shall extend until the date on which the payment of the accrued and unpaid dividend is made.

Preferred shares are entitled to full voting rights with respect to:

- the election of one member to the Board of Directors and Fiscal Board in a straight vote;
- bylaw modifications that seek to limit preferred shareholders' voting rights in respect of selecting new Board members in a straight vote;
- any agreements for the rendering of management services (including technical assistance services) between us and any foreign affiliate of our controlling shareholder;
  - resolutions amending certain provisions of our bylaws; and
- any resolution submitted to the general shareholders meeting during our liquidation process.

Any change in the preference, benefits, conditions of redemption and amortization of preferred shares or the creation of a more favored class would require approval or ratification by holders of a majority of the preferred shares at a special meeting of the preferred shareholders. This meeting would be called by publication of a notice in two Brazilian newspapers during three days, at least 30 days prior to the meeting; however, it would not generally require any other form of notice.

In any circumstances in which holders of preferred shares are entitled to vote, each preferred share will entitle the holder to one vote.

### Preemptive Rights

Each shareholder has a general preemptive right to subscribe for shares of the same class in any capital increase, in an amount sufficient to keep the same proportional participation of each shareholder in the total capital of the corporation. A minimum period of 30 days following the publication of the capital increase notice shall be observed by the corporation for the exercise of the preemptive right by the shareholder. The right of participation in capital increases is assignable under Brazilian Corporate Law. However, the bylaws of a publicly held company that allows

Table of Contents

capital increases may provide for the issuance, without granting any preemptive rights to prior shareholders, of stocks, debentures convertible into stocks, or subscription bonuses, the placement of which shall be made:

- upon sale on a stock exchange or public subscription;
- through an exchange of shares in a public offering, with the purpose of acquiring control of another company; or
- for the use of certain tax incentives.

In the event of a capital increase, which would maintain or increase the proportion of capital represented by preferred shares, holders of ADSs, or of preferred shares, would have preemptive rights to subscribe only to our newly issued preferred shares. In the event of a capital increase, which would reduce the proportion of capital represented by preferred shares, holders of ADSs, or of preferred shares, would have preemptive rights to subscribe to our new preferred shares, in proportion to their shareholdings and to our new common shares only to the extent necessary to prevent dilution of their interest.

Redemption and Right of Withdrawal

According to the Brazilian Corporate Law, dissenting shareholders in a shareholders meeting shall have a right of redemption, with reimbursement of the value of their shares, in case the following matters are approved:

- (i) creation of a new class of preferred shares or an increase in preferred shares of an existing class, without maintaining the proportion with the remaining classes;
- (ii) change in the preferences, advantages and conditions of redemption or amortization of one or more classes of preferred shares, or the creation of a class with more favorable rights or preferences;
- (iii) reduction of the mandatory dividend;
- (iv) merger into another company or consolidation with another company;
- (v) participation in a group of companies;
- (vi) change in the purpose of the corporation; and
- (vii) split-up of the corporation.

It is important to point out that (a) in items (i) and (ii), only the holders of shares of the affected type or class will be entitled to redemption; (b) in items (iv) and (v), the holders of shares of a type or class with liquidity and dispersion in the market will not have the right; and (c) in item (vii), the dissenting shareholders shall only have a right of redemption if the split-up implies a change in the corporate purpose, a reduction of the compulsory dividend or participation in a group of companies.

Reimbursement must be required by the dissenting shareholders within 30 days after the publication of the minutes of the general shareholders meeting or special meeting, as the case may be. Within 10 days after the expiration of the period, management is authorized to call a general shareholders meeting to ratify or reconsider the decision, if management understands that the payment of reimbursement to the dissenting shareholders who have exercised their redemption right may jeopardize the financial stability of the company. A shareholder who fails to exercise the right within the assigned term shall no longer be entitled to redemption.

According to the Brazilian Corporate Law, the amount to be reimbursed may only be lower than the share net value ascertained in the last balance sheet approved by the general shareholders meeting if this amount is based on the economic value of the corporation, to be duly appraised. If the decision of the general shareholders meeting takes place more than 60 days after the issuance of the last approved balance sheet, the shareholder shall be entitled to demand, together with the reimbursement, the preparation of a special balance sheet that complies with the time frame previously described.

Table of Contents

C. Material Contracts

We have six material contracts related to the concession of public telecommunications service granted by ANATEL (each filed as an Exhibit to this Annual Report). These contracts were renewed on December 22, 2005 and expire on December 31, 2025. Three of the contracts authorize the Company to provide local telephone services (Sectors 31, 32 and 34) and the other three authorize the Company to provide long-distance telephone services (Sectors 31, 32 and 34).

Our Multimedia Communication Service Authorization Term is also a material contract. Based on this Authorization Term, the Company is allowed to provide broadband services in the State of São Paulo. The Term was signed on April 17, 2003 for an undetermined period of time and is still currently in effect.

D. Exchange Controls

There are no restrictions on ownership of preferred shares or common shares by individuals or legal entities domiciled outside of Brazil.

The right to convert dividend or interest payments and proceeds from the sale of shares into foreign currency and to remit such amounts outside Brazil is subject to restrictions under foreign investment legislation which generally requires, among other things, that the relevant investments have been registered with the Central Bank and the CVM. The restrictions on the remittance of foreign capital abroad may hinder or prevent the custodian for the preferred shares represented by ADSs or holders of preferred shares from converting dividends, distributions or the proceeds from any sale of these preferred shares into U.S. dollars and remitting the U.S. dollars abroad. Holders of ADSs could be adversely affected by delays in, or refusal to grant any, required government approval to convert Brazilian currency payments on the preferred shares underlying the ADSs and to remit the proceeds abroad.

Resolution No. 1,927 of the CMN provides for the issuance of depositary receipts in foreign markets in respect of shares of Brazilian issuers. It restates and amends Annex V to Resolution No. 1,289 of the National Monetary Council, known as the Annex V Regulations. The ADS program was approved under the Annex V Regulations by the Central Bank and the CVM prior to the issuance of the ADSs. Accordingly, the proceeds from the sale of ADSs by holders outside Brazil are free of Brazilian foreign investment controls, and holders of the ADSs may be entitled to favorable tax treatment. See “—E. Taxation—Brazilian Tax Considerations.”

Under Resolution No. 2,689 of the CMN, foreign investors registered with the CVM may buy and sell Brazilian securities, including the preferred shares, on Brazilian stock exchanges without obtaining separate certificates of registration for each transaction. Registration is available to qualified foreign investors, which principally include foreign financial institutions, insurance companies, pension and investment funds, charitable foreign institutions and other institutions that meet certain minimum capital and other requirements. Resolution 2,689 also extends favorable tax treatment to registered investors. See “—E. Taxation—Brazilian Tax Considerations.”

Pursuant to Resolution No. 2,689 foreign investors must (i) appoint at least one representative in Brazil with the ability to perform actions regarding the foreign investment; (ii) complete the appropriate foreign investor registration form; (iii) obtain registration as a foreign investor with the CVM; and (iv) register the foreign investment with the Central Bank.

The securities and other financial assets held by a foreign investor pursuant to Resolution No. 2,689 must be registered or maintained in deposit accounts or under the custody of an entity duly licensed by the Central Bank or by the CVM or be registered in register, clearing and custody systems authorized by the Central Bank or by the CVM. In addition, the trading of securities is restricted to transactions carried out on the stock exchanges or over-the-counter

markets licensed by the CVM.

#### Registered Capital

Amounts invested in preferred shares by a non-Brazilian holder who qualifies under Resolution No. 2,689 and obtains registration with the CVM, or by the depositary representing an ADS holder, are eligible for registration with the Central Bank. Such registration (the amount so registered is referred to as registered capital) allows the remittance outside Brazil of foreign currency, converted at the commercial market rate, acquired with the proceeds



## Table of Contents

of distributions on, and amounts realized through, dispositions of such preferred shares. The registered capital per preferred share purchased in the form of an ADS, or purchased in Brazil and deposited with the depository in exchange for an ADS, will be equal to its purchase price (stated in U.S. dollars). The registered capital per preferred share withdrawn upon cancellation of an ADS will be the U.S. dollar equivalent of (i) the average price of a preferred share on the Brazilian stock exchange on which the most preferred shares were traded on the day of withdrawal or (ii) if no preferred shares were traded on that day, the average price on the Brazilian stock exchange on which the most preferred shares were traded in the 15 trading sessions immediately preceding such withdrawal. The U.S. dollar equivalent will be determined on the basis of the average commercial market rates quoted by the Central Bank on such date or dates.

An electronic registration has been issued in the name of the depository with respect to the ADSs and is maintained by the custodian on behalf of the depository. Pursuant to the registration, the custodian and the depository are able to convert dividends and other distributions with respect to the preferred shares represented by ADSs into foreign currency and remit the proceeds outside Brazil. In the event that a holder of ADSs exchanges such ADSs for preferred shares, such holder will be entitled to continue to rely on the depository's registration for five business days after such exchange, following which such holder must seek to obtain its own electronic registration with the Central Bank. Thereafter, any holder of preferred shares may not be able to convert into foreign currency and remit outside Brazil the proceeds from the disposition of, or distributions with respect to, such preferred shares, unless such holder is a duly qualified investor under Resolution No. 2,689 and obtains its own electronic registration.

If the holder does not qualify under Resolution 2,689 by registering with the CVM and the Central Bank and appoints a representative in Brazil to act directly in the Brazilian market to acquire preferred shares, the holder will be subject to a less favorable Brazilian tax treatment than a holder of ADSs. Regardless of registration under Resolution No. 2,689, residents of tax havens are subject to less favorable tax treatment than other foreign investors. See “—E. Taxation—Brazilian Tax Considerations.”

Under current Brazilian legislation, the federal government may impose temporary restrictions on remittances of foreign capital abroad in the event of a serious imbalance or an anticipated serious imbalance of Brazil's balance of payments. For approximately six months in 1989 and early 1990, the federal government froze all dividend and capital repatriations held by the Central Bank that were owed to foreign equity investors, in order to conserve Brazil's foreign currency reserves. These amounts were subsequently released in accordance with federal government directives. There can be no assurance that the federal government will not impose similar restrictions on foreign repatriations in the future.

### E. Taxation

The following discussion contains a description of the material Brazilian and U.S. federal income tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs by certain holders. This summary is based upon the tax laws of Brazil and the United States as of the date of this annual report, which are subject to change, possibly with retroactive effect, and to differing interpretations. You should consult your own tax advisors as to the Brazilian, U.S. federal or other tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs, including, in particular, the effect of any state, local or non-U.S., non-Brazilian tax laws.

Although there is presently no income tax treaty between Brazil and the United States, the tax authorities of the two countries have had discussions that may culminate in such a treaty. No assurance can be given, however, as to whether or when a treaty will enter into force or how it will affect the U.S. holders of preferred shares or ADSs.



## Table of Contents

### Brazilian Tax Considerations

The following discussion summarizes the material Brazilian tax consequences of the acquisition, ownership and disposition of preferred shares or ADSs by a U.S. holder not deemed to be domiciled in Brazil for Brazilian tax purposes (a “U.S. holder”). This discussion does not address all the Brazilian tax considerations that may be applicable to any particular non-Brazilian holder, and each non-Brazilian holder should consult its own tax advisor about the Brazilian tax consequences of investing in preferred shares or ADSs.

### Taxation of Dividends

Dividends paid by us in cash or in kind from profits generated on or after January 1, 1996 (i) to the depositary in respect of preferred shares underlying ADSs or (ii) to a U.S. holder or other non-Brazilian holder in respect of preferred shares will generally not be subject to Brazilian withholding tax. We do not have any undistributed profits generated before January 1, 1996. If payment of dividends is made for a beneficiary located outside of Brazil, the Tax on Exchange Transactions applies at a rate of zero.

### Distributions of Interest on Capital

Brazilian corporations may make payments to shareholders characterized as interest on capital as an alternative form of making dividend distributions. Amounts paid as interest on capital (net of applicable withholding tax) may be treated as payments with respect to the dividends we are obligated to distribute to our shareholders in accordance with our bylaws (estatuto social) and Brazilian Corporate Law. The rate of interest may not be higher than the federal government’s long term interest rate, or the TJLP, as determined by the Central Bank from time to time (6% per annum for 2010). The total amount distributed as interest on capital may not exceed the greater of (i) 50% of net income (before taking the distribution and any deductions for income taxes into account) for the year with respect to which the payment is made and (ii) 50% of retained earnings for the year prior to the year with respect to which the payment is made. Payments of interest on capital are decided by the shareholders on the basis of recommendations of the company’s Board of Directors. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Dividends and Dividend Distribution Policy—Additional Payments on Shareholder Equity.”

Distributions of interest on capital paid to Brazilian and non-Brazilian holders of preferred shares, including payments to the depositary in respect of preferred shares underlying ADSs, are deductible by us for Brazilian corporate income tax purposes. These payments to U.S. holders or non-Brazilian holders are subject to Brazilian withholding tax at the rate of 15%. If the recipient of the payment is domiciled in a tax haven jurisdiction, the rate will be 25%.

If payment of interest on shareholders equity is made for a beneficiary located outside of Brazil, the IOF applies at a rate of zero.

Distributions of interest on capital with respect to the preferred shares, including distributions to the depositary with respect to the preferred shares underlying the ADSs, may be converted into U.S. dollars and remitted outside of Brazil, subject to applicable exchange controls.

No assurance can be given that our Board of Directors will not recommend that future distributions of profits will be made by means of interest on capital instead of by means of dividends.

### Taxation of Gains

Gains realized outside Brazil by a U.S. holder or other non-Brazilian holder on the disposition of property located in Brazil, including preferred shares, to another non-Brazilian holder are subject to Brazilian tax. In this case, gains

would be subject to a 15% withholding tax rate, except if the beneficiary is located in a low-tax jurisdiction, as defined by Brazilian law, in which case the applicable rate would be 25%.

Our understanding is that ADSs do not qualify as property located in Brazil and, therefore, are not subject to Brazilian taxes upon disposition to other non-Brazilian holders. Insofar as this understanding has not been tested through the administrative or judicial courts, however, we are unable to evaluate what the final ruling on the matter

## Table of Contents

will be. If Brazilian tax authorities consider that the ADSs are assets located in Brazil, gains may be subject to income tax in Brazil.

Gains realized by a U.S. holder or other non-Brazilian holders on dispositions of preferred shares in Brazil or in transactions with Brazilian residents may be free of Brazilian tax, taxed at a rate of 25% or taxed at a rate of 15%, depending on the circumstances:

- Gains on the disposition of preferred shares obtained upon cancellation of ADSs are not taxed in Brazil if the disposition is made and the proceeds are remitted abroad within five business days after cancellation, unless the investor is a resident of a jurisdiction that, under Brazilian law, is deemed to be a tax haven.
- Gains realized on preferred shares through transactions with Brazilian residents or through transactions in Brazil off the Brazilian stock exchanges are generally subject to tax at a rate of 15%, or 25% in the case of a non-Brazilian holder residing in a tax haven jurisdiction.
- Gains realized on preferred shares through transactions on Brazilian stock exchanges (including the organized over-the-counter market) are generally subject to tax at a rate of 15%, as of January 2005, unless the investor is entitled to tax-free treatment for the transaction under Resolution No. 2,689 of the National Monetary Council Regulations, described immediately below. Non-Brazilian holders residing in a tax haven jurisdiction may be subject to tax at a rate of up to 25%.

Resolution No. 2,689 extends favorable tax treatment to a U.S. holder or other non-Brazilian holder of preferred shares who has (i) appointed a representative in Brazil with power to take action relating to the investment in preferred shares, (ii) registered as a foreign investor with the CVM and (iii) registered its investment in preferred shares with the Central Bank. Under Resolution No. 2,689 securities held by foreign investors must be maintained under the custody of, or in deposit accounts with, financial institutions duly authorized by the Central Bank and the CVM. In addition, the trading of securities is restricted under Resolution No. 2,689 to transactions on Brazilian stock exchanges or qualified over-the-counter markets. The preferential treatment generally afforded under Resolution 2,689 to investors in ADSs is not available to residents of tax havens. All preferred shares underlying ADSs qualify under Resolution No. 2,689.

There can be no assurance that the current preferential treatment for U.S. holders and other non-Brazilian holders under Resolution No. 2,689 will be maintained.

Gain on the disposition of preferred shares is measured by the difference between the amount in Brazilian currency realized on the sale or exchange and the acquisition cost of the shares sold, measured in Brazilian currency, without any correction for inflation. Although the matter is not free from doubt, there are arguments to sustain the position that the acquisition cost of shares registered as an investment with the Central Bank is calculated on the basis of the foreign currency amount registered with the Central Bank. See “—Registered Capital.”

Gains realized by a U.S. holder or other non-Brazilian holder upon the redemption of preferred shares will be treated as gains from the disposition of such preferred shares to a Brazilian resident occurring off a stock exchange and will accordingly be subject to tax at a rate of 15%, unless the non-Brazilian holder is domiciled in a tax haven jurisdiction, in which case the applicable rate would be 25%.

As of January 1, 2005, the purchase price of preferred shares sold on the Brazilian stock exchange and on the Brazilian non-organized over-the-counter market is subject to withholding tax at a rate of 0.005%, except in the case of non-Brazilian holders that invest through Resolution No. 2,689. This tax may be offset against the 15% income tax due on the gains realized upon the sale of the shares.

Any exercise of preemptive rights relating to the preferred shares or ADSs will not be subject to Brazilian taxation. Gains on the sale or assignment of preemptive rights relating to the preferred shares will be treated differently for Brazilian tax purposes depending on (i) whether the sale or assignment is made by the depositary or the investor and (ii) whether the transaction takes place on a Brazilian stock exchange. Gains on sales or

## Table of Contents

assignments made by the depository on a Brazilian stock exchange are not taxed in Brazil, but gains on other sales or assignments may be subject to tax at rates up to 15%, or 25% in the case of residents of tax haven jurisdictions.

The deposit of preferred shares in exchange for the ADSs is not subject to Brazilian income tax if the preferred shares are registered under Resolution No. 2,689 and the respective holder is not in a tax haven jurisdiction. If the preferred shares are not so registered or the holder is in a tax haven jurisdiction, the deposit of preferred shares in exchange for ADSs may be subject to Brazilian capital gains tax at a rate of 15%.

The withdrawal of preferred shares in exchange for ADSs is not subject to Brazilian tax. On receipt of the underlying preferred shares, a U.S. holder or non-Brazilian holder entitled to benefits under Resolution No. 2,689 will be entitled to register the U.S. dollar value of such shares with the Central Bank as described above, under “—D. Exchange Controls—Registered Capital.” If a U.S. holder or non-Brazilian holder does not qualify under Resolution No. 2,689, such person will be subject to the less favorable tax treatment described above in respect of exchanges of preferred shares. Brazil’s tax treaties do not grant relief from taxes on gains realized on sales or exchanges of preferred shares.

### Beneficiaries Residing or Domiciled in Tax Havens or Low-Tax Jurisdictions

With the exception of limited circumstances, any income derived from operations by a beneficiary that resides or is domiciled in a country considered to be a tax haven is subject to income tax to be withheld by the source at a rate of 25% instead of 15%. The increased rate also applies for capital gains paid to residents of low-tax jurisdictions.

In accordance with Law No. 9,959, non-Brazilian holders of ADSs or preferred shares who are residents of tax havens have been excluded from the tax incentives granted to holders of ADSs and investors under Resolution No. 2,689 since January 1, 2000 and are subject to the same tax treatment applicable to holders that are residents of or domiciled in Brazil.

### Tax on Financial Transactions (IOF Tax)

IOF is a tax on foreign exchange transactions, or “IOF/Exchange Tax,” on the conversion of reais into foreign currency and on the conversion of foreign currency into reais. Any inflow of funds related to investments carried out on the Brazilian financial and capital markets by a non-Brazilian holder that has registered its investment in Brazil with the Central Bank is subject to the IOF/Exchange Tax at a rate of 2.0%. Foreign exchange transactions related to outflows of funds in connection with investments carried out on the Brazilian financial and capital markets are subject to the IOF/Exchange Tax at a rate of zero, which also applies to payments of dividends and interest on shareholders’ equity. With the exception of these transactions, the rate applicable to most foreign exchange transactions is 0.38%. Other rates may apply to particular transactions and the Brazilian government may increase the rate at any time by up to 25.0% on the future foreign exchange transaction amount.

“IOF/Bonds Tax” is due on transactions involving bonds and securities, including those carried out on a Brazilian stock exchange. The rate of the IOF/Bonds Tax applicable to the transfer of shares with the sole purpose of enabling the issuance of ADSs is currently 1.5%. The Brazilian government may increase the rate of the IOF/Bonds Tax at any time by up to 1.5% per day of the transaction amount, but only in respect of future transactions.

### Other Brazilian Taxes

There are no Brazilian inheritance, gift or succession taxes applicable to the ownership, transfer or disposition of preferred shares or ADSs by a non-Brazilian holder except for gift and inheritance taxes levied by some states in Brazil on gifts made or inheritances bestowed by individuals or entities not resident or domiciled in Brazil or in the relevant state to individuals or entities that are resident or domiciled within this state in Brazil. There are no Brazilian

stamp, issue, registration, or similar taxes or duties payable by holders of preferred shares or ADSs.



Table of Contents

U.S. Federal Income Tax Considerations

The following are the material U.S. federal income tax consequences to U.S. Holders described herein of owning and disposing of preferred shares or ADSs, but this is not a comprehensive description of all of the tax considerations that may be relevant to a particular person's decision to hold such securities. The discussion applies only to U.S. Holders that hold preferred shares or ADSs as capital assets for tax purposes and it does not describe all of the tax consequences that may be relevant to holders subject to special rules, such as:

- certain financial institutions;
- dealers or traders in securities who use a mark-to-market method of tax accounting;
- persons holding preferred shares or ADSs as part of a hedge, "straddle," integrated transaction or similar transaction;
  - persons whose functional currency for U.S. federal income tax purposes is not the U.S. dollar;
  - entities classified as partnerships for U.S. federal income tax purposes;
  - persons liable for the alternative minimum tax;
  - tax-exempt organizations;
- persons that own or are deemed to own ten percent or more of our voting stock;
- persons who acquired our ADSs or preferred shares pursuant to the exercise of any employee stock option or otherwise as compensation; or
- persons holding preferred shares or ADSs in connection with a trade or business conducted outside of the United States.

If an entity that is classified as a partnership for U.S. federal income tax purposes holds preferred shares or ADSs, the U.S. federal income tax treatment of a partner will generally depend on the status of the partner and upon the activities of the partnership. Partnerships holding preferred shares or ADSs and partners in such partnerships should consult their tax advisers as to the particular U.S. federal income tax consequences of holding and disposing of the preferred shares or ADSs.

This discussion is based on the Internal Revenue Code of 1986, as amended (the "Code"), administrative pronouncements, judicial decisions and final, temporary and proposed Treasury regulations, all as of the date hereof. These laws are subject to change, possibly on a retroactive basis. It is also based in part on representations by the Depositary and assumes that each obligation under the Deposit Agreement and any related agreement will be performed in accordance with its terms.

You are a "U.S. Holder" if, for U.S. federal income tax purposes, you are a beneficial owner of preferred shares or ADSs and if you are:

- an individual citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized in or under the laws of the United States, any state therein or the District of Columbia; or

- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

THE SUMMARY OF U.S. FEDERAL INCOME TAX CONSEQUENCES SET OUT BELOW IS INTENDED FOR GENERAL INFORMATION PURPOSES ONLY. U.S. HOLDERS OF PREFERRED SHARES OR ADSs

## Table of Contents

ARE URGED TO CONSULT WITH THEIR OWN TAX ADVISERS WITH RESPECT TO THE PARTICULAR TAX CONSEQUENCES TO THEM OF OWNING OR DISPOSING OF PREFERRED SHARES OR ADSs, INCLUDING THE APPLICABILITY AND EFFECT OF STATE, LOCAL, NON-U.S. AND OTHER TAX LAWS AND POSSIBLE CHANGES IN TAX LAWS.

In general, if you own ADSs, you will be treated as the owner of the underlying shares represented by those ADSs for U.S. federal income tax purposes. Accordingly, no gain or loss will be recognized if you exchange ADSs for the underlying shares represented by those ADSs.

The U.S. Treasury has expressed concerns that parties to whom American depository shares are released before shares are delivered to the depository (“pre-release”) or intermediaries in the chain of ownership between holders and the issuer of the security underlying the American depository shares may be taking actions that are inconsistent with the claiming of foreign tax credits by holders of American depository shares. Such actions would also be inconsistent with the claiming of the reduced rate of tax, described below, applicable to dividends received by certain non-corporate holders. Accordingly, the creditability of Brazilian taxes, and the availability of the reduced tax rate for dividends received by certain non-corporate holders, each described below, could be affected by actions taken by such parties or intermediaries.

Please consult your tax advisers concerning the U.S. federal, state, local and foreign tax consequences of owning and disposing of preferred shares or ADSs in your particular circumstances.

This discussion assumes that we are not, and will not become, a passive foreign investment company, as described below.

### Taxation of Distributions

Distributions paid on ADSs or preferred shares will generally be treated as dividends to the extent paid out of current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Because we do not maintain calculations of our earnings and profits under U.S. federal income tax principles, it is expected that distributions generally will be reported to U.S. Holders as dividends. Subject to applicable limitations and the discussion above regarding concerns expressed by the U.S. Treasury, dividends paid by qualified foreign corporations to certain non-corporate U.S. Holders in taxable years beginning before January 1, 2013, are taxable at a maximum rate of 15%. A foreign corporation is treated as a qualified foreign corporation with respect to dividends paid on stock that is readily tradable on a securities market in the United States, such as the New York Stock Exchange where our ADSs are traded. You should consult your tax advisers regarding the availability of the reduced tax rate on dividends in your particular circumstances.

The amount of a dividend will include any amounts withheld by us in respect of Brazilian taxes. The amount of the dividend will be treated as foreign-source dividend income to you and will not be eligible for the dividends-received deduction generally allowed to U.S. corporations under the Code. Dividends will be included in your income on the date of your, or in the case of ADSs, the Depository’s, receipt of the dividend. The amount of any dividend income paid in reais will be a U.S. dollar amount calculated by reference to the exchange rate in effect on the date of such receipt regardless of whether the payment is in fact converted into U.S. dollars. If the dividend is converted into U.S. dollars on the date of receipt, you should not be required to recognize foreign currency gain or loss in respect of the dividend income. You may have foreign currency gain or loss if the dividend is converted into U.S. dollars after the date of receipt.

Subject to applicable limitations that may vary depending upon your circumstances and subject to the discussion above regarding concerns expressed by the U.S. Treasury, Brazilian income taxes withheld from dividends on

preferred shares or ADSs will be creditable against your U.S. federal income tax liability. The rules governing foreign tax credits are complex and, therefore, you should consult your tax adviser regarding the availability of foreign tax credits in your particular circumstances. Instead of claiming a credit, you may, at your election, deduct such Brazilian taxes in computing your taxable income, subject to generally applicable limitations under U.S. law. An election to deduct foreign taxes instead of claiming foreign tax credits must apply to all taxes paid or accrued in the taxable year to foreign countries and possessions of the United States.

## Table of Contents

### Sale, Redemption or Other Disposition of Preferred Shares or ADSs

For U.S. federal income tax purposes, gain or loss you realize on the sale, redemption or other disposition of preferred shares or ADSs will generally be capital gain or loss, and will generally be long-term capital gain or loss if you held the preferred shares or ADSs for more than one year. The amount of your gain or loss will equal the difference between your tax basis in the preferred shares or ADSs disposed of and the amount realized on the disposition, in each case as determined in U.S. dollars. If a Brazilian tax on gains is withheld on the sale or disposition of preferred shares or ADSs, a U.S. Holder's amount realized will include the gross amount of the proceeds of such sale or disposition before deduction of the Brazilian tax. See “—Brazilian Tax Considerations—Taxation of Gains” for a description of when a disposition may be subject to taxation by Brazil. Such gain or loss will generally be U.S.-source gain or loss for foreign tax credit purposes. U.S. Holders should consult their tax advisors as to whether the Brazilian tax on gains may be creditable against the holder's U.S. federal income tax on foreign-source income from other sources. In lieu of claiming a foreign tax credit, U.S. Holders may make an election to deduct foreign taxes, including the Brazilian tax, in computing their taxable income, subject to generally applicable limitations under U.S. law. An election to deduct foreign taxes instead of claiming foreign tax credits applies to all taxes paid or accrued in the taxable year to foreign countries and possessions of the United States.

### Other Brazilian Taxes

You should note that any Brazilian IOF Tax (as discussed above under “—Brazilian Tax Considerations”) will not be a creditable foreign tax for U.S. federal income tax purposes, although you may be entitled to deduct such tax, subject to applicable limitations under U.S. law. You should consult your tax advisers regarding the U.S. federal income tax consequences of the payment of Brazilian IOF Tax, including whether you may claim a deduction for such tax or should instead include the amount of tax paid in your initial basis in the preferred shares or ADSs.

### Passive Foreign Investment Company Rules

We believe that we were not a “passive foreign investment company” (“PFIC”) for U.S. federal income tax purposes for our 2010 taxable year. However, because PFIC status depends on the composition of a company's income and assets and the market value of its assets from time to time, there can be no assurance that we will not be a PFIC for any taxable year. If we were a PFIC for any taxable year during which a U.S. Holder held preferred shares or ADSs, gain recognized by such U.S. Holder on a sale or other disposition (including certain pledges) of the preferred shares or ADSs would be allocated ratably over the U.S. Holder's holding period for the preferred shares or ADSs. The amounts allocated to the taxable year of the sale or other disposition and to any year before we became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for individuals or corporations, as appropriate, for such taxable year, and an interest charge would be imposed on the amount allocated to such taxable year. Further, to the extent that any distribution received by a U.S. Holder on its preferred shares or ADSs exceeds 125% of the average of the annual distributions on preferred shares or ADSs received by a U.S. Holder during the preceding three years or such holder's holding period, whichever is shorter, that distribution would be subject to taxation in the same manner as gain, described immediately above. Certain elections may be available that would result in alternative treatments (such as mark-to-market treatment) of the preferred shares or ADSs. U.S. Holders should consult their tax advisers to determine whether any of these elections would be available and, if so, what the consequences of the alternative treatments would be in those holders' particular circumstances.

### Information Reporting and Backup Withholding

Payments of dividends and sales proceeds that are made within the United States or through certain U.S.-related financial intermediaries generally are subject to information reporting and may be subject to backup withholding

unless (i) you are an exempt recipient or (ii) in the case of backup withholding, you provide a correct taxpayer identification number and certify that you are not subject to backup withholding.

The amount of any backup withholding from a payment to you will be allowed as a credit against your U.S. federal income tax liability and may entitle you to a refund, provided that the required information is timely furnished to the Internal Revenue Service.

Table of Contents

For taxable years beginning after March 18, 2010, new legislation requires certain U.S. Holders who are individuals to report information relating to stock of a non-U.S. person, subject to certain exceptions (including an exception for stock held in custodial accounts maintained by a U.S. financial institution). U.S. Holders are urged to consult their tax advisers regarding the effect, if any, of this legislation on their ownership and disposition of preferred shares or ADSs.

U.S. HOLDERS OF OUR PREFERRED SHARES OR ADSs SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE BRAZILIAN, U.S. FEDERAL, STATE, LOCAL AND OTHER TAX CONSEQUENCES OF THE OWNERSHIP AND DISPOSITION OF OUR PREFERRED SHARES OR ADSs BASED UPON THEIR PARTICULAR CIRCUMSTANCES.

F. Dividends and Paying Agents

Not applicable.

G. Statement of Experts

Not applicable.

H. Documents on Display

We are subject to the information requirements of the Exchange Act, except that as a foreign issuer, we are not subject to the proxy rules or the short-swing profit disclosure rules of the Exchange Act. In accordance with these statutory requirements, we file or furnish reports and other information with the SEC. Reports and other information filed or furnished by us with the Commission may be inspected and copied at the public reference facilities maintained by the Commission at 100 F Street, N.E., Washington, D.C. 20549. Copies of such material may be obtained by mail from the Public Reference Section of the Commission, 100 F Street, N.E., Washington, D.C. 20549, at prescribed rates. You may also inspect these reports and other information at the offices of the New York Stock Exchange, 11 Wall Street, New York, New York 10005, on which our ADSs are listed.

In addition, the Commission maintains a website that contains information filed electronically, which can be accessed over the Internet at <http://www.sec.gov>.

We also file financial statements and other periodic reports with the CVM. Copies of our annual report on Form 20-F and documents referred to in this annual report and our bylaws will be available for inspection upon request at our offices at Rua Martiniano de Carvalho, 851 - 21º Andar, 01321-001, São Paulo, SP, Brasil.

I. Subsidiary Information

Not applicable.

ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to several market risks as a result of our commercial operations, debts obtained to finance our activities and financial derivative instruments, including exchange rate risk, interest rate risk, debt acceleration risk and credit risk. To help us manage our risks, we conduct a valuation of our financial assets and liabilities in relation to market values based on available information and appropriate valuation methodologies. However, the interpretation of market information, as well as the selection of methodologies, requires considerable judgment and reasonable estimates in order to produce adequate realization values. As a result, our valuation estimates do not necessarily indicate the amounts which will be realized in the current market. The use of different market approaches

and/or methodologies for the estimates may have a significant effect on the estimated realization values.

We also enter into derivative instruments to manage the risks to which we are exposed in accordance with our risk management policy. All of our derivative instruments are intended to provide coverage against the risk of variation in foreign exchange, therefore, any changes in risk factors generate an opposite effect on the hedged item. We do not hold derivative instruments for speculative purposes.



Table of Contents

To further assist our risk management, we conduct fair value analyses of our derivative financial instruments, as well as sensitivity analyses of our risk variables and our net exposure risk. For more details of the results of our valuation analysis, risk management strategies, and sensitivity analysis of our derivative financial instruments, please see Note 31 to our 2010 consolidated financial statements.

ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES

The depositary, The Bank of New York Mellon, collects its fees for delivery and surrender of ADSs directly from investors depositing shares or surrendering ADSs or from intermediaries acting for them. The depositary also collects fees for making distributions to investors by deducting those fees from the amounts distributed or by selling a portion of distributable property to pay the fees. The depositary may collect its annual fee for depositary services by deductions from cash distributions or by directly billing investors or by charging the book-entry system accounts of participants acting for them. The depositary may generally refuse to provide fee-attracting services until its fees for those services are paid.

Persons depositing or withdrawing shares For:  
must pay:

\$5.00 (or less) per 100 ADSs (or portion of 100 ADSs)

- Issuance of ADSs, including issuances resulting from a distribution of shares or rights or other property

- Cancellation of ADSs for the purpose of withdrawal, including if the deposit agreement terminates

A fee equivalent to the fee that would be payable if securities distributed to you had been shares and the shares had been deposited for issuance of ADSs

- Distribution of securities distributed to holders of deposited securities which are distributed by the depositary to ADS registered holders

Registration or transfer fees

- Transfer and registration of shares on our share register to or from the name of the depositary or its agent when you deposit or withdraw shares

Expenses of the depositary

- Cable, telex and facsimile transmissions (when expressly provided in the deposit agreement)

- Converting foreign currency to U.S. dollars

- As necessary

Taxes and other governmental charges the depositary or the custodian have to pay on any ADS or share underlying an ADS, for example, stock transfer taxes, stamp duty or withholding taxes

Any charges incurred by the depositary or its agents for servicing the deposited securities • As necessary

During 2010, we received from the depositary \$138,676.86 for continuing annual stock exchange listing fees, standard out-of-pocket maintenance costs for the ADRs (consisting of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls), any applicable performance indicators relating to the ADR facility, underwriting fees and legal fees.

Table of Contents

The Bank of New York Mellon has agreed to reimburse us for expenses it incurs that are related to establishment and maintenance expenses of the ADS program. The depositary has agreed to reimburse us for its continuing annual stock exchange listing fees. The depositary has also agreed to pay the standard out-of-pocket maintenance costs for the ADRs, which consist of the expenses of postage and envelopes for mailing annual and interim financial reports, printing and distributing dividend checks, electronic filing of U.S. Federal tax information, mailing required tax forms, stationery, postage, facsimile, and telephone calls. It has also agreed to reimburse us annually for certain investor relationship programs or special investor relations promotional activities. In certain instances, the depositary has agreed to provide additional payments to us based on any applicable performance indicators relating to the ADR facility. There are limits on the amount of expenses for which the depositary will reimburse us, but the amount of reimbursement available to us is not necessarily tied to the amount of fees the depositary collects from investors.

Table of Contents

PART II

ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

As of December 31, 2010, we were not in default under any of our obligations and there were no dividend arrearages or delinquencies.

ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

Law 10,303 of October 31, 2001 amended the provisions of the Brazilian Corporate Law relating to the rights of preferred shareholders. In order to comply with such modifications, at the extraordinary shareholders meeting held on 12/30/2002, an amendment to our bylaws was approved granting the preferred shareholders the right to receive dividends 10% higher than the dividends paid to common shareholders.

ITEM 15. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

Our Chief Executive Officer, or CEO, and Chief Financial Officer, or CFO, are responsible for establishing and maintaining our disclosure controls and procedures. These controls and procedures were designed to ensure that information relating to us required to be disclosed in the reports that we file under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC. We evaluated these disclosure controls and procedures under the supervision of our CEO and CFO as of December 31, 2010. Based on this evaluation, our CEO and CFO concluded that our disclosure controls and procedures were adequate and effective and were designed to ensure that material information relating to us and our consolidated subsidiaries are made known to them by others within those entities to allow timely decisions relating to the required disclosure.

Management's Annual Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act). The Telesp internal control system was designed to provide reasonable assurance as to the integrity and reliability of the published financial statements. All internal control systems, no matter how well designed, may have inherent limitations and can provide reasonable assurance that the objectives of the control system are met.

Management evaluated the effectiveness of internal control over financial reporting under the supervision of our Chief Executive Officer, or CEO and Chief Financial Officer (our Vice-President of Finance), or CFO as of December 31, 2010 based on the criteria set out in the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") framework and concluded that, as of December 31, 2010, our internal control over financial reporting was adequate and effective.

Our independent registered public accounting firm, Ernst & Young Terco, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2010. The report on the audit of our internal control over financial reporting is included herewith.

Attestation Report of the Registered Public Accounting Firm

Ernst & Young Terco, the independent registered public accounting firm that has audited our consolidated financial statements, has issued an attestation report on the effectiveness of our internal control over financial reporting as of December 31, 2010. This attestation report appears on page F-3.

Table of Contents

Changes in Internal Control over Financial Reporting

Our internal audit department periodically evaluates our internal controls for the main cycles, documenting by flow charts the processes used in each cycle, identifying opportunities and suggesting improvements for the existing control mechanisms. There was no change in our internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

ITEM 16. [RESERVED]

ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT

Our Control and Audit Committee is comprised of a minimum of three and a maximum of five non-executive directors. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Committees—Control and Audit Committee.” Our Board of Directors has designated Luis Bastida Iburguen, an independent member of our Board of Directors under Brazilian rules and a member of our Control and Audit Committee, as the company’s “audit committee financial expert,” as such term is defined by the SEC. We anticipate that there will be some similar functions between the Control and Audit Committee and our statutory Fiscal Board (Conselho Fiscal), the latter of which meets the requirements of the general exemption from the listing standards for audit committees set forth in Exchange Act Rule 10A-3(c)(3). See “Item 16D—Exemptions from the Listing Standards for Audit Committees.”

ITEM 16B. CODE OF ETHICS

Our Control and Audit Committee and our Board of Directors had approved a code of ethics (Normativa de Conduta para Financeiros da Telesp S/A). The code of ethics regulates the conduct of our managers in connection with the registration and control of financial and accounting information and their access to privileged and non-public information and data, in order to comply with the requirements of the Sarbanes-Oxley Act and NYSE rules. Our code of ethics follows the code of our parent company, Telefónica S.A. The code of ethics applies to our Chief Executive Officer, Chief Financial Officer, Chief Operating Officer (whom we refer to as our General Executive Officer), our Officers and corresponding foregoing positions at our subsidiaries, as well as to our executives in the areas for financial, management and internal controls. The code applies generally to all those with responsibilities similar to those listed above.

Following our ongoing commitment to transparency to markets and to supervisory authorities, as well as the adoption of high ethical standards in business, and based on the guidelines set forth by Telefónica S.A.’s code of ethics, our code of ethics provides for values, such as:

- Transparency;
- Honesty and integrity;
- Compliance with laws and regulations, including, but not limited to, the securities markets rules and regulations and the rules and regulations related to insider trading and market manipulation;
- Protection of confidential information and property, except when disclosure thereof is authorized or legally required; and
- Reporting of suspected illegal or unethical behavior.

Our code of ethics is included in this Annual Report as an exhibit.

ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES

E&Y acted as our independent auditor for the fiscal years ended December 31, 2010 and December 31, 2009. The chart below sets forth the total amount billed to us by E&Y for services performed in the years 2010 and 2009, and breaks down these amounts by category of service:

Table of Contents

	2010	2009
	(in thousands of reais)	
Audit Fees	4,474	4,591
Audit-Related Fees	755	—
Tax Fees	17	17
All Other Services	—	—
Total	5,246	4,608

For the years ended December 31, 2010 and December 31, 2009, we paid our auditors, E&Y, for auditing services rendered in the total amount of R\$5,246 thousand and R\$4,608 thousand, respectively.

## Audit Fees

Audit fees are fees billed for the audit of our annual consolidated financial statements prepared for purposes of filings with the CVM and the SEC and for the reviews of our quarterly financial statements submitted on Form 6-K and to the audit with respect to processes required by Sarbanes-Oxley, with the purpose of certifying the effectiveness over our internal controls.

## Audit-Related Fees

Refers to the auditing services and review with respect to our compliance with the targets established by ANATEL.

## Tax Fees

Refers to accounting services with respect to the preparation of tax returns.

## All Other Fees

Not applicable.

## Pre-Approval Policies and Procedures

Our Control and Audit committee evaluates the results of all audit and audit-related services provided by our auditors. Our Control and Audit committee has the authority to approve services to be provided by our auditors that are not specifically included within the scope of the audit. Our Board of Directors, with advice from the Control and Audit Committee, is responsible for authorizing the audit services provided by E&Y, the present auditor of the Company. Non-audit services are required to be pre-approved by the Control and Audit Committee pursuant to the policy for pre-approval of non-audit services.

## ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES

Brazilian Corporate Law requires that we have a statutory Fiscal Board (Conselho Fiscal). Our statutory Fiscal Board meets the requirements of the general exemption set forth in Exchange Act Rule 10A-3(c)(3). See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board.” Our statutory Fiscal Board is primarily charged with certain advisory, oversight and review functions with respect to the company’s financial statements; however, the statutory Fiscal Board, as required by Brazilian Corporate Law, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law. Our Board of Directors, under Brazilian Corporate Law, is the only entity with the



legal capacity to appoint and retain any independent registered public accounting firm, and decide the budget appropriation with respect to such auditors.

Since Brazilian Corporate Law does not specifically grant our statutory Fiscal Board the power to establish receipt, retention and complaint procedures regarding accounting, internal control and audit matters, or create

Table of Contents

policies for the confidential, anonymous treatment of employee concerns regarding accounting or auditing matters, we have established a Control and Audit Committee as a best corporate governance practice to address these various issues. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Committees—Control and Audit Committee.”

We do not believe that our use of a fiscal board in accordance with Brazilian Corporate Law in combination with our Control and Audit Committee, as opposed to the provisions set forth in Exchange Act Rule 10A-3(b), materially adversely affects the ability of the conselho fiscal to act independently, satisfy the other applicable requirements of Exchange Act Rule 10A-3 or to fulfill its fiduciary and other obligations under Brazilian law.

ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS

None.

ITEM 16F. CHANGE IN REGISTRANT’S CERTIFYING ACCOUNTANT

Not applicable.

ITEM 16G. CORPORATE GOVERNANCE

Principal Differences Between U.S. and Brazilian Corporate Governance Practices

On November 4, 2003, the SEC approved new corporate governance rules established by the NYSE. Pursuant to these rules, foreign private issuers that are listed on the NYSE, such as our company, must disclose any significant ways in which its corporate governance practices differ from those followed by U.S. companies under the listing rules of the NYSE.

The significant differences between our corporate governance practices and the NYSE corporate governance standards are as follows:

Independence of Directors and Independence Tests

The Brazilian Corporate Law and our bylaws require that our directors be elected by our shareholders at a general shareholders meeting. Fifteen of our directors were appointed by our common shareholders, and one director is appointed by representatives of our minority preferred shareholders. Thirteen of our directors are independent in accordance with rules generally accepted in Brazil.

Both the Brazilian Corporate Law and CVM establish rules in relation to certain qualification requirements and restrictions, investiture, compensation, duties and responsibilities of companies’ executives and directors. We believe these rules provide adequate assurances that our directors are independent and such rules would permit us to have directors that would not otherwise pass the independence tests established by the NYSE.

Executive Sessions

According to the Brazilian Corporate Law, up to one-third of the members of the Board of Directors can be elected to executive positions. The remaining non-management directors are not expressly empowered to serve as a check on management, and there is no requirement that those directors meet regularly without management. Notwithstanding, our Board of Directors consists of fifteen non-management directors, thirteen of whom are independent directors in accordance with rules generally accepted in Brazil, and as such, we believe we are in compliance with this standard.

Control and Audit Committee/Additional Requirements

Brazilian Corporate Law and our bylaws each require that we have a statutory Fiscal Board (Conselho Fiscal). See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board.” Our statutory Fiscal Board meets the requirements of the general exemption from the listing standards for audit committees set

Table of Contents

forth in Exchange Act Rule 10A-3(c)(3). See “Item 16D. Exemptions from the Listing Standards for Audit Committees.” Our statutory Fiscal Board is primarily charged with certain advisory, oversight and review functions with respect to the company’s financial statements. However, the statutory Fiscal Board, as required by Brazilian Corporate Law, has only an advisory role and does not participate in the management of the company. Indeed, decisions of the statutory Fiscal Board are not binding on the company under Brazilian Corporate Law. See “Item 6. Directors, Senior Management and Employees—C. Board Practices—Fiscal Board.”

In addition to our statutory Fiscal Board, we have established a Control and Audit committee as a best corporate governance practice in order to comply with the requirements of the Sarbanes-Oxley Act as described in Item 6C of this annual report. We anticipate that there will be some similar functions between the Control and Audit Committee and our statutory Fiscal Board.

Table of Contents

PART III

ITEM 17. FINANCIAL STATEMENTS

We have responded to Item 18 in lieu of responding to this Item.

ITEM 18. FINANCIAL STATEMENTS

Reference is made to pages F-1 through F-84.

ITEM 19. EXHIBITS

Exhibit Number Description

- |       |  |
|-------|--|
| 1.1   | Bylaws of Telecomunicações de São Paulo S.A. – Telesp, as amended (unofficial English translation)   |
| 2(a)  | Deposit Agreement dated as of July 27, 1998, as amended and restated as of August 13, 2010, among Telesp Participações S.A., The Bank of New York, as Depositary, and Owners and Beneficial Owners of American Depositary Receipts issued thereunder (1) |
| 4(a)  | Contract and Justification of the Merger of Telefónica Data Brasil Holding S.A. into Telecomunicações De São Paulo S.A. – Telesp and Partial Spin-Off of Telefónica Empresas S.A. dated March 9, 2006 (2)  |
| 4(b)1 | Grant Contract for Fixed Commuted Telephone Service in Local Modality (Sector 31) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)              |
| 4(b)2 | Grant Contract for Fixed Commuted Telephone Service in Local Modality (Sector 32) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)              |
| 4(b)3 | Grant Contract for Fixed Commuted Telephone Service in Local Modality (Sector 34) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)              |
| 4(b)4 | Grant Contract for Fixed Commuted Telephone Service in Long-Distance Modality (Sector 31) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)      |
| 4(b)5 | Grant Contract for Fixed Commuted Telephone Service in Long-Distance Modality (Sector 32) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)      |
| 4(b)6 | Grant Contract for Fixed Commuted Telephone Service in Long-Distance Modality (Sector 34) between Agência Nacional De Telecomunicações and Telecomunicações De São Paulo S.A. – Telesp dated December 22, 2005 (unofficial English translation) (3)      |
| 4(b)7 |  |

Edgar Filing: TELESP HOLDING CO - Form 20-F

Certificate of Authorization to Provide Multimedia Communication Service, for the Collective Interest, by and between “Agência Nacional de Telecomunicações - ANATEL” and “Telecomunicações de São Paulo S.A. – Telesp” (unofficial English translation)(4)

- 8.1 List of Subsidiaries
- 11.1 Code of Ethics of Telecomunicações de São Paulo S.A. – Telesp (3)
- 12.1 Section 302 Certification of the Chief Executive Officer

102

---

Table of Contents

- 12.2 Section 302 Certification of the Chief Financial Officer
- 13.1 Section 906 Certification of the Chief Executive Officer
- 13.2 Section 906 Certification of the Chief Financial Officer

---

(1) Incorporated by reference to our Registration Statement of American Depositary Receipt shares on Form F-6POS (No. 333-146901) filed with the Commission on July 30, 2010.

(2) Incorporated by reference to our form CB filed with the Commission on March 14, 2006.

(3) Incorporated by reference to our annual report on Form 20-F (No. 001-14475) filed with the Commission on April 12, 2006.

(4) Incorporated by reference to our annual report on Form 20-F (No. 001-14475) filed with the Commission on April 16, 2007.

Table of Contents

GLOSSARY OF TELECOMMUNICATIONS TERMS

The following explanations are not intended as technical definitions, but rather to assist the reader in understanding certain terms as used in this Annual Report.

**ADSL:** Asymmetric digital subscriber line. ADSL technology allows more data to be sent over existing copper telephone lines.

**Analog:** A mode of transmission or switching that is not digital, e.g., the representation of voice, video or other modulated electrical audio signals which are not in digital form.

**BLEC:** Building local exchange carrier. A BLEC is a service provider that delivers telecommunication services within a specific building. BLECs aggregate traffic at the particular site and employ a single broadband connection for local access.

**Cellular service:** A cellular telecommunications service provided by means of a network of interconnected low-powered base stations, each of which covers one small geographic cell within the total cellular telecommunications system service area.

**CSP:** long-distance carrier selection.

**Digital:** A mode of representing a physical variable such as speech using digits 0 and 1 only. The digits are transmitted in binary form as a series of pulses. Digital networks allow for higher capacity and higher flexibility through the use of computer-related technology for the transmission and manipulation of telephone calls. Digital systems offer lower noise interference and can incorporate encryption as a protection from external interference.

**DTH:** A special type of service that uses satellites for the direct distribution of television and audio signals for subscribers.

**FATOR X:** A measurement of the company's productivity, calculated by ANATEL, which is discounted by the inflation rate and is used for the calculation of the annual rate adjustment applicable to telecommunications companies.

**FTTH:** Internet access through Fiber Optic ("Fiber to the Home").

**Internet:** A collection of interconnected networks spanning the entire world, including university, corporate, government and research networks from around the globe. These networks all use the IP (Internet Protocol) communications protocol.

**IP (Internet protocol):** An interconnection protocol for sub-networks, in particular for those with different physical characteristics used by the Internet.

**IPTV:** Pay TV with video broadcast offered through the use of the IP protocol.

**MMDS: (Multichannel Multipoint Distribution Service ):** It's a wireless telecommunications technology, used for general-purpose broadband networking or, more commonly, as an alternative method of cable television programming reception.



**Network:** An interconnected collection of elements. In a telephone network, these consist of switches connected to each other and to customer equipment. The transmission equipment may be based on fiber-optic or metallic cable or point-to-point radio connections.

**Network usage charge:** Amount paid per minute charged by network operators for the use of their network by other network operators.

**PBX (Private Branch Exchange):** Telephone switchboard for private use, but linked to a telephone network.

Table of Contents

SCM: multimedia communication services, or (“serviços de comunicação multimídia”).

SMP: Personal Mobile Service or, (Serviço Móvel Pessoal).

STFC (Serviço Telefônico Fixo Comutado): Transmission of voice and other signals between determined fixed points.

Switch: Devices used to set up and route telephone calls either to the number called or to the next switch along the path. They may also record information for billing and control purposes.

Universal service: The obligation to supply basic service to all users throughout a national territory at reasonable prices.

VOIP: Voice over Internet Protocol, is a technology for transmitting voice using the internet.

VOD: Video on demand systems allow users to select and watch/listen to video or audio content on demand.

Table of Contents

SIGNATURES

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

TELECOMUNICAÇÕES DE SÃO PAULO S.A.—TELESP

By: /s/ Antonio Carlos Valente da Silva  
Name: Antonio Carlos Valente da Silva  
Title: Chief Executive Officer

By: /s/ Gilmar Roberto Pereira Camurra  
Name: Gilmar Roberto Pereira  
Camurra  
Title: Chief Financial Officer and  
Investor Relations Officer

Date: March 1, 2011

---

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp

Consolidated Financial Statements

As of and for the years ended December 31, 2010 and 2009 and January 1, 2009

Contents

<u>Reports of Independent Registered Public Accounting Firm</u>	<u>F-2</u>
<u>Consolidated Balance sheets</u>	<u>F-5</u>
<u>Consolidated Statements of income</u>	<u>F-7</u>
<u>Consolidated Statement of comprehensive income</u>	<u>F-8</u>
<u>Consolidated Statements of changes in shareholders' equity</u>	<u>F-9</u>
<u>Consolidated Statements of cash flows</u>	<u>F-10</u>
<u>Notes to the consolidated financial statements</u>	<u>F-12</u>

F-1

---

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Telecomunicações de São Paulo S.A. – TELESP

We have audited the accompanying consolidated balance sheets of Telecomunicações de São Paulo S.A.- TELESP and subsidiaries as of December 31, 2010 and 2009 and January 1, 2009, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years ended December 31, 2010 and 2009. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telecomunicações de São Paulo S.A. – TELESP and subsidiaries at December 31, 2010 and 2009 and January 1, 2009, and the consolidated results of their operations and their cash flows for each of the years then ended, in conformity with International Financial Reporting Standards as issued by the International Accounting Standards Board.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Telecomunicações de São Paulo S.A. - TELESP's internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 7, 2011 expressed an unqualified opinion thereon.

São Paulo, February 7, 2011

ERNST & YOUNG TERCO  
Auditores Independentes S.S.

/s/ Alexandre Hoepfers

Alexandre Hoepfers

Partner

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Shareholders of Telecomunicações de São Paulo S.A. – TELESP

We have audited Telecomunicações de São Paulo S.A. – TELESP’s internal control over financial reporting as of December 31, 2010, based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Telecomunicações de São Paulo S.A. - TELESP’s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management’s annual report on internal control over financial reporting. Our responsibility is to express an opinion on the company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Telecomunicações de São Paulo S.A. - TELESP maintained, in all material respects, effective internal control over financial reporting as of December 31, 2010, based on the COSO criteria.

Table of Contents

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Telecomunicações de São Paulo S.A. – TELESP and subsidiaries as of December 31, 2010 and 2009 and January 1, 2009, and the related consolidated statements of income, comprehensive income, shareholders' equity, and cash flows for the years ended December 31, 2010 and 2009 and our report dated February 7, 2011 expressed an unqualified opinion thereon.

São Paulo, February 7, 2011

ERNST & YOUNG TERCO  
Auditores Independentes S.S.

/s/ Alexandre Hoepfers  
Alexandre Hoepfers  
Partner

F-4

---

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp  
 Consolidated Balance sheets  
 As of December 31, 2010 and 2009 and January 1, 2009  
 (In thousands of reais)

	Note	As of December 31, 2010	2009	As of January 1, 2009
Assets				
Current assets		5,147,449	6,482,880	5,878,467
Cash and cash equivalents	5 and 31	1,556,715	2,277,016	1,741,006
Trade accounts receivable, net	6	2,546,225	2,988,798	3,152,831
Inventories	7	77,499	148,436	164,410
Recoverable taxes	8.1	659,357	712,663	448,217
Derivatives	31	166	575	95,747
Other	9	307,487	355,392	276,256
Noncurrent assets		14,818,845	14,159,868	14,445,198
Trade accounts receivable, net	6	67,343	66,225	61,563
Recoverable taxes	8.1	326,677	143,913	136,228
Deferred taxes	8.2	503,679	564,064	854,214
Escrow deposits	10	1,710,683	1,335,340	1,142,528
Other	9	178,455	244,422	156,312
Investments	11	100,837	340,299	301,830
Property, plant and equipment, net	12	10,200,697	9,672,137	9,868,933
Intangible assets, net	13	1,730,474	1,793,468	1,923,590
Total assets		19,966,294	20,642,748	20,323,665

The accompanying notes are an integral part of these Consolidated Financial Statements.



Table of Contents

	Note	As of December 31, 2010	2009	As of January 1, 2009
Liabilities and shareholders' equity				
Current liabilities		5,719,846	6,372,350	5,529,710
Payroll and related accruals	14	307,245	142,185	174,672
Trade accounts payable		2,780,672	2,362,422	2,314,698
Taxes payable	15	972,123	933,298	938,260
Loans and financing	16	420,412	256,753	502,503
Debentures	17	-	1,510,806	16,339
Dividends and interest payable to shareholders	18	450,897	495,543	758,561
Provisions	19	240,213	183,308	128,488
Derivatives obligations	31	9,502	8,389	15,200
Other	20	538,782	479,646	680,989
Non-current liabilities		2,579,334	2,970,096	4,411,725
Taxes payable	15	38,707	22,284	7,250
Loans and financing	16	1,405,314	1,752,402	1,717,352
Debentures	17	-	-	1,500,000
Provisions	19	665,856	756,263	899,769
Post-retirement benefit plans liability	30	219,000	191,927	148,770
Derivatives obligations	31	18,542	23,282	22,148
Other	20	231,915	223,938	116,436
Shareholders' equity	21	11,667,114	11,300,302	10,382,230
Capital		6,575,480	6,575,480	6,575,480
Capital reserves		2,733,562	2,733,562	2,733,562
Legal reserve		659,556	659,556	659,556
Accumulated deficit		-	(8,759 )	(58,571 )
Other comprehensive income		4,417	88,817	77,094
Additional dividend proposed		1,694,099	1,251,646	395,109
Total liabilities and shareholders' equity		19,966,294	20,642,748	20,323,665

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp  
 Consolidated Statements of income  
 For the years ended December 31, 2010 and 2009  
 (In thousands of reais, except earnings per share data)

	Note	2010	2009
Net operating revenue	22	15,756,144	15,805,955
Cost of goods and services	23	(8,792,898 )	(9,091,750 )
Gross profit		6,963,246	6,714,205
Operating expenses		(3,416,519 )	(3,316,227 )
Selling	23	(2,550,741 )	(2,536,902 )
General and administrative	23	(1,087,043 )	(754,984 )
Equity in earnings of associates	11	2,889	18,788
Other operating income (expenses), net	24	218,376	(43,129 )
Operating income before financial expenses		3,546,727	3,397,978
Financial expense, net	25	(120,738 )	(188,792 )
Income before income tax and social contribution		3,425,989	3,209,186
Income tax and social contribution	26	(1,027,153 )	(1,005,097 )
Net income for the year		2,398,836	2,204,089
Attributed to:			
Participation of non-controlling shareholders		-	-
Equity holders of the parent company		2,398,836	2,204,089
Basic and diluted earnings per share - common		4,45	4,08
Basic and diluted Earnings per share - preferred		4,89	4,49

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp

Consolidated Statement of comprehensive income

For the years ended December 31, 2010 and 2009

(In thousands of reais – except earnings per share data)

	2010	2009
Net income for the year	2,398,836	2,204,089
Gains (Losses) on investments available for sale	(117,609 )	22,251
Taxes on (gains) losses on investments available for sale	39,987	(7,565 )
Unrealized actuarial gains (losses) and effect of the limitation of surplus plan assets	(60,585 )	25,526
Taxes on unrealized actuarial (gains) losses and effect of the limitation of surplus plan assets	18,522	(6,830 )
Cumulative translation adjustments	(6,778 )	(2,963 )
Net Gains (Losses) recognized in equity	(126,463 )	30,419
Comprehensive income for the year	2,272,373	2,234,508
Attributable to:		
Participation of non-controlling shareholders	-	-
Equity holders of the parent company	2,272,373	2,234,508
Basic and diluted comprehensive income per share - common	4,21	4,14
Basic and diluted comprehensive income per share - preferred	4,63	4,56

The accompanying notes are an integral part of these Consolidated Financial Statements.

F-8

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp

Consolidated Statements of changes in shareholders' equity

For the years ended December 31, 2010 and 2009

(In thousands of reais)

	Capital	Special goodwill reserve	Capital reserves	Treasure shares	Legal reserve	Retained earnings	Additional proposed dividend	Unrealized gains on securities net of tax	Cumulative translations adjustments	Total equity
Balances as of January 1, 2009	6.575.480	63.074	2,688,207	(17,719)	659.556	(58,571 )	395,109	76,232	862	10.300,000
Unclaimed dividends and interest on shareholders' equity, net of taxes						153,673				153,673
Net income for the year						2,204,089				2,204,089
Other comprehensive income						18,696		14,686	(2,963)	30,419
Appropriations:										
Dividends						(470,000 )	(395,109 )			(865,109)
Interest on shareholders' equity						(514,250 )				(514,250)
Withholding tax on interest on shareholders' equity						(90,750 )				(90,750)
Additional proposed dividend						(1,251,646)	1,251,646			-
Balances at December 31, 2009	6.575.480	63.074	2,688,207	(17,719)	659.556	(8,759 )	1,251,646	90,918	(2,101)	11,300,000
Unclaimed dividends and interest on shareholders' equity						134,440				134,440

equity, net of taxes										
Net income for the year						2,398,836				2,398,836
Other comprehensive income						(42,063 )		(77,622)	(6,778)	(126,463)
Appropriations:										
Dividends						(196,355 )	(1,251,646)			(1,448,001)
Interest on shareholders' equity						(503,200 )				(503,200)
Withholding tax on interest on shareholders' equity						(88,800 )				(88,800)
Additional proposed dividend						(1,694,099)	1,694,099			-
Balances at December 31, 2010	6,575,480	63.074	2,688,207	(17,719)	659,556	-	1,694,099	13,296	(8,879)	11,600,000
Number of shares outstanding at the balance sheet date – in thousands										505,841
Book values of shares										23.06

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Telecomunicações de São Paulo S.A. - Telesp  
 Consolidated Statements of cash flows  
 For the years ended December 31, 2010 and 2009  
 (In thousands of reais)

	2010	2009
Cash flows from operations		
Income before income tax and social contribution	3,425,989	3,209,186
Items that do not affect cash		
Expenses (revenues) not affecting cash	2,224,596	3,343,779
Depreciation and amortization	1,913,494	2,505,475
Monetary and exchange variations	(638 )	(49,847 )
(Gain) loss from equity in earnings of associates	(2,889 )	(18,788 )
(Gain) loss on permanent asset disposals	(317,486 )	14,374
Provision for doubtful accounts	386,340	564,580
Pension and other post-retirement benefits plans	4,504	6,433
Interest expense	240,367	317,008
Others	904	4,544
(Increase) decrease in operating assets	(282,502 )	(840,295 )
Trade accounts receivable, net	87,501	(395,235 )
Other current assets	9,776	(188,857 )
Other noncurrent assets	(379,779 )	(256,203 )
Increase (decrease) in operating liabilities:	(835,825 )	(1,263,197)
Payroll and related accruals	166,994	(9,584 )
Accounts payable and accrued expenses	95,036	80,213
Taxes other than income taxes	38,215	(64,994 )
Other current liabilities	43,621	(272,808 )
Tax, civil and labor provisions	(33,502 )	8,204
Other noncurrent liabilities	1,301	88,717
Interest paid	(265,792 )	(328,370 )
Income and social contribution taxes paid	(881,698 )	(764,575 )

Table of Contents

Cash provided by operations	4,532,258	4,449,473
Cash flows generated from (used in) investing activities		
Capital increase in subsidiaries and associates	(3,557 )	-
Acquisition of fixed and intangible assets, net of grants	(2,126,465)	(2,324,141)
Cash from sales of fixed assets	292,858	28,240
Cash received from sales of investment	178,453	-
Cash used in investing activities	(1,658,711)	(2,295,901)
Cash flows generated from (used in) financing activities		
Loans paid	(1,742,818)	(432,924 )
New loans obtained	74,275	272,600
Net payment on derivatives contracts	(5,399 )	31,467
Dividends and interest on shareholders' equity paid	(1,919,906)	(1,488,705)
Cash used in financing activities	(3,593,848)	(1,617,562)
Increase (decrease) in cash and cash equivalents	(720,301 )	536,010
Cash and cash equivalents at beginning of year	2,277,016	1,741,006
Cash and cash equivalents at end of year	1,556,715	2,277,016
Changes in cash during the year	(720,301 )	536,010

The accompanying notes are an integral part of these Consolidated Financial Statements.

Table of Contents

Notes to the consolidated financial statements  
 For the years ended December 31, 2010 and 2009 and January 1, 2008  
 (in thousands of reais)

1. Operations and background

a) Controlling shareholders

Telecomunicações de São Paulo S.A.-Telesp (hereinafter “Telesp” or “Company”), is headquartered at Rua Martiniano de Carvalho, 851, in the capital of the State of São Paulo. Telesp belongs to the Telefónica Group, telecommunications industry leader in Spain which is also present in several European and Latin American countries. The Company is controlled by Telefónica S.A., which as of December 31, 2010, held total indirect interest of 87.95% of which 85.57% are common shares and 89.13% are preferred shares.

b) Operations

The Company’s basic business purpose is the rendering of fixed wire telephone services in the state of São Paulo under Fixed Switch Telephone Service Concession Agreement - STFC granted by the National Communications Agency (ANATEL), which is in charge of regulating the telecommunications sector in Brazil (Note 1.c). The Company has also authorizations from ANATEL, directly or through its subsidiaries, to provide other telecommunications services, such as data communication, to the business market and broadband internet services under the Speedy and Ajato brands, pay TV services (i) by satellite all over the country (Telefonica TV Digital) and (ii) using (MMDS) Multichannel Multipoint Distribution Service technology in the cities of São Paulo, Rio de Janeiro, Curitiba and Porto Alegre. On February 16, 2009, the authorizations for use of 2.5GHz frequency associated with pay TV service by MMDS technology was extended through year 2024 and await a position from ANATEL regarding the renewal and payment conditions.

The Company is registered with the Brazilian Securities Commission (CVM) as a publicly held company - category A (issuers authorized to negotiate any securities) and its shares are traded on the São Paulo Stock Exchange (BOVESPA). The Company is also registered with the US Securities and Exchange Commission (SEC) and its American Depository Shares (ADSs) - level II, listed only as preferred shares are traded on the New York Stock Exchange (NYSE).

c) The STFC concession agreement

The Company is a concessionaire of the fixed switch telephone service (STFC) to render local and domestic long-distance calls originating in Region 3, which comprises the State of São Paulo, in Sectors 31, 32 and 34, established in the General Concession Plan (PGO).

The current Concession Agreement, dated December 22, 2005, in place since January 1, 2006, subject to a fee concession, awarded as an onerous title, will be valid until December 31, 2025. However, the agreement can be reviewed on May 02, 2011, and December, 31 2015 and 2020. Such condition allows ANATEL to set up



Table of Contents

new requirements and goals for universalization and quality of telecommunication services, according to the conditions in place at that moment.

The Concession Agreement establishes that all assets owned by the Company and which are indispensable to the provision of the services described on such agreement are considered reversible assets and are deemed to be part of the concession assets. These assets will be automatically returned to ANATEL upon expiration of the concession agreement, according to the regulation in force at that moment. On December 31, 2010, the carrying value of reversible assets is estimated at R\$6,925,052 (R\$6,954,479 in 2009), comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

Every two years, during the agreement's new 20-year period, public regime companies will have to pay a renewal fee which will correspond to 2% of its prior-year SFTC revenue, net of taxes and social contributions. The next payment will be made in 2011, based on the 2010 STFC net revenues.

d) The telecommunications services subsidiaries and associated companies

A. Telecom S.A.

A. Telecom S.A. is a closely held, wholly owned subsidiary of the Company. It is engaged primarily in providing the telecommunication and data services and customer internal telephony network maintenance. The principal services are as follows:

- (i) Digital Condominium: integrated solution equipment and services for voice transmission, data and images on commercial buildings until December 31, 2009. From that date on these services started being provided by Telesp, as per the restructuring mentioned in note 2.a);
- (ii) Installation, maintenance, exchange and extension of new points of internal telephony wire in companies and houses;
- (iii) iTelefônica, provider of free internet access;
- (iv) Speedy Wi-Fi, broadband service for wireless internet access;
- (v) Speedy Corp, broadband provider developed specially for the corporate market;
- (vi) Integrated IT solution named "Posto Informático" allowing access to Internet, connection of private networks and rent of IT equipment. Since August 2010 the service of internet access has been provided by Telesp;
- (vii) Product At-home solutions, home automation that is among the consulting services and development of automation design and installation and configuration of the solution;

Table of Contents

(viii) Satellite TV services (Direct to Home – DTH) throughout the country and by optical fiber – IPTV (Internal Protocol Television). The DTH is a special type of subscription TV service, which uses satellites for direct distribution of TV and audio signals to subscribers.

Telefônica Sistema de Televisão S.A.

The corporate purpose of Telefônica Sistema de Televisão S.A. (“TST”) is to provide pay-TV services in the form of Multichannel Multipoint Distribution Service (MMDS), as well as telecommunication and internet-based services.

Telefônica Data S.A.

The corporate purpose of Telefônica Data S.A. is to provide and operate telecommunications services, as well as to prepare, implement and deploy projects involving integrated corporate solutions, telecommunication advisory services, technical assistance services, sale, lease and maintenance of telecommunication equipment and networks.

Aliança Atlântica Holding B.V:

A company formed under the laws of the Netherlands in Amsterdam, whose main asset is the ownership of 0.61% in Portugal Telecom, whose shares were sold in June 2010. Currently, the Company held a 50% interest in Aliança Atlântica and Telefônica S.A. held the remaining 50%. The Holding is in foreclosure and consequently the division of the existing assets that are valued at liquidation value is in process.

Companhia AIX de Participações

This company is engaged in both direct and indirect development of activities related to the construction, conclusion and operation of underground fiber optic networks. Currently, Telesp holds a 50% interest in this company.

Companhia ACT de Participações

Companhia ACT is engaged in providing technical assistance for the preparation of network conclusion project by providing studies to make it more profitable, as well as to inspect the activities in progress related to the project. Currently, Telesp holds a 50% interest in this company.

2. Corporate events in 2009 and 2010

a) Corporate restructuring involving A.Telecom S.A.

By resolution of the General Shareholders’ Meeting held on December 30, 2009, A.Telecom was split off, and its split-off portion was later merged into the Company. This transaction comprised the transfer of fixed assets items and rights related to part

Table of Contents

of the A. Telecom customer portfolio. The net assets merged into Telesp amounted to R\$99,293.

b) Merger of TS Tecnologia da Informação Ltda.:

On May 22, 2009, the subsidiary TS Tecnologia da Informação Ltda. was merged into its parent company Telefônica Data S.A., for its book value, according to a valuation report. This company ceased to exist after the merger.

c) Other events

The management of Vivo Participações S.A. (“Vivo Part.”) and Telecomunicações de São Paulo S.A. – Telesp (“Telesp”) (collectively referred to as “Companies”) managements, under and for the purpose of CVM Rules No. 319/99 and No. 358/02, state that on December 27, 2010, their corresponding Boards of Directors approved a corporate restructuring proposal regarding the merger of Vivo Part. shares with Telesp, so as to unify the Companies’ share base (“Corporate Restructuring”) as relevant fact published in the newspaper “Valor Econômico” on December 28, 2010 and on December 29, 2010 in the “Diário Oficial” of the state of São Paulo.

The Corporate Restructuring aims to simplify the corporate structure of both Companies, both publicly held and listed on BM&FBOVESPA (São Paulo stock exchange) and with American Depositary Receipts (“ADRs”) traded in the United States of America, which provides to their corresponding shareholders interest in only one company with shares traded on Brazilian and international stock exchanges, providing higher liquidity. In addition, Corporate Restructuring will rationalize the Company’s cost structure and will help in integrating businesses and generating synergies arising there, with positive impacts on the Companies. The Companies’ managements will follow the recommendations contained in CVM Guidance Report No. 35/08, with a view to contributing to protect their corresponding interests and overseeing that the operation observes switching conditions. Accordingly, special independent committees (Special Committees) were organized in Vivo Part. and in Telesp, so as to negotiate the exchange ratio of shares and express themselves on other Corporate Restructuring conditions which may be proposed, and later submit their recommendation to the Companies’ Board of Directors.

Furthermore, financial advisors and specialized companies will be engaged to conduct supplementary studies related to the operation and to prepare Companies’ assessment reports, which will be considered a parameter to set up the exchange ratio of shares and capital increase arising from share merger and also for the purpose of article 264 of Law No. 6404/76.

The Restructuring will be subject to approval of shareholders at the Extraordinary General Meetings, specially required for this purpose, ensuring the right to withdraw the dissenting shareholders, as provided by law.

Table of Contents

3. Basis of presentation of the financial statements

The accompanying consolidated financial statements as of December 31, 2010 and 2009 were prepared in accordance with accounting practices adopted in Brazil, which comprise the provisions of corporate legislation set forth in Law No. 6404/76, as amended by Law no. 11,638/07 and by Law no. 11,941/09, and the standards established by the Brazilian Securities Commission (CVM) and pronouncements, interpretations and guidelines issued by the Brazilian Accounting Pronouncements Board (CPC) as of December, 31 2010.

Under CVM Rule No. 457/2007, publicly traded companies must present consolidated financial statements for the fiscal year 2010, as well as comparative information for fiscal year 2009, in accordance with fiscal year technical pronouncements issued by the International Accounting Standards Board – IASB, based on the pronouncements issued by the CPC and approved by the Brazilian Securities and Exchange Commission (CVM), which are aligned with International Financial Reporting Standards.

The Company states that the consolidated financial statements are in full compliance with International Financial Report Standards (IFRS), as issued by the IASB and also in accordance with pronouncements, interpretations and guidelines issued by the CPC in place on December 31, 2010 (CPCs).

The effects from first time adoption of are shown in Note 3.1. The Company did not adopt early any new pronouncement issued by IASB with mandatory effective date after December 31, 2010 (Note 4.1).

Approval of the financial statements conclusion occurred in the executive committee meeting held on January 31, 2011.

3.1 First-time adoption of IFRS

The preparation of consolidated financial statements under IFRS requires certain modifications to the presentation and assessment that were being applied until December 31, 2009, as some IFRS principles and requirements differ substantially from the accounting practices adopted until then in Brazil (BR GAAP).

Adjustment of the consolidated information to IFRS has been carried out by applying IFRS 1 – First Time Adoption of International Financial Reporting Standards which deal with first time adoption of IFRS. The Company prepared the opening balance sheet using January 1, 2009 as the transition date.

As required by IFRS 1, for the preparation of financial statements for all periods presented, the Company applied the rules in place on December 31, 2010, except for the exceptions provided for in that rule.

Table of Contents

OPENING BALANCE SHEET AS OF	PUBLISHED			NOTE	IFRS BALANCE
	BRGAAR	RECLASSIFICATIONS	ADJUSTMENTS		
01/01/2009	BALANCE	(NOTE 3.1.2 f)	IFRS	3.1.2	SHEET Opening Balance
Current assets	6,459,832	(584,300 )	2,935		5,878,467
Cash and cash equivalents	1,741,006	-	-		1,741,006
Trade accounts receivable, net	3,152,831	-	-		3,152,831
Recoverable taxes	1,032,517	(584,300 )	-		448,217
Inventories	164,410	-	-		164,410
Derivatives	95,747	-	-		95,747
Other	273,321	-	2,935	c	276,256
Noncurrent assets	13,532,177	884,963	28,058		14,445,198
Trade accounts receivable, net	61,563	-	-		61,563
Deferred and recoverable taxes	845,240	116,199	29,003	e	990,442
Escrow deposits	711,300	431,228	-		1,142,528
Other	156,312	-	-		156,312
Investments	301,830	-	-		301,830
Property, plant and equipment, net	9,868,933	-	-		9,868,933
Intangible assets, net	1,586,999	337,536	(945 )		1,923,590
Total assets	19,992,009	300,663	30,993		20,323,665
Current liabilities	5,846,874	11,823	(328,987 )		5,529,710
Loans and financing	502,503	-	-		502,503
Debentures	16,339	-	-		16,339
Trade accounts payable	2,314,698	-	-		2,314,698
Taxes payable	926,437	11,823	-		938,260
Dividends and interest payable to shareholders	1,153,670	-	(395,109 )	d	758,561
Payroll and related accruals	174,672	-	-		174,672
Provisions	128,488	-	-		128,488
Derivatives obligations	15,200	-	-		15,200
Other	614,867	-	66,122	b	680,989
Non-current liabilities	4,099,443	288,840	23,442		4,411,725
Loans and financing	1,717,352	-	-		1,717,352
Debentures	1,500,000	-	-		1,500,000
Taxes payable	47,401	67,585	-		114,986
Provisions	570,778	221,255	-		792,033
Post-retirement benefit plans liability	148,770	-	-		148,770
Derivatives obligations	22,148	-	-		22,148
Other	92,994	-	23,442	b	116,436
Shareholders' equity	10,045,692	-	336,538		10,382,230
Capital	6,575,480	-	-		6,575,480
Special goodwill reserve	63,074	-	-		63,074
Capital reserve	2,670,488	-	-		2,670,488
Legal reserve	659,556	-	-		659,556
Accumulated deficit	-	-	(58,571 )		(58,571 )

Edgar Filing: TELESP HOLDING CO - Form 20-F

Additional proposed dividend	-	-	395,109	d	395,109
Other comprehensive income	77,094	-	-		77,094
Total liabilities and shareholders' equity	19,992,009	300,663	30,993		20,323,665

F-17

---

Table of Contents

3.1.1 Exemptions and exceptions applied for first-time adoption of IFRS in the opening balance sheet

IFRS 1 provides for certain elective exemptions for retroactive adoption of IFRS in the opening balance sheet. In this regard, the option selected by the Company on the transition date are as follows:

IFRS 3 – Business combinations

The Company has elected to apply IFRS 3(R), Business Combinations, prospectively from the transition date. Therefore, business combinations occurring prior to January 1, 2009 were not restated. As such, the goodwill balance in Intangible Assets reflects the net balance presented in accordance with accounting practices adopted in Brazil at December 31, 2008 and has not been adjusted for any impairment.

IAS 16 – Fair value or revaluation of property, plant and equipment as deemed cost

The Company has elected not to restate its fixed and intangible assets at their fair value. This is justified by: (i) the periodic renewal of its investments in plant, following the technological evolution; (ii) the cost method, less provision for losses is the best method to measure fixed assets and intangible assets of the Company; (iii) the fact that the Company has a segregation of assets in well-defined classes and related to its operating activities; (iv) the Company has effective controls over fixed and intangible assets that enable prompt identification of losses and the need for changes in estimated useful life of assets. Consequently, fixed and intangible assets were held by the same acquisition cost in accordance with accounting practices adopted in Brazil on December 31, 2008.

Exemptions to retrospective application according to IFRS 1 are not applicable to the Company.

The reconciliation of (i) consolidated shareholders' equity as of January 1, and December 31, 2009, (ii) net income and (iii) comprehensive income for the year ended December 31, 2009, as well as a brief description of the major differences between accounting practices adopted in Brazil until December 31, 2009 and IFRS are presented below:

Table of Contents

Reconciliation of consolidated shareholders' equity as of January 1, 2009 and December 31, 2009:

	Note	Opening	
	3.1.2	1/1/2009	12/31/2009
Shareholders' equity according to BRGAAP		10,045,692	10,057,415
Revenue recognition—Revenue from activation fees	b	(89,564 )	(79,383 )
Deferred taxes	e	30,451	26,990
Employee benefits (pension plan)	c	2,936	65,186
Deferred taxes	e	(954 )	(20,112 )
Additional proposed dividends	d	395,109	1,251,646
Other		(1,440 )	(1,440 )
Total IFRS adjustments		336,538	1,242,887
Shareholders' equity attributes to the parent company		10,382,230	11,300,302
Minority interest		-	-
Shareholders' equity according to IFRS		10,382,230	11,300,302

Reconciliation of consolidated net income for the year ended December 31, 2009:

	Note	12/31/2009
	3.1.2	
Net income according to BRGAAP		2,172,973
Revenue recognition—Revenue from activation fees	b	10,180
Deferred taxes	e	(3,461 )
Employee benefits (pension plan)	c	36,724
Deferred taxes	e	(12,327 )
Total IFRS adjustments		31,116
Net income according to IFRS		2,204,089

Reconciliation of comprehensive income for the year ended December 31, 2009:

	Note 3.1.2	12/31/2009
Net income according to BRGAAP		2,172,973
Unrealized gains (losses) on available for sale securities		22,251
Deferred taxes		(7,565 )
Cumulated translation adjustment		(2,963 )
Unrealized actuarial gains and effect of the limitation of surplus plan assets	c	25,526
Deferred taxes	e	(6,830 )
Total adjustments		30,419
IFRS adjustments in net income		31,116
Consolidates Comprehensive Income according to IFRS		2,234,508



Table of Contents

3.1.2 Major differences that impacted the consolidated financial statements on the transition date and on December 31, 2009

a) Business combinations

In connection with transactions that involve business combinations until December 31, 2008, the Company elected not to apply IFRS 3(R) – Business Combinations requirements retrospectively, maintaining the same accounting treatment applied on the previous GAAP until December 31, 2008 which effects are presented in the consolidated balance sheet as intangible assets. No operations involving business combinations were conducted in 2009 and 2010.

b) Revenue recognition

According to IAS 18 Revenue, which addresses revenue recognition, revenues from services rendered must be recognized according to the period in which the service is rendered. According to BRGAAP, revenue from activation fees was recognized upon connection of the client to the network. For IFRS purposes, revenue from non-substantive activation is deferred and recognized in income throughout the average estimated customer relationship period. This difference in revenue recognition accounting policies resulted in the recognition of a liability (deferred revenue) in the opening balance sheet at January 1, 2009 to reflect the portion of revenue from activation fees that will be recognized in future periods.

c) Post-employment benefits

The Company maintained BRGAAP accounting policy whereby actuarial gains and losses are immediately recognized. Under BRGAAP, actuarial gains or losses were immediately recognized in P&L, whereas for IFRS purposes (IAS19 – Employee Benefits), such gains and losses are allowed to be recognized in Shareholders' equity (Other Comprehensive Income).

Concerning to overfunded pension plans, according to BRGAAP, employee benefits assets may only be recorded if there is evidence that the surplus will be reimbursed to the sponsor. For this reason, according to plan's characteristics, such surplus was not recognized. As per IFRS, assets from overfunded defined benefit pension plans are recognized by the amount of surplus or by the probable amount that will reduce the Company's future contributions to such plans discounted to present value, whichever is shorter.

d) Additional proposed dividends

According to the Interpretation IFRIC 17 – Distribution of Non-cash assets to owners – a dividend payable shall be recognized as liability upon effective approval by the board of directors. Under previous GAAP, profit for the year not yet approved by the

Table of Contents

board of directors should be recognized as liability. According to IFRS, dividends proposed above the minimum required by the Article of Incorporation that has not been approved by the Ordinary General Shareholders' Meeting shall be maintained in shareholders' equity, under a specific account (additional dividends proposed).

e) Income taxes

Deferred income and social contribution taxes were accrued on the previously mentioned adjustments, as applicable.

f) Reclassifications

There are other accounting standards adopted for IFRS purposes which differ from their equivalents adopted in Brazil which do not affect shareholders' equity but only presentation of balance sheet. The adjustments carried out refer to the following:

- Reclassifications of escrow deposits related to liabilities (provisions) – For BRGAAP purposes, liabilities and provision balances were presented net of the corresponding escrow deposits. For IFRS purposes, such offset is not permitted, therefore, the escrow deposits must remain in assets;
- Reclassifications of deferred income and social contribution taxes – BRGAAP required the segregation of deferred tax item in the balance sheet into current and non-current. For IFRS purposes, deferred income and social contribution tax assets and liabilities must be recorded as non-current.

4. Summary of principal accounting practices

- a) Trade accounts receivable, net: are stated at the rendered service value according to the contracted conditions adjusted by the estimated amount of eventual losses. This caption also includes accounts receivable from services rendered but not yet billed at the balance sheet date. Allowance for doubtful account is recorded in order to cover eventual losses and mainly considers expected losses.
- b) Inventories: are stated at average acquisition cost, net of allowance for reduction to net realizable value. This corresponds to items for use, maintenance or resale, and the latter includes basically equipment for finance lease operations (see note 4.f.)
- c) Investments: equity interests in associates, jointly controlled, affiliated companies and investments in affiliates over which it exercises significant influence are stated by the equity method in the individual financial statements. In the consolidated financial statements, investments in subsidiaries are fully consolidated and investments in jointly controlled subsidiaries are consolidated proportionally. The date for equity method and consolidation purposes is December 31 of each year. The list of subsidiaries for 2010 and 2009 is as follows:

Table of Contents

The list of subsidiaries for 2010 and 2009 is as follows:

Subsidiaries	2010		2009	
A.Telecom S.A.	100	%	100	%
Telefonica Data S.A.	100	%	100	%
Telefonica Sistemas de Televisão S.A.	100	%	100	%
Aliança Atlântica Holding B.V.	50	%	50	%
Companhia AIX de Participações	50	%	50	%
Companhia ACT de Participações	50	%	50	%

In consolidation, all assets, liabilities, revenues and expenses resulting from intercompany transactions and equity holdings between the company and its subsidiaries have been eliminated.

In consolidation, all assets, liabilities, revenues and expenses resulting from intercompany transactions and equity holdings between the Company and its subsidiaries have been eliminated.

The exchange rate variation on the shareholders' equity of the jointly controlled Aliança Atlântica are recognized in the shareholders' equity as cumulated translation adjustment .

d)Property, plant and equipment: this item is measured at acquisition and/or construction cost, less accumulated depreciation and any impairment losses, if applicable. Asset costs are capitalized until the asset becomes operational.

Costs incurred after the asset becomes operational are immediately expensed, under the accrual method of accounting. Expenses that represent asset improvement (expanded installed capacity or useful life) are capitalized.

Depreciation is calculated under the straight-line method based on the estimated useful lives of the assets, which is based on technical studies that are regularly reviewed (see Note 12 – Property, plant and equipment);

e)Intangible assets (including goodwill): these are stated at acquisition and/or construction cost, less accumulated amortization and any impairment losses, if applicable.

Intangible assets with finite lives are amortized on the straight-line basis over their estimated useful lives. Intangible assets with indefinite useful lives are not amortized but tested for impairment annually or when there is an indication that their carrying amount may not be recovered.

The Company's goodwill which arose from the acquisition of investments occurred until December 31, 2008, are based on future profits and are treated as intangible assets with indefinite useful lives. In order to validate the absence of impairment, the Company assess the recoverable value of the cash generating unit to which goodwill refers.

Table of Contents

f) Leases: agreements providing for use of specific assets are subject to analysis so as to identify the accounting treatment applicable to lease arrangements. Agreements in which the lessor substantially transfers the underlying risks and benefits to the lessee are classified as finance lease.

The Company has agreements classified as finance lease from both lessor's and lessee's standpoint. As a lessor, subsidiary A.Telecom has equipment lease agreements (Posto Informático), for which it recognizes revenue on the installation date at the present value of the agreement installments, matched against Accounts Receivable. As a lessee in agreements classified as finance lease, the Company records a fixed asset item, classified according to its nature, at the beginning of the lease term, at the present value of the agreement minimum mandatory installments matched against Other Liabilities. The difference between the nominal value of the installments and the accounts receivable/payable recorded is recognized as financial income/expense under the effective interest rate method based on the contract term.

Agreements in which lessor retains a substantial part of risks and benefits are deemed as operating lease, and their effects are recognized in P&L for the year throughout the contractual term.

g) Asset recoverability analysis: Management reviews at least annually the net book value of assets (including, property, plant and equipment, goodwill and intangible assets, among others) in order to evaluate events or changes in economic, technological or operating circumstances, which may indicate asset impairment or loss in its carrying amount. When such evidence is identified, the realizable amount is estimated as the higher of fair value less selling costs and value in use. To determine the value in use, future cash flows generated through the use of the asset or its cash-generating unit, as appropriate, are estimated and discounted to present value using a discount rate before tax that reflects the current market conditions for the time value of money and risks associated with the specific asset. When the net book value exceeds the realizable value, a provision for impairment is set up adjusting the net book value to realizable value.

h) Financial Instruments, cash and cash equivalents:

Initial recognition and subsequent measurement

(i) Cash and cash equivalent

Includes cash, credit balances in bank accounts and investments redeemable within 90 days of the date of acquisition with immediate liquidity.

(ii) Financial Assets

Initial recognition and measurement

Financial assets are classified as financial assets at fair value through profit or loss, loans and receivables, investments held to maturity, available for sale financial assets or as derivatives, designated as hedging instruments in an effective hedge as appropriate. The Company determines the classification of its financial

## Table of Contents

assets upon their initial recognition, when they become part of the contractual provisions of the instrument. Financial assets are initially recognized at fair value plus, in the case of investments not classified as at fair value through profit or loss, transaction costs that are directly attributable to the acquisition of the financial asset. Sales and purchases of financial assets that require delivery of goods within a time frame established by regulation or market convention (regular way trades) are recognized on the transaction date, i.e. the date that the Company commits to buy or sell the asset. The Company's financial assets include cash and cash equivalents, trade accounts receivable and other receivables, quoted and unquoted financial instruments and derivative financial instruments.

### Subsequent measurement

Subsequent measurement of financial assets depends on their classification as follows:

#### Financial assets at fair value through profit or loss

This category includes derivative financial instruments entered into the Company that do not meet the hedge accounting criteria as defined by the corresponding standard. Financial assets at fair value through profit or loss are presented in the balance sheet at fair value, with corresponding gains or losses recognized in the income statement. The Company has not designated any financial asset upon initial recognition at fair value through profit or loss.

#### Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. After initial measurement, such assets are carried at amortized cost using the effective interest rate method, less impairment, if and when applicable. Amortized cost is calculated by taking into account any discount or premium in the acquisition and fees or other costs incurred. Amortization under the effective interest method is included in financial income in the income statement. The losses arising from impairment are recognized as financial expense in the income statement, if and when applicable.

#### Available for sale financial assets

Available for sale financial assets are those non-derivative financial assets that are not classified as (a) loans and receivables, (b) held to maturity investments or (c) financial assets at fair value through profit or loss. These financial assets include equity instruments.

After initial measurement, available for sale financial assets are measured at fair value with unrealized gains or losses recognized directly in the available for sale reserve within the group of other comprehensive income until the investment is derecognized, expected cases of impairment losses. When the investment is derecognized or when impairment is detected, the cumulative gains or losses previously recognized in other comprehensive income should be recognized in the statement of income.

The fair value of available for sale financial assets in foreign currency is measured and converted into foreign currency using the spot exchange rate prevailing at the date of the financial statements. The changes in fair value attributable to translation differences are recognized directly in equity.

## Table of Contents

### Derecognition

A financial asset (or, where appropriate, a part of a financial asset or part of a group of similar financial assets) is derecognized when:

- The rights to receive cash flows from the asset have expired;
- The Company transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the cash flows received in full, without significant delay to a third party under a pass-through agreement, and (a) the Company has transferred substantially all risks and rewards of the asset, or (b) the Company has neither transferred nor retained substantially all risks and rewards related to the asset, but has transferred control of the asset.

When the Company has transferred its rights to receive cash flows from an asset or has entered into pass-through agreement and has neither transferred nor retained substantially all risks and rewards related to the asset, the asset is recognized to the extent of the Company's continuing involvement in the asset.

In this case, the Company also recognizes an associated liability. The transferred asset and associated liability are measured on a basis that reflects the rights and obligations that the Company has retained.

Continuing involvement that takes the form of a guarantee over the transferred asset is measured at original book value of the asset or the maximum amount of consideration that may be required of the Company, whichever is lower.

### (iii) Impairment of financial assets

The Company assesses at each reporting date whether there is any objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is considered to be impaired if and only if, there is objective evidence of impairment as a result of one or more events that have happened after the initial recognition of the asset (an incurred "loss event") and loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reasonably estimated.

### Financial assets carried at amortized cost

In relation to the financial assets carried at amortized cost, the Company firstly assesses individually if there is objective evidence for impairment for each financial asset that is individually significant, or collectively for financial assets that are not individually significant. If the Company concludes that there is no evidence of impairment for an individually assessed financial asset, whether significant or not, the asset is included in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a joint assessment for impairment.

When there is objective evidence of the occurrence of impairment, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future expected credit losses not yet incurred).

The carrying amount of the asset is reduced through the use of allowance account, and the impairment amount is recognized in the income statement. Interest income continues to be accrued on the reduced carrying amount based on the original effective interest rate for the asset. The loans, together with the associated allowance are written off when there is no realistic prospect of their future recovery and all guarantees have been realized or transferred to the Company. If in a subsequent year

Table of Contents

the estimated impairment amount increases or decreases due to an event occurring after the recognition of impairment, previously recognized impairment is increased or reduced by adjusting the allowance account. In the event of any future recovery of a written off amount, the recovery is recognized in the income statement.

Available for sale financial investments

For financial instruments classified as available for sale, the Company analyzes whether there is any objective evidence that the investment is recoverable at each balance sheet date. For investments in equity instruments classified as available for sale, objective evidence includes a significant and prolonged decline in fair value of investments below their cost. When there is evidence of impairment, the cumulative loss, measured as the difference between the acquisition cost and current fair value, less any impairment loss that has been previously recognized in income, is reclassified from shareholders' equity to the income statement. Increases in fair value after the recognition of impairment are recognized directly in comprehensive income.

(iv) Financial liabilities

Initial recognition and measurement

Financial liabilities are classified as financial liabilities at fair value through profit or loss, loans and financing or as derivatives classified as hedge instruments, as appropriate. The Company determines the classification of its financial liabilities upon their initial recognition. Financial liabilities are initially recognized at fair value and, in the case of loans and financing, are increased by the cost directly related to the transaction. The Company's financial liabilities include accounts payable to suppliers, loans and financing and derivative financial instruments.

Subsequent measurement

Measurement of financial liabilities depends on their classification, which may be as follows:

Financial liabilities at fair value through profit or loss

Financial liabilities at fair value through profit or loss includes financial liabilities designated at initial recognition at fair value through profit or loss. This category also includes derivative financial instruments entered into by the Company that do not meet the criteria for hedge accounting as defined by the corresponding standard. The Company has not designated any financial liability upon initial recognition at fair value through profit or loss.

Loans and financing

After initial recognition, loans and financing subject to interest are subsequently measured at amortized cost, using the effective interest rate method. Gains and losses are recognized in the income statement when the liabilities are derecognized as well as during the amortization process using the effective interest rate method.

Derecognition

A financial liability is derecognized when the obligation is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender with substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as a derecognition

Table of Contents

of the original liability and the recognition of a new liability, and the difference in corresponding carrying amounts is recognized in the income statement.

(v) Offsetting of Financial instruments

Financial assets and liabilities are presented net in the balance sheet if, and only if, there is a currently enforceable legal right to offset the recognized amounts and if there is an intention of offsetting or realizing the asset and settling the liability simultaneously.

(vi) Fair value of financial instruments

The fair value of financial instruments actively traded in organized financial markets is determined based on quoted-market prices at the close of business on the balance sheet date, without deduction of transaction costs. The fair value of financial instruments for which there is no active market is determined using valuation techniques. Techniques may include using recent market transactions (on an arm's length basis) or reference to the current fair value of other similar instrument, such as discounted cash flow analysis or other valuation models.

i) Derivative financial instruments and hedge accounting

Initial recognition and subsequent measurement

The Company uses derivative financial instruments such as currency swaps to provide protection against the risk of changes in exchange rates. Derivative financial instruments designated as hedge transactions are initially recognized at fair value on the date on which the derivative contract is signed, and subsequently are remeasured at fair value. Derivatives are carried as financial assets when the instrument's fair value is positive and as financial liabilities when the fair value is negative. Any gains or losses arising from changes in the fair value of derivatives during the year are recorded directly in income. For the purposes of hedge accounting, the Company's contracts were classified as fair value hedges to provide protection against exposure to changes in the fair value of an identified part of certain liabilities that are attributable to a particular risk (exchange variation) and can affect net income. At the inception of a hedge relationship, the Company formally designates and documents the hedge relationship to which the Company wishes to apply hedge accounting, as well as the objective and risk management strategy for undertaking the hedge. The documentation includes identification of the hedge instrument, the item or transaction being hedged, the nature of the risk being hedged, the nature of the risks excluded from the hedge, the prospective statement of the effectiveness of the hedge relationship and the way in which the Company will assess the effectiveness of the hedge instrument for the purpose of offsetting the exposure to changes in fair value of the hedged item. Such hedges are expected to be highly effective in offsetting changes in fair value and are being continually assessed to determine whether they were actually highly effective over all the financial reporting periods for which they were designated.

Fair value hedges which meet the criteria for their accounting are recorded as follows:

The gain or loss resulting from changes in fair value of a hedge instrument shall be recognized in income. The gain or loss resulting from the hedged item attributable to the hedged risk should adjust the recorded amount of the hedged item to be recognized in income. The changes in fair value of the hedge instrument and changes



Table of Contents

in fair value of the hedged item attributable to the hedged risk are recognized in the line of the income statement related to the hedged item.

Current versus non-current classification

Derivative instruments that are not designated and effective hedging instruments are classified as current or noncurrent or segregated into current or noncurrent portions based on an evaluation of the contracted cash flows.

- When the Company maintains a derivative as an economic hedge (and does not apply hedge accounting) for a period exceeding 12 months after the balance sheet date, the derivative is classified as non-current (or segregated into current or non-current portions), consistently with the classification of the corresponding item.
- Derivative instruments that are designated as, and are effective hedging instruments are classified consistently with the classification of the corresponding hedged item. The derivative instrument is segregated into current or non-current portions only when a reliable allocation can be made.

j) Provisions: These are recognized for those cases in which at the balance sheet date it is probable that an outflow of resources will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

Provisions are presented by the gross amount, without considering the respective escrow deposits and are classified as labor, civil and tax. Escrow deposits are classified as assets, since conditions required to present them net of provisions are not met.

k) Post-retirement benefit plans: Company sponsors pension plans for individual employees and retirees as well as multi-sponsored health care plans for former employees. Actuarial liabilities relating to defined-benefit plans were calculated using the projected unit credit method. Actuarial gains and losses are immediately recognized in Other Comprehensive Income.

For plans with defined contribution features, the obligation is limited to the payment of contributions, which are recognized in income on the accrual basis.

The defined benefit asset or liability to be recognized in the financial statements comprises the present value of the defined benefit obligation, less cost of past services not yet recognized and less the fair value of plan assets that will be used to settle the obligations. Plan assets are assets held by a closed pension fund. Plan assets are not available to creditors of the Company nor can they be paid directly to the Company. The fair value is based on market price information about and in the case of quoted securities, it is the published purchase price. The value of any defined benefit asset recognized is limited to the sum of any past service cost not yet recognized and the present value of any economic benefit available in the form of reductions in future contributions to the plan.

l) Other assets and liabilities: an asset is recognized in the balance sheet when it is more likely than not that its future economic benefits will be generated on behalf of the Company and its subsidiaries and its cost or value can be reliably measured.

Table of Contents

A Liability is recognized in the balance sheet when the Company and its subsidiaries have a legal or constructive obligation arising from past events.

Assets and liabilities are classified as current when their realization or settlement is likely to occur within the next twelve months. Otherwise, they are considered as noncurrent.

m) Revenue recognition: revenues related to Telecommunications services rendered are recorded on the accrual basis based on the contractual terms. Revenue unbilled from the date of the last billing until the date of the balance sheet is recognized in the month the service is rendered.

The Company's revenues consist primarily of voice and data telecommunication services and additional services that are offered to customers through traffic packages with fixed price (monthly) or according to customers' traffic consumption.

Revenue from the sales of cards for public telephones is deferred and recognized in income as the cards are utilized based on consumption estimates.

Income from equipment under lease agreements classified as finance leases is recognized upon equipment installation, when the risk is actually transferred. Income is recognized for the present value of future minimum lease payments.

Revenues from sales and services are subject to the following taxes and contribution taxes: State VAT - ICMS, Social Contribution Taxes on Gross Revenue for Social Integration Program - PIS, Social Security Financing - COFINS and Service Tax- ISS.

n) Foreign-currency-denominated balances and transactions: the Company's functional currency is the Brazilian real (R\$). Foreign currency transactions are recorded at the prevailing exchange rate at date of the transaction. Foreign currency denominated assets and liabilities are translated using the exchange rate at the balance sheet date. Exchange differences resulting from foreign currency transactions were recognized in financial income and financial expenses.

o) Income tax and social contribution: income tax and social contribution expenses includes the effects of current and deferred taxes.

The carrying amount of current income tax assets and liabilities for the current period and prior periods represents the amount expected to be recovered from or paid to tax authorities. The tax rates and tax legislation used to calculate the amounts are those enacted at the balance sheet date. In the balance sheet the current income taxes are stated net of the amounts paid during the year.

Deferred tax assets are obtained using the liability method on temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes.

## Table of Contents

At balance sheet date, deferred tax assets are recognized to the extent that their future realization is assessed as more likely than not based on the future taxable income.

The deferred tax assets and liabilities are classified in the balance sheet as noncurrent, regardless of the expected realization. The tax effects of items recorded directly in shareholders' equity are recognized in equity.

- p) Concession agreement's renewal fee: it is a fee which will be paid each odd year during the term of the concession agreement is in force, equivalent to 2% of its prior-year SFTC net revenue, according to the contract. The corresponding expense is recognized proportionally over each biennium concerned (Note 23).
- q) Accounting estimates: The preparation of the consolidated financial statements requires management to make judgments and estimates and adopt assumptions that affect the reported amounts of revenue, expenses, assets and liabilities and the disclosure of contingent liabilities at balance sheet date. However, uncertainty relating to these assumptions and estimates could result in outcomes that would require significant adjustment to the carrying value of the asset or liability affected in future periods.

The main assumptions concerning the future and other important sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a significant adjustment in the carrying value of assets and liabilities within the next financial year are discussed below

### Impairment of non-financial assets

An impairment exists when the carrying value of an asset or cash-generating unit exceeds its recoverable value, which is the higher of its fair value less selling costs and its value in use. The calculation of fair value less selling costs is based on information available from bidding sales transactions of similar assets or observable market prices less additional costs for disposing of the asset. The calculation of value in use is based on the discounted cash flow method. Cash flows are derived from the budget for the next ten years and do not include restructuring activities that the Company is not yet committed to or significant future investments that will improve the assets performance of the cash-generating unit being tested. The recoverable value is sensitive to the discount rate used in the discounted cash flow method, as well as the expected future cash inflows and the growth rate used for extrapolation purposes.

### Taxes

There are uncertainties regarding the interpretation of complex tax regulations and the amount and timing of future taxable income. The Company records provisions, based on reasonable estimates, for possible consequences of audits by tax authorities of the jurisdictions in which it operates. The amount of these provisions is based on several factors, such as experience of previous tax audits and differing interpretations of tax regulations by the taxable entity and the tax authority in charge. Such differences of interpretation may arise in a wide variety of subjects, depending on the conditions prevailing in the jurisdiction in which the Company operates.

## Table of Contents

### Post-employment benefits

The cost of defined benefits pension plans and other post-employment health care benefits and the present value of pension obligations are determined using actuarial valuation methods. An actuarial valuation involves the use of assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future increases in pension benefits. The defined benefit obligation is highly sensitive to changes in these assumptions. All assumptions are reviewed at each balance sheet date.

The mortality rate is based on mortality tables available in Brazil. Future increases in wages and pension benefits are based on expected future inflation rates for Brazil.

For more details on the assumptions used, see Note 30.

### Fair value of financial instruments

When the fair value of financial assets and liabilities presented in the balance sheet cannot be obtained in active markets, it is determined using valuation techniques including the discounted cash flow method. The input for these methods is taken from observable markets when possible. However, when this is not possible, a certain level of judgment is required in establishing fair values. This judgment includes consideration of data used, e.g., liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the fair value of financial instruments.

### Provisions for tax, civil and labor risks

The Company recognizes a provision for civil, labor and tax claims. The assessment of probability of loss includes evaluation of available evidence, the hierarchy of laws, available case law, most recent court decisions and their relevance in the legal system, as well as the evaluation of outside counsel. Provisions are reviewed and adjusted to take into account changes in circumstances, such as applicable statutes of limitation, conclusions of tax audits or additional exposures identified based on new issues or judicial rulings.

r) Statements of cash flows The statements of cash flows were prepared using the indirect method and reflect changes in cash over the stated years. The terms used in the statements of cash flows are as follows:

- Operating activities: refer to the main transactions performed by the Company and its subsidiaries and activities other than investment and financing;
- Investing activities: refer to additions and dispositions of noncurrent assets and other investments not included in cash and cash equivalents;
  - Financing activities: refer to activities resulting in changes in equity and loans.

Table of Contents

## 4.1 New Pronouncements and Interpretations Issued by IASB

As of the date of issuance of these consolidated financial statements, the following pronouncements and interpretations issued by the IASB were published, but were not mandatory for fiscal year 2010:

		Mandatory application: for fiscal years started from
New Standards		
IFRS 9	Financial Instruments	January 1, 2013
IAS 24 Revised	Related Party: Disclosures	January 1, 2011
Amendments to Existing Standards		
Amendment to IAS 32 Financial Instruments: Presentation	Classification of rights issues	February 1, 2010
Amendments to IFRS 7 Financial Instruments: Disclosure	Transfer of Financial Assets	January 1, 2013
New Interpretations		
IFRIC 19	Extinguishment of financial Liabilities with equity instruments	July 1, 2010
Amendment to IFRIC 14	Prepayments of a minimum of funding requirement	January 1, 2011

The Company is analyzing the impacts resulting from the application of these standards, amendments and interpretations. Based on preliminary analysis, the Company does not expect any significant impact on the consolidated financial statements as a consequence of the initial adoption of such new accounting pronouncements and interpretations.

Table of Contents

## 5. Cash and cash equivalents

	2010	2009	01/01/2009
Bank accounts	8,930	10,120	31,993
Short-term investments	1,547,785	2,266,896	1,709,013
Total	1,556,715	2,277,016	1,741,006

Short-term investments are basically CDB (Bank Deposits Certificate), indexed under CDI (Inter bank Deposits Certificate) rate variation, which are readily liquid and maintained with reputable financial institutions.

## 6. Trade accounts receivable, net

	2010	2009	01/01/2009
Billed amounts	2,042,760	2,622,613	2,608,012
Accrued unbilled amounts	1,336,441	1,266,049	1,374,080
Gross accounts receivable	3,379,201	3,888,662	3,982,092
Allowance for doubtful accounts	(765,633 )	(833,639 )	(767,698 )
Total	2,613,568	3,055,023	3,214,394
Current	2,147,380	2,245,950	2,248,736
Past-due – 1 to 30 days	403,738	597,410	530,238
Past-due – 31 to 60 days	101,943	130,331	195,213
Past-due – 61 to 90 days	49,404	66,949	113,101
Past-due – 91 to 120 days	44,018	56,299	110,720
Past-due – more than 120 days	721,492	849,229	784,084
Total	3,467,975	3,946,168	3,982,092
Current	2,546,225	2,988,798	3,152,831
Non-current	67,343	66,225	61,563

Table of Contents

## Changes in Allowance for doubtful accounts

	2010	2009
Opening balance	(833,639 )	(767,698 )
Provision charged to selling expenses (Note 23)	(386,340 )	(564,580 )
Write-offs	454,346	498,639
Ending balance	(765,633 )	(833,639 )

Subsidiary A.Telecom offers “Posto Informático”, a product that consists in the lease of IT equipment to small- and medium-sized companies for fixed installments received over the agreed term. Considering the related contractual conditions, the Company classified this product as “Finance Lease” in its December 31, 2010 and 2009 consolidated financial statements (Note 4.f).

The consolidated accounts receivable as of December 31, 2010 and 2009 reflects the following effects:

	2010	2009	01/01/2009
Present value of minimum payments receivable	112,352	125,234	139,214
Unrealized financial income	23,213	21,231	20,154
Gross investment in finance lease receivables at year-end	135,565	146,465	159,368
Allowance for doubtful accounts	(18,102 )	(22,576 )	(26,159 )
Financial Leases receivable, net	117,463	123,889	133,209
Current	45,009	59,009	77,651
Noncurrent	67,343	66,225	61,563

Aging list of financial leases receivable:

Year	Gross investment	Present value
Falling due within one year	45,009	45,009
Falling due within five years	90,556	67,343
Total	135,565	112,352

There are neither unsecured residual values that produce benefits to the lessor nor contingent payments recognized as revenues during the year.

Table of Contents

## 7. Inventories

	2010	2009	01/01/2009
Consumption materials	74,682	118,030	129,600
Resale items (*)	92,461	97,524	106,734
Other inventories	10,052	8,810	13,622
Allowance for reduction to net recoverable value and obsolescence	(99,696 )	(75,928 )	(85,546 )
<b>Total current</b>	<b>77,499</b>	<b>148,436</b>	<b>164,410</b>

(\*) Includes the inventory of IT equipments.

The allowance for reduction to recoverable value and obsolescence takes into account timely analyses carried out by the Company.

## 8. Deferred and Recoverable taxes

## 8.1 Recoverable taxes

	2010	2009	01/01/2009
Withholding taxes	91,185	92,019	77,370
Recoverable income tax and social contribution	27,088	35,021	36,755
ICMS (state VAT) (*)	534,323	476,523	357,897
ICMS (state VAT)-Convênio 39/Portaria CAT 06	313,177	222,042	98,295
Other	20,261	30,971	14,128
<b>Total</b>	<b>986,034</b>	<b>856,576</b>	<b>584,445</b>
<b>Current</b>	<b>659,357</b>	<b>712,663</b>	<b>448,217</b>
<b>Noncurrent</b>	<b>326,677</b>	<b>143,913</b>	<b>136,228</b>

(\*) Refers to credits on the acquisition of property, plant and equipment items, available for offset against VAT obligations in 48 months.

## 8.2 Deferred taxes

The Company recognized deferred income and social contribution tax assets considering the existence of taxable income in the last five fiscal years and the expected generation of future taxable income based on a technical feasibility study, approved by the Board of Directors on December 14, 2010.



Table of Contents

	2010	2009	01/01/2009
Deferred Assets			
Tax loss carry-forwards – Income tax and social contribution	2,325	1,716	5,091
Provisions (tax, labor and civil)	302,607	315,977	340,850
Post-retirement benefit plans	74,460	65,255	50,581
Allowance for doubtful accounts	100,194	95,057	94,691
Fust	73,251	58,069	42,370
Allowance for obsolescence of modems	46,318	46,224	57,600
Employee Profit sharing	38,730	15,997	24,325
Allowance for reduction of inventory to recoverable value	31,593	23,880	28,909
Merged tax credits – DABR (*)	34,691	47,305	59,920
Other non deductible provisions	129,798	123,489	155,557
Income tax and social contribution on other temporary differences	180,045	135,737	125,841
	1,014,012	928,706	985,735
Deferred liabilities			
Innovation Law	238,957	192,377	73,224
Exchange rate variation	25,811	25,702	-
Merged tax credits (*)	136,015	59,673	-
Income tax and social contribution on other temporary differences	109,550	86,890	58,297
	510,333	364,642	131,521
Total noncurrent	503,679	564,064	854,214

(\*) Relate to tax benefits arising from corporate reorganizations represented by goodwill amounts based on future expected profitability to be used in compliance with the limits established by tax legislation.

Company estimates the realization of the deferred taxes as of December 31, 2010 as follows

Year	
2011	461,681
2012	150,314
2013	170,649
2014	77,271
2015	69,785
Thereafter	84,312
Total	1,014,012

The recoverable amounts above are based on projections subject to changes in the future.

Tax losses and temporary differences in the respective amounts of R\$ 123,597 and R\$83,777 (R\$106,166 and R\$109,670 as of December 31, 2009), respectively, were not recognized as deferred tax assets by the subsidiaries as

of December 31, 2010 in view of the unlikely generation of future taxable profits.

F-36

---

Table of Contents

## Changes in deferred income and social contribution tax assets

	12/31/2009	Additions	Write-offs	12/31/2010
Tax losses	1,716	609	-	2,325
Other deferred assets	926,990	111,175	(26,478)	1,011,687
<b>Total</b>	<b>928,706</b>	<b>111,784</b>	<b>(26,478)</b>	<b>1,014,012</b>

	01/01/2009	Additions	Write-offs	12/31/2009
Tax losses	5,091	-	(3,375 )	1,716
Other deferred assets	980,644	15,039	(68,693)	926,990
<b>Total</b>	<b>985,735</b>	<b>15,039</b>	<b>(72,068)</b>	<b>928,706</b>

## Changes in deferred income and social contribution tax liabilities

	12/31/2009	Additions	Write-offs	Other comprehensive income	12/31/2010
<b>D e f e r r e d</b> Liabilities	364,642	207,869	(3,669 )	(58,509 )	510,333
<b>Total</b>	<b>364,642</b>	<b>207,869</b>	<b>(3,669 )</b>	<b>(58,509 )</b>	<b>510,333</b>

	01/01/2009	Additions	Write-offs	Other comprehensive income	12/31/2009
<b>D e f e r r e d</b> Liabilities	131,521	222,096	(3,370 )	14,395	364,642
<b>Total</b>	<b>131,521</b>	<b>222,096</b>	<b>(3,370 )</b>	<b>14,395</b>	<b>364,642</b>

Table of Contents

## 9. Other assets

	2010	2009	01/01/2009
Advances	53,704	46,466	41,774
Prepaid expenses	41,372	45,420	34,758
Related parties receivables (note 28)	95,452	120,257	130,426
Pension plan surplus (note 4.k)	-	-	2,936
Other assets	116,959	143,249	66,362
<b>Current</b>	<b>307,487</b>	<b>355,392</b>	<b>276,256</b>
Prepaid expenses	24,647	35,639	31,941
Receivables from Barramar S.A. (a)	56,700	61,151	62,526
Amounts linked to National Treasury securities	12,884	12,005	11,289
Pension assets surplus (note 4.k)	27,171	65,186	-
Related parties receivables (Note 28)	16,943	23,541	22,864
Other assets	40,110	46,900	27,692
<b>Noncurrent</b>	<b>178,455</b>	<b>244,422</b>	<b>156,312</b>

a) Refers to receivables from Barramar S.A., registered in Companhia AIX de Participações, net of allowance for losses.

## 10. Escrow deposits

	Nature				Total
	Labor claims	Tax litigation	Civil litigation	Freeze of assets by court order	
Balance as of January 1, 2009	298,859	523,975	274,770	44,924	1,142,528
Additions	77,026	39,423	55,285	79,850	251,584
Write-offs / reversal	(9,140 )	(112,570 )	(9,588 )	-	(131,298 )
Monetary restatement	13,213	30,712	28,601	-	72,526
Transfers	56,195	124	28,233	(84,552 )	-
<b>Noncurrent as of December 31, 2009</b>	<b>436,153</b>	<b>481,664</b>	<b>377,301</b>	<b>40,222</b>	<b>1,335,340</b>
Additions	104,480	33,840	117,414	75,441	331,175
Write-offs / reversal	(11,980 )	-	(17,839 )	-	(29,819 )
Monetary restatement	14,355	30,920	28,712	-	73,987
Transfers	12,314	(37 )	23,299	(35,576 )	-
<b>Noncurrent as of December 31, 2010</b>	<b>555,322</b>	<b>546,387</b>	<b>528,887</b>	<b>80,087</b>	<b>1,710,683</b>

See note 19. Provisions for further details of the matters that gave rise to these deposits.



Table of Contents

## 11. Investments

	2009	Result of Equity method	Future capital contribution	Received dividends	Other comprehensive income	Write-off (residual value)	2010
Associates	55,101	2,889	3,557	(3,557 )	-	-	57,990
GTR Participações e Empreendimentos S.A.	2,121	(66 )	60	(60 )	-	-	2,055
Lemontree Participações S.A.	14,292	2,755	1,029	(1,029 )	-	-	17,047
Comercial Cabo TV São Paulo S.A.	31,844	548	2,336	(2,336 )	-	-	32,392
TVA Sul Paraná S.A.	6,844	(348 )	132	(132 )	-	-	6,496
Other investments (*)	285,198	-	-	-	(124,353 )	(117,998 )	42,847
Portugal Telecom	227,702	-	-	-	(109,704 )	(117,998 )	-
Zon Multimédia	17,654	-	-	-	(5,429 )	-	12,225
Other investments	39,842	-	-	-	(9,220 )	-	30,622
<b>Total consolidated investment</b>	<b>340,299</b>	<b>2,889</b>	<b>3,557</b>	<b>(3,557 )</b>	<b>(124,353 )</b>	<b>(117,998 )</b>	<b>100,837</b>

(\*) Other investments are measured at fair value.

	1/1/2009	Result of Equity method	Future capital contribution	Received dividends	Other comprehensive income	Merge	2009
Associates	36,313	18,788	-	-	-	-	55,101
GTR Participações e Empreendimentos S.A.	1,476	645	-	-	-	-	2,121
Lemontree Participações S.A.	9,608	4,684	-	-	-	-	14,292
Comercial Cabo TV São Paulo S.A.	21,215	10,629	-	-	-	-	31,844
TVA Sul Paraná S.A.	4,014	2,830	-	-	-	-	6,844
Other investments (*)	265,517	-	-	-	19,681	-	223,668
Portugal Telecom	210,431	-	-	-	17,271	-	227,702
Zon Multimédia	19,531	-	-	-	(1,877 )	-	17,654
Other investments	35,555	-	-	-	4,287	-	39,842
<b>Total consolidated investment</b>	<b>301,830</b>	<b>18,788</b>	<b>-</b>	<b>-</b>	<b>19,681</b>	<b>-</b>	<b>340,299</b>

(\*) Other investments are measured at fair value.

F-39

---

Table of Contents

The Company sold the consolidated interest held in Portugal Telecom on June 21, 2010, which generated the following effects:

Sale amount	205,149
Acquisition cost	(117,998)
Net gain from the sale	87,151

Jointly controlled companies consolidated on a proportional basis

The Group has ownership interest of 50% in Aliança Atlântica Holding B.V., Companhia AIX de Participações e Companhia ACT de Participações, which are consolidated on a proportional basis. The nature of each company is detailed in Note (1.d).

The aggregate amounts of assets, liabilities, revenues and expenses related to Telesp's interest in entities consolidated proportionally at December 31, 2010 and 2009, and January 1, 2009 included in the consolidated financial statements are set out below:

	2010			2009			01/01/2009		
	Cia ACT	Cia AIX	Aliança Atlântica	Cia ACT	Cia AIX	Aliança Atlântica	Cia ACT	Cia AIX	Aliança Atlântica
Current Assets	7	4,820	57,456	4	7,115	5,377	16	7,462	6,470
Noncurrent Assets	-	72,146	3,189	-	77,091	61,531	-	82,742	57,703
Current liabilities	1	5,727	397	-	6,336	447	-	2,228	30
Noncurrent liabilities	-	2,339	-	-	11,862	-	-	29,080	-
Shareholders' Equity	6	68,900	60,248	4	66,008	66,461	16	58,896	64,143
Revenue	27	31,254	13,200	26	31,520	3,994	30	30,871	5,283
Expenses	(24 )	(21,985)	(99 )	(23 )	(13,583)	(185 )	(27 )	(28,032)	(98 )
Net income for the year	3	9,269	13,101	3	17,937	3,809	3	2,839	5,185

The main information of associated companies accounted for by the equity method are:

Affiliates	Total assets	Total liabilities	Shareholders' equity	Net income (loss)	Ownership interest	Voting shares
G T R P a r t i c i p a ç õ e s e						
Empreendimentos S.A	3,342	154	3,188	(66 )	66.67 %	0.0 %
Lemontree Participações S.A.	25,837	269	25,568	2,755	66.67 %	0.0 %
Comercial Cabo TV São Paulo S.A.	163,586	109,554	54,032	548	59.95 %	19.9 %



Edgar Filing: TELESP HOLDING CO - Form 20-F

TVA Sul Paraná S.A.	42,126	33,407	8,719	(348 )	74.50 %	49.0 %
---------------------	--------	--------	-------	--------	---------	--------

F-40

---

Table of Contents

## 12. Property, plant and equipment, net

	Annual depreciation rate %	Net book value as of 12/31/2009	Additions	Disposals	Transfers	Depreciation	Net book value as of 12/31/2010
Switching equipment	10.00	1,038,595	115,444	91	295,996	(216,045 )	1,234,081
Transmission equipment	5.00 to 10.00	3,354,458	339,740	(4,188 )	391,947	(372,791 )	3,709,166
Terminal equipment and modems	10.00 to 66.67	1,183,554	575,672	(4,121 )	79,378	(560,446 )	1,274,037
Infrastructure	4.00 to 12.50	2,990,801	71,235	(40,405 )	96,139	(306,265 )	2,811,505
TV materials and equipment	8.00 to 20.00	327,898	17,066	(261 )	(82,586 )	(74,774 )	187,343
Other	10.00 to 20.00	225,996	64,325	(1,299 )	5,729	(76,282 )	218,469
Provision for losses (a)		(15,985 )	7	-	(25,395 )	-	(41,373 )
Property, plant and equipment in progress		566,820	1,013,334	(12,170 )	(760,515 )	-	807,469
<b>Total</b>		<b>9,672,137</b>	<b>2,196,823</b>	<b>(62,353 )</b>	<b>693</b>	<b>(1,606,603 )</b>	<b>10,200,697</b>
<b>Average annual depreciation rates %</b>		<b>10.85</b>					<b>8.01</b>

	Annual depreciation rate %	Net book value as of 01/01/2009	Additions	Disposals	Transfers	Depreciation	Net book value as of 12/31/2009
Switching equipment	12.50	1,027,604	36,385	-	313,200	(338,594 )	1,038,595
Transmission equipment	5.00 to 12.50	3,427,727	278,516	(7,472 )	545,531	(889,844 )	3,354,458
Terminal equipment and modems	10.00 to 66.67	1,087,823	619,115	3,955	(55,934 )	(471,405 )	1,183,554
Infrastructure	4.00 to 12.50	3,161,459	22,576	(11,081 )	100,980	(283,133 )	2,990,801
TV materials and equipment	8.00 to 20.00	359,373	51,598	(16,600 )	53,188	(119,661 )	327,898
Other	10.00 to 20.00	187,679	73,994	(634 )	45,050	(80,093 )	225,996
Provision for losses (a)		(11,807 )	(4,178 )	-	-	-	(15,985 )
Property, plant and equipment in progress		629,075	1,003,307	(6,427 )	(1,059,135 )	-	566,820

Total	9,868,933	2,081,313	(38,259 )	(57,120 )	(2,182,730 )	9,672,137
Average annual depreciation rates %		10.64				10.85

(a) The Company and its subsidiaries recognized a provision for possible obsolescence of materials used for assets maintenance based on historical and expected future use.

F-41

---

Table of Contents

Below is the breakdown of cost and accumulated depreciation as of December 31, 2010 and 2009:

2010	Cost	Accumulated depreciation	Net book value
Switching equipment	11,795,681	(10,561,600)	1,234,081
Transmission equipment	19,122,768	(15,413,602)	3,709,166
Terminal equipment and modems	4,777,349	(3,503,312)	1,274,037
Infrastructure	8,477,774	(5,666,269)	2,811,505
TV materials and equipment	614,921	(427,578)	187,343
Other	1,429,962	(1,211,493)	218,469
Provision for losses	(41,373)	-	(41,373)
Property, plant and equipment in progress	807,469	-	807,469
<b>Total</b>	<b>46,984,551</b>	<b>(36,783,854)</b>	<b>10,200,697</b>

2009	Cost	Accumulated depreciation	Net book value
Switching equipment	11,384,240	(10,345,645)	1,038,595
Transmission equipment	18,433,445	(15,078,987)	3,354,458
Terminal equipment and modems	4,046,748	(2,863,194)	1,183,554
Infrastructure	8,399,611	(5,408,810)	2,990,801
TV materials and equipment	801,479	(473,581)	327,898
Other	1,367,476	(1,141,480)	225,996
Provision for losses	(15,985)	-	(15,985)
Property, plant and equipment in progress	566,820	-	566,820
<b>Total</b>	<b>44,983,834</b>	<b>(35,311,697)</b>	<b>9,672,137</b>

The main acquisitions in 2010 were the following:

- Terminal Equipment/Modem: the main acquisitions were modems and terminal equipment for the general public.
- Transmission equipment: the main acquisitions were of aerial cables and plesiochronous transmission equipment.
- Switching equipment: mainly, digital switching equipment referred to IP networks package and;
- Other: acquisitions mainly of IT equipment.

Table of Contents

Review of property, plant and equipment useful lives.

During the 1st semester of 2010, the Company detected the need of adopting new useful lives for certain categories of assets. Because of this a change in accounting estimates, the effects will be recorded on a prospective basis as from 2010. This change represented both an extension and a reduction in useful lives in relation to those considered in 2009, causing a decrease in the depreciation expense of R\$399,599 for the period ended December 31, 2010.

## 13. Intangible assets, net

	2010	2009	01/01/2009
Goodwill	1,064,792	1,064,792	1,064,792
Other Intangibles assets	665,682	728,676	858,798
Total	1,730,474	1,793,468	1,923,590

Following is the opening of goodwill on these dates:

Goodwill	2010	2009	01/01/2009
Ajato Telecomunicações Ltda.	149	149	149
Goodwill Spanish and Figueira (merged from TDBH)(a)	212,058	212,058	212,058
Santo Genovese Participações Ltda. (b)	71,892	71,892	71,892
Telefônica Televisão Participações S.A. (c)	780,693	780,693	780,693
	1,064,792	1,064,792	1,064,792

- (a) Goodwill arising from the spin-off of Figueira, which was merged into the Company as a result of the merger of Telefônica Data Brasil Holding S.A. (TDBH) in 2006.
- (b) Goodwill arising from the acquisition of control over Santo Genovese Participações Ltda. (controlling shareholder of Atrium Telecomunicações Ltda.) in 2004.
- (c) Goodwill arising from the acquisition of TTP (formerly Navytreet), incorporated in 2008 which is and based on a future profitability analysis.

Table of Contents

	Annual depreciation rate %	Net book value as of 12/31/2009	Additions	Disposals	Transfers	Depreciation	Net book value as of 12/31/2010
Softwares	20.00	682,776	239,986	-	(159 )	(283,628 )	638,975
Customer Portfolio (Network IP)	10.00	21,768	-	-	-	(7,256 )	14,512
Others	10.00 to 20.00	24,132	4,604	-	(534 )	(16,007 )	12,195
<b>Total</b>		<b>728,676</b>	<b>244,590</b>		<b>(693 )</b>	<b>(306,891 )</b>	<b>665,682</b>
<b>Average annual depreciation rates %</b>		<b>19.78</b>					<b>19.89</b>

The acquisitions in software are mainly due to distributed software, mainly ATIS software.

	Annual depreciation rate %	Net book value as of 01/01/2009	Additions	Disposals	Transfers	Depreciation	Net book value as of 12/31/2009
Softwares	20.00	789,028	134,160	-	56,959	(297,370 )	682,777
Customer Portfolio (Network IP)	10.00	29,024	-	-	-	(7,256 )	21,768
Others	10.00 to 20.00	40,746	1,343	-	161	(18,119 )	24,131
<b>Total</b>		<b>858,798</b>	<b>135,503</b>	<b>-</b>	<b>57,120</b>	<b>(322,745 )</b>	<b>728,676</b>
<b>Average annual depreciation rates %</b>		<b>19.97</b>					<b>19.78</b>

2010	Cost	Accumulated depreciation	Net book value
Softwares	2,953,275	(2,314,300 )	638,975
Customer Portfolio (Network IP)	72,561	(58,049 )	14,512
Other	201,621	(189,426 )	12,195
<b>Total</b>	<b>3,227,457</b>	<b>(2,561,775 )</b>	<b>665,682</b>

2009	Cost	Accumulated depreciation	Net book value
Softwares	2,712,773	(2,029,997 )	682,776
Customer Portfolio (Network IP)	72,561	(50,793 )	21,768
Other	197,587	(173,455 )	24,132

Total	2,982,921	(2,254,245 )	728,676
-------	-----------	--------------	---------

F-44

---

Table of Contents

## 14. Payroll and related accruals

	2010	2009	01/01/2009
Salaries and fees	25,583	20,701	19,723
Payroll charges	101,021	80,714	84,728
Employee profit sharing	105,841	40,770	68,835
Other indemnities	74,800	-	1,386
Total	307,245	142,185	174,672

## 15. Taxes payable

	2010	2009	01/01/2009
Taxes on income			
Income tax and social contribution (a)	1,329	718	-
Indirect taxes	1,009,501	954,864	945,510
ICMS (state VAT)	635,358	638,649	683,445
PIS and COFINS (taxes on revenue)	120,430	109,083	102,023
FUST and FUNTTEL	237,791	191,047	145,529
Other	15,922	16,085	14,513
Total	1,010,830	955,582	945,510
Current	972,123	933,298	938,260
Non-current	38,707	22,284	7,250

(a) Income and social contribution taxes payable are presented net of payments on an estimate basis.



Table of Contents

## 16. Loans and financing

	Currency	Annual interest rate	Maturity	2010	(*) 2009	(*) 01/01/2009 (*)
Loans and financing BNDES	URTJLP	TJLP+3.73%	Until 2015	1,715,580	1,917,521	1,708,804
Loans and financing BNDES	URTJLP	TJLP+1.73%	Until 2015	92,842	68,628	-
Mediocrédito	US\$	1.75%	2014	17,304	23,006	35,425
Untied Loan – JBIC	JPY	Libor + 1.25%	2009	-	-	129,173
Resolution 2770	JPY	0.50% to 5.78%	2009	-	-	213,339
Resolution 2770	EUR	5.74%	2009	-	-	84,799
Resolution 2770	JPY	1.00%	2009	-	-	48,315
Total consolidated				1,825,726	2,009,155	2,219,855
Current				420,412	256,753	502,503
Noncurrent				1,405,314	1,752,402	1,717,352

(\*) Amounts presented at fair value, when applicable.

BNDES: In 2007 it was approved a credit facility to the Company to finance investments in services and products produced domestically. The totality of these resources have been drawn and their investments are proven and accepted by BNDES. The TJLP is a specific referential rate not comparable with other market-observable rates applicable to similar repayment terms. Accordingly, at December 31, 2010 this instrument was recognized in the balance sheet at its amortized cost, which is equivalent to its fair value as of that date.

MÉDIOCRÉDITO: loan agreed in 1993 between Telecomunicações Brasileiras SA – Telebrás and Instituto Centrale per il Credito a Médio Termine – Mediocredito Centrale in the amount of US\$ 45,546, in order to build a rural telephony via satellite network in the State of Mato Grosso. This loan is paid semiannually and matures in 2014. There is a derivative contracted to hedge the exchange rate risks related to such debt and, given it is assessed as an effective hedge, the hedge accounting methodology has been adopted. Therefore, at December 31, 2010, the hedge risk of this instrument was recognized at its fair value as of such date.

Consolidated long term maturities schedule:

Year	Amounts
2012	412.808
2013	412.544
2014	410.051
2015	169.911
Total	1.405.314

F-46

---

Table of Contents

17. Debentures						
	Currency	Annual interest rate	Maturity	2010	2009	01/01/2009
Debentures	R\$	CDI + 0.35%	2010	-	1,510,806	1,516,339
<b>Total</b>				-	1,510,806	1,516,339
Current				-	1,510,806	16,339
Noncurrent				-	-	1,500,000

The maturity date of these debentures was September 1, 2010, but on June 7, 2010 the Company made an early redemption of all outstanding debentures.

## 18. Dividends and interest on shareholders' equity payable

	2010	2009	01/01/2009
Interest on shareholders' equity	248,515	249,706	437,720
Telefónica Internacional S.A.	113,839	115,530	234,441
SP Telecomunicações Participações Ltda.	37,407	37,962	77,036
Minority shareholders	97,269	96,214	126,243
Dividends	202,382	245,837	320,841
Minority shareholders'	202,382	245,837	320,841
<b>Total</b>	450,897	495,543	758,561

Brazilian corporations are permitted to attribute interest on shareholder's equity similar to dividends declared, which is deductible for income tax purposes. The Company has elected to pay such interest to its shareholders with respect to the years ended December 31, 2010 and 2009 and January 1, 2009, and has accrued the amount due with a direct charge to shareholder's equity. The distribution to the shareholders is subject to withholding income tax at the rate of 15%.

Most of the interest on shareholders' equity and total dividends payable to minority shareholders refer to available amounts declared, but not claimed yet.

## 19. Provisions

The Company, as an entity and also as the successor to the merged companies, and its subsidiaries are involved in labor, tax and civil lawsuits filed with different courts. The Company's management, based on the opinion of its legal counsel, recognized provisions for those cases in which an unfavorable outcome is considered probable. The table below shows the breakdown of provisions by nature and activities during, 2010 and 2009:



Table of Contents

	2010			
	Labor	Nature Tax	Civil	Total
Balances as of December 31, 2009	404,106	91,655	443,810	939,571
Additions	15,772	165	60,799	76,736
Payments / reversal	(69,684 )	(276 )	(129,351 )	(199,311 )
Monetary restatement	16,197	1,975	70,901	89,073
Balances as of December 31, 2010	366,391	93,519	446,159	906,069
Current	38,642	-	201,571	240,213
Noncurrent	327,749	93,519	244,588	665,856
	2009			
	Labor	Nature Tax	Civil	Total
Balances as of January 1, 2009	497,132	275,692	255,433	1,028,257
Additions	49,725	2,678	175,592	227,995
Payments / reversal	(183,992 )	(190,507 )	(28,156 )	(402,655 )
Monetary restatement	41,241	3,792	40,941	85,974
Balances as of December 31, 2009	404,106	91,655	443,810	939,571
Current	27,543	-	155,765	183,308
Noncurrent	376,563	91,655	288,045	756,263

## 19.1. Labor contingencies and provisions

Risk	Amount involved		
	2010	2009	01/01/2009
Probable	366,391	404,106	497,132
Possible	155,107	32,399	66,608
Total	521,498	436,505	563,740

Provisions and labor contingencies refer to labor claims filed by former and employees of outsourced companies (the later alleging joint or subsidiary liability) claiming for, among other things, overtime, wage equivalence, post-retirement salary supplements; job hazard

Table of Contents

premium and additional payment for unhealthy work conditions; extended free health care to retired employees, and some outsourcing-related procedures.

In addition, the Company is party to a Public Civil Action instituted by the Labor Public Prosecution Office in respect of the decision to refrain Telesp from engaging an unrelated appointed company to carry out the Company's main activities. No amount has been assigned in the table above to the possible likelihood of an unfavorable outcome in connection with this action, since in the case of loss, estimating the corresponding amount payable by the Company is not practicable at this time. Likewise, establishing a provision for contingency equivalent to the amount sought is not possible.

## 19.2. Tax contingencies and provisions

Risk	Amount involved		
	2010	2009	01/01/2009
Probable	93,519	91,655	275,692
Possible	4,102,806	3,664,280	2,864,127
Total	4,196,325	3,755,935	3,139,819

At December 31, 2010, the Company has filed claims for purposes of obtaining recognition that payment of the following taxes is unconstitutional:

## a) CIDE

Social Contribution Tax for Intervention in the Economic Order (CIDE) required by the Federal Government on funds remitted to other countries, arising from technology transfer agreements, trademark and software licensing etc.

Adopting a conservative approach, the Company recorded the amount of R\$25,891 as of December 31, 2010 for this purpose.

## b) FGTS

Additional Contributions to the Brazilian Government Unemployment Compensation Fund (Fundo de Garantia por Tempo de Serviço - FGTS) required by the Brazilian Institute of Social Security (INSS) on the contributions made by employers (the discussion does not result in reducing part of FGTS contributions made by the Company on behalf of its employees). The amount involved totals R\$61,185. The claim is now at the highest court for a final decision. Based on the Company's legal advisors opinion, a provision was established and a judicial deposit was made for the total amount.

## c) Other provisions

There are also other contingencies provisioned related to Finsocial and PASEP credits offset declared unconstitutional and other municipal issues regarding municipal tax on services - ISS, municipal property tax - IPTU and various fees, in the amount involved of R\$ 6,443 million, where an unfavorable outcome is considered probable by management.

Table of Contents

Possible contingencies

Federal level

At December 31, 2010, the Company and its subsidiaries maintained several tax claims at the federal level, both administrative proceeding and lawsuits, which await decisions at a range of levels. The claims amount to R\$1,338,380 and are related to:

- (a) protest letters arising from non-approval of offset requests made by the Company;
- (b) debts reported but allegedly not paid;
- (c) fine for dividend distribution with allegedly unpaid federal debts;
- (d) social security contribution on compensation payment for salary devaluation arising from inflationary losses derived from “Plano Verão” (Summer Plan) and “Plano Bresser” (Bresser Plan), SAT (Work Accident Insurance), Social Security and payables to third parties (INCRA and SEBRAE);
- (e) income and social contribution taxes on bonuses;
- (f) Withholding Income Tax (IRRF) on remittances to other countries for technical services, administrative assistance and alike, as well as royalties;
- (g) sundry offsets;
- (h) Inspection and Working Rate;
- (i) additions to PIS/COFINS tax bases (Law No. 9718/98).

According to management and its legal advisors the chances for an unfavorable outcome for these proceedings is considered possible.

State level

At December 31, 2010, the Company and its subsidiaries maintained several ICMS-related administrative proceedings (arising from tax delinquency notices) and lawsuits at the state level, amounting to R\$1,989,332, which are pending judgment at several court levels. The referred proceedings and lawsuits are related to:

- (a) Provision of supplemental services and value added (Convention No. 69/98)
- (b) Rental of Speedy modem;
- (c) international long-distance calls (DDI);
- (d) debts reported but allegedly not paid;
- (e) amounts unduly credited in connection with fixed assets;
- (f) Lack of proportional reversal of credit related to acquisition of fixed asset items;
- (g) amounts unduly credited allocated for previously unused ICMS credits;
- (h) service provision outside São Paulo State and ICMS paid to São Paulo State, and
- (i) Co-billing.

According to management and its legal advisors the chances for an unfavorable outcome for these proceedings is considered possible.

Municipal level

At December 31, 2010, the Company and its subsidiaries maintained several tax administrative proceedings (arising from tax delinquency notices) and lawsuits at municipal level, which are pending judgment at several court levels, and amount to R\$280,446.

The referred proceedings and lawsuits relate to: (a) ISS; (b) IPTU; (c) Charge for Soil Use; (d) services rendered by third parties, and (e) several municipal charges.

According to management and its legal advisors the chances for an unfavorable outcome for these proceedings is considered possible.

Table of Contents

Based on the opinion of its tax advisors, management believes that the resolution of the aforementioned issues will not have a negative material effect on its financial position.

ANATEL

FUST (Contribution for the Fund for Universal Access to Telecommunication Services): security mandate petitioned to fixed telecommunications operators for the recognition of the right to exclude interconnection and EILD expenses from FUST taxable base, as provided for in Abridgement No. 7, of December 15, 2005, for disagreement with provisions contained in sole paragraph of article 6, Law No. 9998, of August 17, 2000. A partially favorable decision was obtained at first court level, and currently, a second-court-level decision is awaited. Total amount involved is R\$594,436. A portion of the amount, R\$75,768, refers to ITX and EILD differences arises from the adoption of the non-cumulative system for the retroactive period (2001 to 2005); the other part of R\$241,110 refers to ITX and EILD differences computed for the period between 2006 and the current date, whose amount was recorded under the taxes payable caption and has been monthly deposited in court. Other values involved are related to several notices for debt received from Anatel in the amount of R\$277,558 over the amounts under discussion in the Security Mandate, where chances of loss were assessed as possible.

FUNTTEL (Telecommunication Contribution for the Fund of Technological Development): In opposition to the legal provision, Anatel has issued several notices for debt against the Company and its subsidiaries to collect the FUNTTEL contribution on other revenues (other than telecommunications), as well as on expenses transferred to other operators (Interconnection and EILD) for the 2001-2005 period. The proceedings are awaiting first-level administrative decision and the total amount involved is R\$109,967.

FISTEL (Fund for Telecommunications Regulation): Upon extension of the effective term of licenses for using telephony switches related to the exploitation of STFC, Anatel charges the Installation Inspection Charge (TFI) related to the extension of licenses granted.

Such collection is a result of ANATEL's understanding that article 9, item III of Rule No. 255 would be applicable to this case, so that the period extension would be the triggering event of TFI. The Company is challenging this issue in court because understands that TFI payment for the license extension is undue. A favorable decision was obtained at first court level and currently, the second court level decision is awaited. The total amount involved is R\$31,355.

According to management and its legal advisors the chances for an unfavorable outcome for these proceedings is considered possible.



Table of Contents

Risk Consolidated	Civil contingencies and provisions		
	2010	2009	01/01/2009
Probable	446,159	443,810	255,433
Possible	808,006	539,968	623,605
Total	1,254,165	983,778	879,038

## Civil provisions

## Main claims

- a) On June 9, 2000, WCR do Brasil Serviços Ltda. proposed enforcement proceedings following ordinary procedural steps against the Company, claiming the collection of the alleged difference between the amounts calculated by Telesp regarding the use of the “0900 Service” and the amounts transferred to that company. In 2010, an unfavorable decision was awarded for the appeal filed with the highest court level and, therefore, the Company reached an agreement in November 2010 to close this issue. Proceeding archiving is awaited.
- b) Suits for additional shares. These refer to suits involving the Company and addressing the right to receive additional shares calculated with regard to network expansion plans after 1996. These suits are at various stages: first stage, Supreme Court and Federal Superior Court of Appeals. Considering the risk of a probable loss, provision was recorded in the amount of R\$ 21,889.
- c) The Company and its subsidiaries are defendants in several civil claims, at several levels, related to service rendering. Such claims have been filed by individual consumers, civil associations representing consumer rights or by the Bureau of Consumer Protection (PROCON), as well as by the Federal and State Public Ministry. They are also defendants in other claims of several types, related to the normal course of business. Total provision recorded for such issues amounts to R\$153,330.

## Massive Claims

## Consumption relationship

- d) The Company is also involved in several lawsuits filed by individual consumers, with similar characteristics, which individually are not considered to be material. A provision in the amount of R\$100,541 was recorded, based on statistical analysis of the average historical losses for such claims.

Table of Contents

Anatel

- e) At December 31, 2010, the Company was involved in several administrative proceedings against Anatel, which were filed based on alleged non-compliance with the obligations established in industry regulations, whose likelihood of an unfavorable outcome was assessed as probable and a provision was recorded in the amount of R\$170,399.

Possible contingencies

Main civil contingencies

- a) Community Telephone Plan PCT. Refers to a Public Civil Action to which the Company is party related to the PCT, a plan that claims the possible indemnity rights to purchasers of telephone line expansion plans who did not receive shares for their financial investment in the municipality of Mogi das Cruzes. The total amount involved is approximately R\$160,790. Legal counsel assessed chances of loss as possible. São Paulo Court of Justice (TSP) has amended the decision, judging the action as inadmissible.

The telephony association of Mogi das Cruzes (plaintiff) filed an special appeal to alter this judgment, which is currently awaiting a decision.

- b) Civil Class Action filed by ASTEL – SISTEL Members' Association in the State of São Paulo against the Company, SISTEL foundation, and others, seeking annulment of the PBS private pension plan spinoff in year 2000, which gave rise to a specific PBS-Telesp plan, and of the related allocations of technical surplus funds and tax contingency existing by the time of the spin off. The Company's legal counsel considers this proceeding as possible risk. Estimating the amount involved is impracticable and contingent upon expert analysis, since it concerns Sistel's spin-off portion related to telecom operators from the former Telebrás System.

- c) The Public Ministry has filed lawsuits claiming that the amounts charged on PIS and COFINS are unduly included in the fixed telephony service tariffs and requests that such unduly charged amounts should be returned double. There are seven collective lawsuits and several individual ones grounded on the same argument and request. Brazilian Supreme Court of Justice has decided for the lawfulness of PIS and COFINS transfer when judging the proceeding (considering the repetitive appeals law) against another telephony concessionaire, which was considered a leading case. No provisions have been set up for these lawsuits, whose likelihood of an unfavorable outcome has changed from possible to remote.

- d) The Public Prosecutor Office of the State of São Paulo commenced a class action claiming moral and property damages suffered by all consumers of telecommunications services from 2004 to 2009 due to the bad quality of services and failures of the communications system. The public Prosecutor Office suggested that the indemnification to be paid should be R\$1 billion. The decision handed down on April 20, 2010 imposes the payment of indemnification for damages caused to all consumers who have filed a suit for such. Conversely, in

Table of Contents

the event that the number of consumers claiming to the award is not in line with the gravity of their damages, after the lapsing of one year, the judge determined that the amount of R\$ 60 million be deposited in the Special Expenses Fund to Recover Natural Rights Damages (Fundo Especial de Despesa de Reparação de Interesses Difusos Lesados). It is not possible to estimate the number of consumers who will individually file suits nor the amounts claimed thereby. The Company filed an appeal on the merit of the case. The judgment effects are in abeyance. No amount has been assigned to the possible likelihood of an unfavorable outcome in connection with this action, since in the case of loss, estimating the corresponding amount payable by the Company is not practicable at this time. Likewise, establishing a provision for contingency equivalent to the amount sought is not possible.

e)The Company and its subsidiaries are involved other civil claims, at several levels, related to service rendering. Such claims have been filed by individual consumers, civil associations representing consumer rights or by the Bureau of Consumer Protection (PROCON), as well as by the Federal and State Public Ministry. They are also involved in other claims of several types, related to the normal course of business. Total contingency amounts to R\$309,803, whose likelihood of an unfavorable outcome has been assessed by their legal advisors as possible.

Anatel

f)At December 31, 2010, the Company was involved in administrative proceedings filed based on alleged non-compliance with the obligations established in industry regulations in the amount of R\$337,413, whose likelihood of an unfavorable outcome was assessed by their legal advisors as possible.

F-54

---

Table of Contents

20.	Other liabilities	2010	2009	01/01/2009
	Consignments on behalf of third parties	139,724	147,995	198,052
	Amounts to be refunded to subscribers	54,666	60,020	48,525
	Concession renewal fee (note 1.c)	102,568	-	102,863
	Deferred revenue (b)	103,339	113,925	126,112
	Accounts payable – sale of share fractions (a)	-	-	113,377
	Finance Lease (c)	11,507	10,729	-
	Liabilities to related parties (note 28)	120,981	118,228	49,857
	Other	5,997	28,749	42,203
	<b>Current</b>	<b>538,782</b>	<b>479,646</b>	<b>680,989</b>
	Accounts payable – sale of share fractions (a)	112,594	112,873	-
	Deferred revenue (b)	38,400	20,769	23,442
	Finance Lease (c)	23,346	31,190	-
	Liabilities to related parties (note 28)	10,738	15,542	31,216
	Other	46,837	43,564	61,778
	<b>Noncurrent</b>	<b>231,915</b>	<b>223,938</b>	<b>116,436</b>

(a) Amounts resulting from the auction of share fractions after the reverse spin-off process in 2005, and TDBH acquisition process in 2006.

(b) Refer mainly to deferral of revenue from activation fee (Note 3.1.2b) and calling cards.

(c) The Company has finance lease contracts for use of IT equipment.

	2010	2009
Future payments of the gross finance lease	42,194	53,580
Unrealized financial expense	(7,341 )	(11,661 )
Present value of minimum payments due	34,853	41,919
<b>Current</b>	<b>11,507</b>	<b>10,729</b>
<b>Noncurrent</b>	<b>23,346</b>	<b>31,190</b>

## Maturity Schedule:

Year	Gross investment	Present value
Maturing within one year	11,507	11,507
Maturing more than one year within five years	30,687	23,346
<b>Total</b>	<b>42,194</b>	<b>34,853</b>

There are neither unsecured residual values that produce benefits to the lessor nor contingent payments recognized as revenues during the year.

F-55

---

Table of Contents

## COMMITMENTS AND GUARANTEES

## Rentals

The Company rents equipment and facilities through several operating agreements maturing on different dates. The monthly rental payments are of an equal amount for the period of the contract. Total annual rent expenses amounted to R\$613,057 in 2010 (R\$522,858 in 2009).

Rental commitments mainly refer to facilities where future minimum payments under leases with remaining noncancellable terms in excess of one year, are as follows:

Year	Value
2011	22,300
2012	22,300
2013	18,418
2014	14,842
Total	77,860

## Guarantees

At December 31, 2010, the Company had properties given as guarantee in lawsuits amounting to R\$23,411 (R\$43,719 in 2009).

Table of Contents

## 21. Shareholders' equity

## a) Capital

Paid-in capital is R\$6,575,480 at December 31, 2010 and 2009. Subscribed and paid-in capital is represented by shares without par value, as follows:

	2010	2009	01/01/2009
Total Capital in shares			
Common shares	168,819,870	168,819,870	168,819,870
Preferred shares	337,417,402	337,417,402	337,417,402
Total	506,237,272	506,237,272	506,237,272
Treasury shares			
Common shares	(210,579 )	(210,579 )	(210,579 )
Preferred shares	(185,213 )	(185,213 )	(185,213 )
Total	(395,792 )	(395,792 )	(395,792 )
Outstanding shares			
Common shares	168,609,291	168,609,291	168,609,291
Preferred shares	337,232,189	337,232,189	337,232,189
Total	505,841,480	505,841,480	505,841,480
Book value per outstanding share in R\$	23.06	22.34	19.86

The Company is authorized to increase its capital up to the limit of 700,000,000 (seven hundred million) shares, common or preferred. The capital increase and consequent issue of new shares are to be approved by the Board of Directors, with observance of the authorized capital limit.

Capital increases do not necessarily have to observe the proportion between the numbers of shares of each type. However, the number of preferred shares, nonvoting or with restricted voting, must not exceed 2/3 of the total shares issued.

Preferred shares are nonvoting, but have priority in the reimbursement of capital and are entitled to dividends 10% higher than those paid on common shares, as per article 7 of the Company's bylaws and clause II, paragraph 1, article 17, of Law No. 6,404/76.

## b) Capital reserves

## Share premium

This reserve represents the amount exceeding book value of the shares arising from the issuance or capitalization on the date of issue.

## c) Treasury shares

These correspond to the Company's treasury shares which resulted from merger with TDBH that occurred in 2006, part of which refer to exercise of withdrawing rights and the remaining to the share auctions carried out by the

Company. The average cost of acquisition was R\$44.77. At December 31, 2010, the market value of treasury shares was R\$16,060.

F-57

---



Table of Contents

## d) Income reserves

## Legal reserve

According to article 193 of Law No. 6,404/76, the Company chose not to set up the legal reserve, as such balance added to the capital reserve balance exceeded capital by 30%.

## e) Special goodwill reserve

This represents the tax benefit generated by the merger of DABR which will be capitalized on an annual basis on behalf of the controlling shareholder as the tax credit becomes realized, according to CVM Instruction No. 319/99.

## f) Dividends

The Company's bylaws provide for mandatory distribution of minimum dividends to all shareholders corresponding to 25% of adjusted net income, as established by article 202, subparagraphs II and III of Law No. 6404/76 provided there are funds available for distribution.

Dividends are calculated in accordance with the Company's by-laws and with the Brazilian Corporation Law. The Company presents the calculation of dividends and interest on shareholders' equity for 2010 and 2009 as follows:

Minimum mandatory dividends calculated based on adjusted net income	2010	2009
Net income for the year	2,398,836	2,204,089
Minimum mandatory dividends – 25% of adjusted net income	599,709	551,022
Dividends and interest on shareholders' equity distributed:		
Interest on shareholders' equity (gross)	592,000	605,000
Interim dividends	196,355	470,000
Profit available for distribution	1,610,481	1,129,089
(+) Interest on shareholders' equity / Prescribed dividends	134,440	153,673
(-) Actuarial (gains)/losses recognized and effect of the limitation of the surplus plan assets, net of tax	42,063	(18,696 )
(-) IFRS effects on 2009 equity	8,759	(8,759 )
(-) First-time adoption of IFRS – opening balance 01/01/2009	-	58,571
Proposed dividends	1,694,099	1,251,646

Table of Contents

Amounts in R\$ per share (a)	2010		2009	
	Gross	Net	Gross	Net
Interest on shareholders' equity - common	1.097180	0.932603	1.121274	0.953083
Interest on shareholders' equity - preferred	1.206898	1.025863	1.233401	1.048391
Amounts in R\$ per share (a)			2010	
			Common	Preferred
Interim dividends declared in April 2010			2.319731	2.551704
Interim dividends declared in September 2010			0.363913	0.400305
Interest on shareholders' equity - net of withholding income tax			0.614384	0.675822
Interest on shareholders' equity - net of withholding income tax			0.318219	0.350041
			3.616247	3.977872
Amounts in R\$ per share (a)			2009	
			Common	Preferred
Interim dividends declared in March 2009			0.732276	0.805503
Interim dividends declared in May 2009			0.871072	0.958179
Interest on shareholders' equity - net of withholding income tax			0.630137	0.693151
Interest on shareholders' equity - net of withholding income tax			0.322945	0.355240
			2.556430	2.812073

(a) Do not include the amount of proposed dividends.

The balance of unallocated net income for the year at December 31, 2010, in the amount of R\$1,610,481, the dividends and interest on shareholders' equity prescribed in 2010 in the amount of R\$134,440 and other comprehensive income in the amount of R\$ (50,822), totaling R\$1,694,099, were classified as additional proposed dividends in shareholders' equity according to management's proposal distribution of net income for the year, to be submitted for approval of the Ordinary General Shareholders' Meeting.

Table of Contents

Management's proposed dividend payment to be approved:

Total proposed for approval	R\$1,694,099	
Amount per share	Common registered shares (ON)	Preferred registered shares (PN)
Total proposed for approval – amount per share	3.139752	3.453727

## g)Interest on shareholders' equity

As proposed by Management, in 2010 and 2009 interest on shareholders' equity was credited to shareholders in accordance with article 9 of Law No. 9,249/95, net of withholding tax, as follows:

	2010	2009
Gross interest on shareholders' equity	592,000	605,000
Common shares	184,995	189,057
Preferred shares	407,005	415,943
Withholding income tax	(88,800 )	(90,750 )
Interest on shareholders' equity, net of withholding tax	503,200	514,250

Tax-exempt shareholders receive interest on shareholders' equity in full, not subject to withholding tax.

## h)Payment of dividends and interest on shareholders' equity

On April 7, 2010, the Ordinary General Shareholders' Meeting approved the allocation of additional proposed dividends referring to the remaining profit balance of 2009 and expired dividends and interest on shareholders' equity of 2009, in the amount of R\$1,251,646, provided for in the profit allocation proposal to common and preferred shareholders included in the Company's records by the end of April 7, 2010. As from April 26, 2010, the first installment of R\$ 800,000 began being paid, and the remaining portion of R\$451,646 began being paid by December 13, 2010.

On September 29, 2010, the Board of Directors approved the payment of interim dividends in the amount of R\$196,355, based on profit recorded in the balance sheet as of June 30, 2010, to holders of common and preferred shares included in the Company's records by the end of September 30, 2010. Payment of such interim dividends began on December 13, 2010.

Table of Contents

On September 29, 2010, the Board of Directors approved the credit of interest on shareholders' equity for the financial year 2010, in the amount of R\$390,000, subject to 15% withholding income tax, resulting in the net amount of R\$331,500 to holders of common and preferred shares included in the Company's records by the end of September 30, 2010. Payment of interest on shareholders' equity began on December 13, 2010.

On December 14, 2010, the Board of Directors approved the credit of interest on shareholders' equity for the financial year 2010 in the amount to R\$202,000, subject to 15% withholding income tax, resulting in the net amount of R\$171,700 to holders of common and preferred shares included in with the Company's records by the end of December 30, 2010. Payment of such interest will start until December 21, 2011, and the date will be established and communicated by the Company's Executive Board.

i. Unclaimed dividends

Dividends and interest on shareholders' equity are barred by statute of limitation after three years, as from the date of beginning of payment thereof, if not claimed by shareholders, according to article 287, clause II, item a. of Law No. 6,404, dated December 15, 1976.

22.	Net operating revenue	2010	2009
	Gross operating revenue	21,358,957	21,584,363
	Taxes on gross revenue	(5,602,813 )	(5,778,408 )
	Net operating revenue	15,756,144	15,805,955

Table of Contents

## 23. Breakdown of operating expenses

	2010	2009
Depreciation and amortization (a)	(1,913,494 )	(2,505,475 )
Personnel (b)	(1,030,510 )	(722,626 )
Network Interconnection and network usage	(4,520,992 )	(4,386,266 )
Outsourced services	(4,101,459 )	(3,629,996 )
Allowance for doubtful accounts	(386,340 )	(564,580 )
Taxes	(251,099 )	(281,960 )
Concession agreement fee (note 1.c)	(102,568 )	(100,470 )
Other	(124,220 )	(192,263 )
<b>Total</b>	<b>(12,430,682)</b>	<b>(12,383,636)</b>
Cost of goods and services	(8,792,898 )	(9,091,750 )
Selling expenses	(2,550,741 )	(2,536,902 )
General and administrative expenses	(1,087,043 )	(754,984 )
<b>Total</b>	<b>(12,430,682)</b>	<b>(12,383,636)</b>

(a) As mentioned in Note 12, the depreciation account was impacted by the review of property, plant and equipment useful lives.

(b) In 2009 personnel expenses were affected in the amount of R\$ 158,478 by the change in estimate for calculation of the claims relating to massive actions, which are calculated based on the historical average of payments made in massive actions.

## 24. Other operating income (expenses), net

	2010	2009
Fines on telecommunication services	92,794	115,920
Rental of infrastructure	46,398	46,578
Donation and sponsorships	(37,726 )	(30,598 )
Provision for civil contingencies, net	(121,973 )	(115,447 )
Net profit on disposal of assets (a)	230,335	(14,375 )
Net Income from sales of investments (note 11)	87,151	-
Other income/expenses	(78,603 )	(45,207 )
<b>Total</b>	<b>218,376</b>	<b>(43,129 )</b>
Other operating income	881,184	706,289
Other operating expenses	(662,808 )	(749,418 )
<b>Total</b>	<b>218,376</b>	<b>(43,129 )</b>

(a) In the fourth quarter of 2010, Telesp assigned the right to commercially explore spaces existing in approximately 1,085 transmission towers it owns, and transferred the activity of managing and maintaining the telecommunication tower to a third-party company that specializes in providing such services for the amount of R\$233,421 (net amount

of the monthly rent of land deferred). Considering that significant risks and benefits were transferred, for purposes of the conditions of the concession, such operation was assessed under IAS 17 – Leases perspective, and classified as a financial lease. Net effect on 2010 P&L is recorded as "Other Operating Income (Expenses)".

F-62

---

Table of Contents

In addition, Telesp has entered into an infrastructure sharing agreement for the use of part of the assigned towers for a 13-years' period. Based on IFRIC 4 – Determining whether an Arrangement Contains a Lease, the Company has assessed that this sharing agreement qualifies as a service agreement since parties other than Telesp and its related companies commonly share and are more likely than not to continue to share the cost of such towers. Therefore the cost of this service agreement will be recognized as expenses over the effective term of the agreement.

The transaction aimed to offer higher quality and efficiency of the infrastructure sharing activity of these towers, in addition to generating greater operating efficiency of the telecommunication services, thus allowing Telesp to focus its efforts and investments in developing its main business activity.

## 25. Financial income (expenses)

	2010	2009
Financial income	344,354	455,888
Income from short-term investments	181,717	172,164
Gains on derivative transactions	18,567	65,878
Interest receivable	33,834	45,545
Monetary/exchange variations receivable	86,950	147,471
Other financial income	23,286	24,830
Financial expenses	(465,092 )	(644,680 )
Interest payable	(355,971 )	(421,599 )
Losses on derivative transactions	(20,746 )	(118,061 )
Expenses on financial transactions	(73,876 )	(69,380 )
Monetary/exchange variations payable	(14,499 )	(35,640 )
Total	(120,738 )	(188,792 )

Table of Contents

## 26. Income and social contribution taxes

The Company recognizes income tax and social contribution monthly on the accrual basis and pays the taxes on an estimated basis, in accordance with the trial balance for suspension or reduction. The taxes calculated on income until the month of the financial statements are recorded in liabilities or assets, as applicable.

## Reconciliation of reported income tax expense and combined statutory tax rates

Reconciliation of the reported tax charges and the amounts calculated by applying 34% (income tax of 25% and social contribution tax of 9%) in December of 2010 and 2009 is shown in the table below:

	2010	2009
Income before taxes	3,425,989	3,209,186
Income and social contribution taxes		
Income and social contribution taxes expenses	(1,164,836)	(1,091,123)
Permanent differences		
Equity pickup	982	6,387
Unclaimed interest on shareholders' equity	(7,483 )	(14,407 )
Unrecognized deferred tax asset of subsidiaries	(60,726 )	(109,670 )
Nondeductible expenses, gifts, incentives and dividends received	(24,532 )	(23,237 )
Tax benefit of interest on shareholders' equity	201,280	205,700
Other items		
Incentives (cultural, food and transportation)	28,162	21,253
Total general	(1,027,153)	(1,005,097)
Effective rate	30 %	31 %
Current income and social contribution taxes	908,259	729,342
Deferred income and social contribution taxes	118,894	275,755
Total	1,027,153	1,005,097

The components of deferred income and social contribution tax assets and liabilities on temporary differences are shown in note 8.2.



Table of Contents

## 27. Earnings per Share

Basic and diluted earnings per share were calculated by dividing income attributed to the Company's shareholders by the weighted average of the number of outstanding common and preferred shares for the year. No transactions were carried out that could have potential shares issued through the date of issuance of the consolidated financial statements; therefore, there are no adjustments of diluting effects inherent to the potential issue of shares.

The table below shows for the periods ended the calculation of earnings per share:

	2010	2009
Net income attributable to the shareholders:	2,398,836	2,204,089
Common shares	749,615	688,759
Preferred shares	1,649,221	1,515,330
Number of shares:	505,841	505,841
Weighted average common shares outstanding during the year	168,609	168,609
Weighted average preferred shares outstanding during the year	337,232	337,232
Basic and diluted earnings per share:		
Common shares	4.45	4.08
Preferred shares	4.89	4.49

Table of Contents

## 28. Transactions with related parties

The principal balances with related parties are as follows:

	Atento Brasil S.A.	TIWS Brasil Ltda.	Vivo	Telefônica Serviços Empresariais do Brasil Ltda.	Telefônica S.A.	Other	Total 2010	2009
<b>Assets</b>								
Current assets	8,250	1,752	312,910	13,167	51	103,537	439,667	643,407
Trade accounts receivable	4,865	1,674	312,199	710	-	24,767	344,215	523,150
Other assets	3,385	78	711	12,457	51	78,770	95,452	120,257
Noncurrent assets	-	134	427	1,943	92	14,347	16,943	23,541
Other assets	-	134	427	1,943	92	14,347	16,943	23,541
<b>Total assets</b>	<b>8,250</b>	<b>1,886</b>	<b>313,337</b>	<b>15,110</b>	<b>143</b>	<b>117,884</b>	<b>456,610</b>	<b>666,948</b>
<b>Liabilities</b>								
Current liabilities	104,330	24,072	343,365	20,200	35,543	182,020	709,530	863,707
Trade accounts payable	101,628	23,207	274,410	20,166	846	17,046	437,303	591,987
Interest on shareholders' equity	-	-	-	-	-	151,246	151,246	153,492
Other liabilities	2,702	865	68,955	34	34,697	13,728	120,981	118,228
<b>Noncurrent liabilities</b>	<b>338</b>	<b>259</b>	<b>-</b>	<b>2,324</b>	<b>-</b>	<b>7,817</b>	<b>10,738</b>	<b>15,542</b>
Other liabilities	338	259	-	2,324	-	7,817	10,738	15,542
<b>Total liabilities</b>	<b>104,668</b>	<b>24,331</b>	<b>343,365</b>	<b>22,524</b>	<b>35,543</b>	<b>189,837</b>	<b>720,268</b>	<b>879,249</b>
<b>STATEMENT OF INCOME</b>								
Revenue	30,356	3,837	419,445	2,261	1,553	49,332	506,784	381,307
Telecommunications services	30,356	3,837	419,445	2,147	-	43,608	499,393	376,333
Financial income	-	-	-	114	1,553	5,724	7,391	899
Other operating revenues	-	-	-	-	-	-	-	4,075
Costs and expenses	(704,683 )	(80,560 )	(1,816,903 )	(89,118 )	(89,365 )	(51,922 )	(2,832,551 )	(2,876,914 )
Cost of services provided	(309,483 )	(80,560 )	(1,701,361 )	(39,292 )	(16 )	(28,839 )	(2,159,551 )	(2,302,228 )

Edgar Filing: TELESP HOLDING CO - Form 20-F

Selling	(364,261 )	-	(115,481 )	(4,809 )	(106 )	(10,533 )	(495,190 )	(486,675 )
General and administrative	(30,939 )	-	(54 )	(45,017 )	(89,187 )	(790 )	(165,987 )	(83,643 )
Financial expenses	-	-	(7 )	-	(56 )	(2,818 )	(2,881 )	-
Other operating expenses	-	-	-	-	-	(8,942 )	(8,942 )	(4,368 )

F-66

---

Table of Contents

Trade accounts receivable include receivables for telecommunication services, principally from Vivo S.A., Terra Networks Brasil S.A. particularly for long-distance calls, and Tiws Brasil Ltda. due to the contract of rendering services of rights of use of undersea fiber optic.

Other intercompany receivables in Current Assets and Noncurrent Assets include credits with Telefónica Internacional S.A., Telefónica del Peru, Terra Networks Brasil S.A., Telefônica Serviços Empresariais do Brasil Ltda., Telefónica Telecom Colombia, Atento Brasil S.A. and other Group companies, corresponding to services rendered, advisory fees, expenses with salaries and other expenses paid by the Company to be refunded by the corresponding companies.

Trade accounts payable include services rendered, particularly by Atento Brasil S.A. for call center management services, Vivo S.A. for interconnection and traffic services (mobile terminal), Tiws Brasil Ltda. for provision of transmission infrastructure to various international data circuits, Terra Networks Brasil S.A., other satellite services rendered by Tiws España and signal processing and transmission for satellite TV service with Media Networks Latin. We also highlight the rendering of administrative management services in the accounting, finance, HR, equity, logistics and IT functions payable to Telefônica Serviços Empresariais do Brasil Ltda.

Other intercompany payables in Current and Noncurrent Liabilities mainly include payables for technical support and management services to Telefónica Internacional S.A., SP Telecomunicações Holding Ltda. and Telefónica S.A. and reimbursements payable to Telefónica del Peru and Vivo S.A.

Revenues from telecommunication services are mainly related to billing speedy services and interregional long-distance services with Vivo S.A., Terra Networks Brasil S.A. and Atento Brasil S.A.

Other operating revenues mainly include network infrastructure leased to Vivo S.A and Atento Brasil S.A.

The balance of costs of services provided mainly refers to interconnection and traffic services (mobile terminal), rendered by Vivo S.A., call center management services rendered by Atento Brasil S.A., international transmission infrastructure provided by Tiws Brasil Ltda.

The balance of Selling Expenses mainly refers to marketing services rendered by Atento Brasil S.A. and commission paid to mobile telephony operators with Vivo S.A.

General and administrative expenses mainly relate to Atento Brasil S.A., and management and technical services payable to Telefónica S.A.

Table of Contents

## MEMBERS OF BOARD OF DIRECTORS AND EXECUTIVE COMMITTEE

Antonio Carlos Valente da Silva	Chief Executive Officer
José María Álvarez-Pallete López	Vice-Chairman
Mariano Sebastian de Beer	General Director of Fixed Telephony
Gilmar Roberto Pereira Camurra	Chief Financial Officer and Investor Relations Officer
Gustavo Fleichman	General Secretary
Antonio Pedro de Carvalho Viana-Baptista	Member of the Board of Directors
Fernando Abril-Martorell Hernandez	Member of the Board of Directors
Fernando Xavier Ferreira	Member of the Board of Directors
Francisco Javier de Paz Mancho	Member of the Board of Directors
Guillermo José Fernandez Vidal	Member of the Board of Directors
Iñaki Urdangarin	Member of the Board of Directors
José Fernando de Almansa Moreno-Barreda	Member of the Board of Directors
Luciano Carvalho Ventura	Member of the Board of Directors
Luis Javier Bastida Ibarguen	Member of the Board of Directors
Luiz Fernando Furlan	Member of the Board of Directors
Luis Miguel Gilperez Lopez	Member of the Board of Directors
Miguel Ángel Gutiérrez Méndez	Member of the Board of Directors
Narcís Serra Serra	Member of the Board of Directors
José Manuel Fernandez Norniella	Member of the Board of Directors

## MANAGEMENT FEES

Fees paid by the Company to its Board of Directors and Executive Committee in 2010 amounted to approximately R\$13,000 (R\$13,500 in 2009). From such amounts, R\$9,500 (R\$8,700 in 2009) corresponds to salaries and benefits and R\$3,400 (R\$4,800 in 2009) to bonuses. Telesp also paid approximately R\$7,300 (R\$2,600 in 2009) in connection with the Telefónica S.A.'s Performance Share Plan (PSP), a long-term incentive plan.

For the years ended December 31, 2010 and 2009, our Board of Directors and Executive Committee received no benefits related to pension, retirement or other similar plans.

F-68

---

Table of Contents

## 29. Insurance (unaudited)

The Company and its subsidiaries' policies as well as those of the Telefónica Group includes the maintenance of insurance coverage for all assets and liabilities involving significant amounts and high risks based on management's judgment and following Telefónica S.A.'s corporate program guidelines. The assumptions adopted, given their nature, are not in the scope of an audit of financial statements, and therefore, were not audited by our independent auditors.

The main assets, liabilities or interests covered by insurance and their respective amounts are as follows:

Type	Insurance coverage
Operational risks (with loss of profits)	R\$24,517,535
Optional civil responsibility vehicles	R\$1,000
ANATEL guarantee insurance	R\$19,996

## 30. Post-retirement benefit plans

The plans sponsored by the Company and the related benefit types are as follows:

Plan	Type (1)	Entity	Sponsor
PBS-A	DB	Sistel	Telecomunicações de São Paulo S.A. – Telesp in conjunction with the other companies resulting from the breakup of Telebras.
PAMA/PCE	DB	Sistel	Telecomunicações de São Paulo S.A. – Telesp in conjunction with the other companies resulting from the breakup of Telebras.
CTB	DB	TELESP	Telecomunicações de São Paulo S.A. - Telesp
PBS TELESP	DB	VisãoPrev	Telecomunicações de São Paulo S.A. - Telesp
VISÃO A. TELECOMDB		VisãoPrev	A .Telecom S.A.
VISÃO ASSIST	Hybrid	VisãoPrev	A .Telecom S.A.
VISÃO TELEFÔNICA EMPRESAS	Hybrid	VisãoPrev	Telefônica Data S.A.
VISÃO TELESP	Hybrid	VisãoPrev	Telecomunicações de São Paulo S.A. - Telesp and VisãoPrev Sociedade de Previdência Complementar.

- (1) DB = Defined Benefit Plan;  
 DC = Defined Contribution Plan;  
 Hybrid = Plan that offers both DB and DC-type benefits.

Telesp individually sponsors a defined benefit retirement plan (PBS Telesp Plan), administered by Visão Prev, which covers approximately 0.54% of the Company's employees. In addition to the supplemental pension benefit, a multiemployer plan (PBS-A) and health care plan (PAMA) are provided to retired employees and their dependents (administered by Fundação Sistel), at shared costs. Contributions to the PBS Telesp Plan are determined based on actuarial valuations prepared by independent actuaries, in accordance with the rules in force in Brazil. The funding procedure is the capitalization method and the sponsor's contribution is 13.92% of



Table of Contents

payroll of employees covered by the plan, of which 12.42% is allocated to fund the PBS Telesp Plan and 1.5% to the PAMA Plan.

For other Telesp employees, there is an individual defined contribution plan - Visão Telesp Benefit Plan. The Visão Telesp Plan is funded by contributions made by the participants (employees) and by the sponsor which are credited to participants' individual accounts. Telesp is responsible for bearing all plans administrative and maintenance expenses, including participant's death and disability risks. The Company's contributions to the Visão Telesp Plan are equal to those of the employees, varying from 2% to 9% of the contribution salary, based on the percentage chosen by the participant.

Additionally, the Company supplements the retirement benefits of certain employees of the former CTB - Companhia Telefônica Brasileira.

During 2010, the Company made contributions to the PBS Telesp Plan in the amount of R\$17 (R\$22 in 2009) and to Plano Visão Telesp in the amount of R\$24,788 (R\$22,861 in 2009).

A. Telecom sponsors two private pension plans for defined contribution; namely, one similar to that of Telesp, denominated Visão Assist Benefits Plan, which is granted to approximately 28% of its employees and another, denominated Visão A. Telecom Benefits Plan, whose basic and additional contributions by sponsor correspond to 30% of basic and additional contribution by participants. The contributions of A. Telecom to these plans totaled R\$211 (R\$330 in 2009).

Telefonica Data S.A. individually sponsors a defined contribution plan similar to that of the Company, the Visão Telefônica Empresas Benefit Plan. Total contributions to this plan amounted to R\$575 (R\$652 in 2009).

The actuarial valuation of the plans was made in December 2010 and 2009 based on the record of plan members projected on December 31, 2010 and 2009, respectively, for the plans administered by Sistel and by Visão Prev and the financial information as of December 31, 2010 and 2009, respectively, adopting the projected unit credit method. Actuarial gains or losses for each year were immediately recognized in each of the periods. The plan assets relate to December 31, 2010 and 2009, respectively, and that for multiemployer plans (PAMA and PSB-A), apportionment of the plan assets was made based on the sponsoring entity's actuarial liabilities in relation to the plans' total actuarial liabilities.

Actuarial liabilities recorded by the Company as of December 31, 2010 and 2009 are as follows:

Plan	2010	2009	01/01/2009
CTB	20,818	23,508	26,482
PAMA	198,182	168,419	122,288
T o t a l	219,000	191,927	148,770
Consolidated			

Table of Contents

## a. Reconciliation of assets and liabilities

	2010					Total
	CTB	PAMA(i)	PBS-A(i)	PBS	Visão Telesp/ Assist/TData	
Total actuarial liabilities	20,818	272,141	1,138,330	94,177	31,914	1,557,380
Fair value of assets	-	73,959	1,717,747	111,613	121,377	2,024,696
Liabilities (assets), net	20,818	198,182	(579,417 )	(17,436 )	(89,463 )	(467,316 )
Assets limitation	-	-	579,417	17,436	62,292	659,145
Net liability recognized in the balance sheet	20,818	198,182	-	-	-	219,000
Net asset recognized in the balance sheet	-	-	-	-	27,171	27,171

	2009					Total
	CTB	PAMA(i)	PBS-A(i)	PBS	Visão Telesp/ Assist/TData	
Total actuarial liabilities	23,508	238,767	1,082,458	93,098	31,348	1,469,179
Fair value of assets	-	70,348	1,479,620	108,062	110,828	1,768,858
Liability (assets), net	23,508	168,419	(397,162 )	(14,964 )	(79,480 )	(299,679 )
Assets limitation	-	-	397,162	14,964	14,294	426,420
Net liability recognized in the balance sheet	23,508	168,419	-	-	-	191,927
Net asset recognized in the balance sheet	-	-	-	-	65,186	65,186

(i) Refers to the proportional share of Telesp in the assets and liabilities of the PAMA and PBS-A multiemployer plans.

## b. Total expenses recognized in the statement of income

	2010					Total
	CTB	PAMA	PBS	Visão Telesp/ Assist/TData		
Current service cost	-	159	78	3,663		3,900
Interest cost	2,148	23,038	8,803	2,865		36,854

Edgar Filing: TELESP HOLDING CO - Form 20-F

Expected return on plan assets	-	(6,489 )	(11,334 )	(11,970 )	(29,793 )
	2,148	16,708	(2,453 )	(5,442 )	10,961

2009

	CTB	PAMA	PBS	Visão Telesp/ Assist/TData	Total
Current service cost	-	157	135	3,368	3,660
Interest cost	2,503	18,973	8,935	2,736	33,147
Expected return on plan assets	-	(7,064 )	(9,976 )	(10,381 )	(27,421 )
	2,503	12,066	(906 )	(4,277 )	9,386

F-71

---

Table of Contents

## c. Amounts recognized in other comprehensive income

	2010				Total
	CTB	PAMA	PBS	Visão Telesp/ Assist/TData	
Actuarial (gains) losses recognized immediately	(1,809 )	13,069	(7 )	(1,138 )	10,115
Limitation effect	-	-	2,472	47,998	50,470
Total cost recognized in other comprehensive income	(1,809 )	13,069	2,465	46,860	60,585

  

	2009				Total
	CTB	PAMA	PBS	Visão Telesp/ Assist/TData	
Actuarial (gains) losses recognized immediately	(2,344 )	34,080	(13,453 )	(8,066 )	10,217
Limitation effect	-	-	14,379	(47,168 )	(32,789 )
Total cost recognized in other comprehensive income	(2,344 )	34,080	926	(55,234 )	(22,572 )

## d. Changes in net actuarial (assets) liabilities

	CTB	PAMA	PBS-A	PBS	Visão Telesp/ Assist/TData	Total
Plan (assets) liabilities as of January 1, 2009	26,482	122,288	-	-	(2,936 )	145,834
Expenses in 2009	2,503	12,066	(65,281 )	(906 )	(4,277 )	(55,895 )
Contributions of the companies to plans in 2009	(3,133 )	(15 )	-	(20 )	(2,738 )	(5,906 )
Amounts recognized in other comprehensive income	(2,344 )	34,080	65,281	926	(55,234 )	42,709
Plan (assets) liabilities as of December 31, 2009	23,508	168,419	-	-	(65,185 )	126,742
Expenses in 2010	2,148	16,708	(39,472 )	(2,453 )	(5,442 )	(28,511 )
Contributions of the companies to plans in 2010	(3,029 )	(14 )	-	(12 )	(3,404 )	(6,459 )
Amounts recognized in other comprehensive income	(1,809 )	13,069	39,472	2,465	46,860	100,057
Plan (assets) liabilities as of December 31, 2010	20,818	198,182	-	-	(27,171 )	191,829

Actuarial asset recognized in the balance sheet	-	-	-	-	27,171	27,171
Actuarial liability recognized in the balance sheet	20,818	198,182	-	-	-	219,000

F-72

---

Table of Contents

## e. Changes in actuarial liabilities

	CTB	PAMA	PBS-A	PBS	Visão Telesp/ Assist/TData	Total
Actuarial liabilities as of January 1, 2009	26,482	190,541	1,068,380	91,583	28,875	1,405,861
Cost of current service	-	157	-	135	3,368	3,660
Interest on actuarial liabilities	2,503	18,973	104,319	8,935	2,736	137,466
Benefits paid in the year	(3,133 )	(7,817 )	(84,183 )	(6,341 )	(552 )	(102,026 )
Contributions of participants in the year	-	-	-	10	224	234
Actuarial (gains) losses in the year	(2,344 )	36,913	(6,057 )	(1,224 )	(3,303 )	23,985
Actuarial liabilities as of December 31, 2009	23,508	238,767	1,082,459	93,098	31,348	1,469,180
Cost of current service	-	159	-	78	3,663	3,900
Interest on actuarial liabilities	2,148	23,038	102,290	8,803	2,865	139,144
Benefits paid in the year	(3,029 )	(9,916 )	(93,289 )	(6,665 )	(585 )	(113,484 )
Contributions of participants originated in the year	-	-	-	1	302	303
Actuarial (gains) losses in the year	(1,809 )	20,092	46,870	(1,138 )	(5,678 )	58,337
Actuarial liabilities as of December 31, 2010	20,818	272,140	1,138,330	94,177	31,915	1,557,380

## f. Changes in plan assets

	CTB	PAMA	PBS-A	PBS	Visão Telesp/ Assist/TData	Total
Fair value of plan assets as of January 1, 2009	-	68,253	1,463,441	92,168	93,273	1,717,135
Benefits paid in the year	(3,133 )	(7,817 )	(84,183 )	(6,341 )	(552 )	(102,026 )
Total contributions in the year	3,133	15	-	30	2,962	6,140
Expected return of plan assets in the year	-	7,064	169,599	9,976	10,381	197,020
Gains / (losses) on assets	-	2,833	(69,237 )	12,229	4,764	(49,411 )
Fair value of plan assets as of December 31, 2009	-	70,348	1,479,620	108,062	110,828	1,768,858
Benefits paid in the year	(3,029 )	(9,916 )	(93,289 )	(6,665 )	(585 )	(113,484 )
Total contributions in the year	3,029	14	-	12	3,404	6,459
Expected return on plan assets in the year	-	6,490	141,762	11,334	11,970	171,556

Edgar Filing: TELESP HOLDING CO - Form 20-F

Gains / (losses) on assets	-	7,023	189,654	(1,131 )	(4,539 )	191,007
Fair value of plan assets as of December 31, 2010	-	73,959	1,717,747	111,612	121,378	2,024,396

F-73

---

Table of Contents

## g. Expenses estimated for 2011

	CTB	PAMA	PBS	Visão Telesp/ Assist/TData	Total
Cost of current service	-	145	17	3,960	4,122
Interest cost	1,978	27,400	9,283	3,051	41,712
Expected return on plan assets	-	(7,654 )	(12,529 )	(6,871 )	(27,054 )
Total expenses (reversions) for 2011	1,978	19,891	(3,229 )	140	18,780

## h. Actuarial assumptions

2010	Expected return rate on plan assets	Future salary growth rate	Medical care cost growth rate	Annual nominal index of private pension benefit restatement	Increase in medical services use according to age	Expected age to qualify for the use of medical services	Expected retirement age
PBS/Visão Telesp/Visão Assist/Visão T.Data	11.60%	PBS: 6.54% Visão: 7.20%	N/A	5.00%	N/A	N/A	First age entitled to one of the benefits
CTB	N/A	N/A	N/A	5.00%	N/A	N/A	First date on which it becomes eligible for Social Security benefit
PAMA	11.07%	N/A	8.15%	N/A	4.00%	5% upon reaching 52 years old and 10 years participating; 3% for each subsequent year; 100% in eligibility for regular retirement	N/A
PBS-A	12.08%	N/A	N/A	5.00%	N/A	N/A	N/A

Note: These are all nominal rates, except for medical services claim frequencies.



In addition to the above-mentioned assumptions, other assumptions common to all plans were adopted, as follows:

- Actuarial liability discount-to-present-value rate: 10.25%;
  - Inflation rate: 5.0%;
    - Capacity factor for salaries and benefits: 98%;
    - Turnover: 0.15 (years of service +1), zero from age 50;
    - Disability entry table: Mercer Disability;
    - Actuarial Table: AT2000 segregated by sex; and
    - Disability mortality table: IAPB-57.

Table of Contents

2009	Expected return rate on plan assets	Future salary growth rate	Medical care cost growth rate	Annual nominal index of private pension benefit restatement	Increase in medical services use according to age	Expected age to qualify for the use of medical services	Expected retirement age
PBS/Visão Telesp/Visão Assist/Visão T.Data	10.84%	PBS: 6.14% Visão: 6.79%	N/A	4.60%	N/A	N/A	First age entitled to one of the benefits
CTB	N/A	N/A	N/A	4.60%	N/A	N/A	First date on which it becomes eligible for Social Security benefit
PAMA	9.84%	N/A	7.73%	N/A	4.00%	5% upon reaching 52 years old and 10 years participating; 3% for each subsequent year; 100% in eligibility for regular retirement	N/A
PBS-A	9.86%	N/A	N/A	4.60%	N/A	N/A	N/A

Note: These are all nominal rates, except for medical services claim frequencies.

In addition to the above-mentioned assumptions, other assumptions common to all plans were adopted, as follows:

- Actuarial liability discount-to-present-value rate: 9.83%;
- Inflation rate: 4,60%;
- Capacity factor for salaries and benefits: 98%;
- Turnover: 0.15(years of service +1), zero from age 50;
- Disability entry table: Mercer Disability;
- Actuarial Table: AT83 segregated by sex; and
- Disability mortality table: IAPB-57.

i. Expected long-term investment return

2010 2009

--

Percentage of allocation of plan assets		
Capital instruments	14.28%	12.49%
Debt instruments	85.09%	87.20%
Other	0.63%	0.31%
	100%	100%

Expected return from plan assets		
Capital instruments	15.61%	14.94%
Debt instruments	10.82%	9.98%
Other	10.25%	9.83%
Total	11.50%	10.60%

F-75

---

Table of Contents

Expected long-term investment return rates related to the plans assessed were selected by the Company, being determined based on expected long-term profitability, considering long-term projections provided by Tendências Consultoria and ANBIMA data, among others, as follows:

- § Variable income assets: risk premium estimated by Mercer (actuarial advisor) history;
- § Fixed income securities: weighted average rate based on National Treasury Bills (LTN) available and National Treasury Notes – F Series (NTN-F) market portfolio;
- § Assets linked to inflation: weighted average rate based on NTN-B and NTN-C portfolio available in the market;
- § Foreign exchange securities: average SELIC rate weighted by the foreign exchange variation rate projected for the following ten years;
- § Fixed income assets: average internal nominal interest rate variation, projected for the following 10 years;
- § Loans to participants: the higher rate between CDI and the plan actuarial goal is considered;
- § Properties: the plan actuarial goal used was that of its administrator.

## j. History of assets and obligations observed

	2010	2009	2008	2007	2006
Liabilities present value	419,050	386,722	337,480	257,787	230,717
Fair value of assets	306,949	289,239	253,695	232,378	199,318
Deficit	112,101	97,483	83,785	25,409	31,398
Adjustment for liabilities experience (%)	1.29 %	7.77 %	11.83 %	6.87 %	14.11 %
Adjustment for liabilities experience (amounts)	5,397	30,043	39,929	17,709	32,557
Adjustment for assets experience (%)	(0.44 %)	(6.85 %)	(3.39 %)	(9.65 %)	(7.42 %)
Adjustment for assets experience (amounts)	(1,352 )	(19,826 )	(8,598 )	(22,428 )	(14,794 )

## k. Estimates of benefits payable within the following years

	2011	2012	2013	2014	2015	2016 -thereof
Defined pension plan	24,986	25,758	26,547	27,372	28,237	1,069,246

Table of Contents

## I. Significant considerations on PAMA Plan

The effect of a one percent increase and the effect of one percent decrease in medical cost trend rates are as follows:

a) +1% in nominal growth rate of medical costs

Effect on current service cost and on interest on actuarial liabilities	3,815
Effect on liabilities present value	44,541

b) -1% in nominal growth rate of medical costs

Effect on current service cost and on interest on actuarial liabilities	(3,437)
Effect on liabilities present value	(36,077)

## 31. Financial instruments

The Company and its subsidiaries made a valuation of their financial assets and liabilities in relation to market values based on available information and appropriate valuation methodologies. However, the interpretation of market information, as well as the selection of methodologies, requires considerable judgment and reasonable estimates in order to produce adequate realizable values. As a result, the estimates presented do not necessarily indicate the amounts which might be realized in the current market. The use of different market approaches and/or methodologies may have a significant effect on the estimated realizable values.

The table below shows a breakdown of financial assets and liabilities as of December 31, 2010.

	Fair value		Amortized cost		Fair value hierarchy			Total Book Value	Total Fair Value
	Measured at fair value through profit or loss	Available for sale	Loans and receivables	Investments held to maturity	Level 1 Market price	Level 2 Estimated based on other market data			
<b>Financial assets</b>									
<b>Current assets</b>									
Cash and cash equivalents (note 5)	-	-	1,556,715	-	-	-	1,556,715	1,556,715	
Derivatives	166	-	-	-	-	166	166	166	
<b>Noncurrent assets</b>									
Interests in other companies	-	42,708	-	-	42,708	-	42,708	42,708	
	-	-	-	12,884	-	-	12,884	12,884	

Amounts linked  
to the National  
Treasury  
Securities (note  
9)

Total financial assets	166	42,708	1,556,715	12,884	42,708	166	1,612,473	1,612,473
---------------------------	-----	--------	-----------	--------	--------	-----	-----------	-----------

F-77

---

Table of Contents

Financial liabilities	Measured at fair value through profit or loss	Amortized cost	Hedge	Level 1 Market price	Level 2 Estimated based on other market data	Total Book Value	Total Fair Value
<b>Current liabilities</b>							
Loans and financing (Note 16)	-	420,412	-	-	-	420,412	420,412
Derivatives	696	-	8,806	-	9,502	9,502	9,502
<b>Noncurrent liabilities</b>							
Loans and financing (Note 16)	-	1,405,314	-	-	-	1,405,314	1,405,314
Derivatives	-	-	18,542	-	18,542	18,542	18,542
<b>Total financial liabilities</b>	<b>696</b>	<b>1,825,726</b>	<b>27,348</b>	<b>-</b>	<b>28,044</b>	<b>1,853,770</b>	<b>1,853,770</b>

## Interests in other companies

The Company has direct and indirect interests in other companies resulting from the privatization process. These investments, measured at market value, consider the latest quotation available in December 31, 2010 and 2009.

The table below shows the composition of investments in other companies at market value as of December 31, 2010 and 2009:

	% of Interest	2010	2009	01/01/2009
Portugal Telecom	0.91	-	227,702	210,431
Zon Multimédia	0.52	12,226	17,654	19,531
Other investments		30,483	39,703	35,416
<b>Total</b>		<b>42,709</b>	<b>285,059</b>	<b>265,378</b>

## Risk management policy

The Company is exposed to several market risks as a result of its commercial operations, debts obtained to finance its activities and debt-related financial instruments.

The principal market risk factors that affect the Company's business are detailed below:

a)

Exchange rate risk

This risk arises from the possibility that the Company may incur losses due to exchange rate fluctuations, which would increase the financial expenses of loans denominated in foreign currency.

F-78

---



Table of Contents

At December 31, 2010, 0,95% (0,65% at December 31, 2009) of the financial debt was denominated in foreign currency (US dollar). The Company has entered into derivative transactions (exchange rate hedge) with financial institutions to protect itself against exchange rate variation on its gross debt in foreign currency (R\$17,304 at December 31, 2010 and R\$ 23,006 at December 31, 2009).

In view of this at December 31, 2010 and 2009, the entirety of the debt was covered by asset positions on currency hedge transactions swap for CDI.

There is also the exchange rate risk related to nonfinancial assets and liabilities in foreign currency, which can lead to a lower amount receivable or higher amount payable, depending on exchange rate variation in the period.

As from May 2010, hedge operations were contracted to minimize the exchange rate risk related to these non-financial assets and liabilities in foreign currency. This balance is subject to daily changes due to business dynamics, however, the Company aims to cover the net balance of these rights and obligations (US\$3,380 receivable and €37,784 receivable at December 31, 2010) to minimize the related foreign exchange risk.

b) Interest rate risk

This risk arises from the possibility of the Company incurring losses due to changes in internal interest rates, which may affect negatively derivatives in liability positions (exchange rate hedges) contracted at floating interest rates (CDI).

The debt taken out from BNDES bank is indexed by the TJLP (Long Term Interest Rate quarterly set by the National Monetary Council), which was kept at 6,0% per annum since July 2009.

The Company invests cash surplus of R\$1,547,785 (R\$2,266,896 at December 31, 2009), mainly in short-term financial investments (Bank Deposit Certificates) based on CDI variation, thus generating exposure to variable internal interest rate (CDI). The book value of these instruments approximates market, since they are redeemable within a short term.

c) Debt acceleration risk

As of December 31, 2010, the Company had one financing agreement in force, containing restrictive clauses (covenants), typically applicable to such agreements, relating to cash generation, debt ratios and other restrictions. These covenants – which could otherwise demand payment of liabilities at an earlier time – have been fully performed by the Company, and all economic and financial indexes contractually provided have been achieved.

Table of Contents

d) Credit risk

This risk arises from the possibility that the Company may incur losses due to the difficulty in receiving amounts billed to its customers. The credit risk on accounts receivable is dispersed. The Company constantly monitors the level of accounts receivable and limits the risk of past-due accounts, interrupting access to telephone lines in case the customer does not pay the related bills in 30 days. Exceptions are made for telecommunication services that must be maintained for security or national defense reasons.

As of December 31, 2010, the Company's customer portfolio had no subscribers whose receivables were individually higher than 1% of the total accounts receivable from services.

The Company is also subject to credit risk arising from short-term investments, letters of guarantee received as collateral in connection with certain operations and receivables from swap transactions. The Company controls the credit limit granted to all counterparties and diversifies such exposure among top-rated financial institutions.

As far as to credit risks are concerned, the Company represents low risk to the market, with good financial indicators and stable operations, being classified as "investment grade" by one of the most well regarded international rating agencies.

Derivatives

All the Company's derivative instruments have the objective of providing a hedge against the risk of variation in exchange rates arising from assets and liabilities in foreign currency, according to the Company's risk management policy. As such, any changes in risk factors generate an opposite effect on the hedged end. There are no derivative instruments for speculative purposes and liabilities in foreign exchange are hedged.

The Company has internal controls over its derivative instruments, which, according to management, are adequate to control the risks associated with each market strategy. The Company's results derived from its derivative financial instruments indicate that the risks have been adequately managed.

The Company and its subsidiaries determine the effectiveness of the derivative instruments entered into to hedge its financial liabilities upon origination and on an ongoing basis (quarterly). As of December 31, 2010, the derivative instruments taken were effective for the debts they are intended to provide coverage. Provided these derivatives contracts qualify as hedge accounting, the debt hedge may also be adjusted at fair value as per the rules applicable to fair value hedge.

Table of Contents

## Fair value of derivative financial instruments

The discounted cash flow method was used to determine the market value of finance liabilities (where applicable) and derivative instruments (foreign currency swap), considering expected settlement of liabilities or realization of assets and liabilities at the market rates prevailing at balance sheet date.

Fair values are calculated by projecting future operating flows, using BM&F Bovespa curves, and discounting to present value through market DI rates for swaps, as informed by BM&F Bovespa.

The market values of exchange rate derivatives was obtained through market currency rates in force at the balance sheet date and projected market rates were obtained from currency coupon curves. The coupon for positions indexed to foreign currencies was determined using the 360-calendar-day straight-line convention; the coupon for positions indexed to CDI was determined using the 252-workday exponential convention.

The consolidated derivative financial instruments shown below are registered with CETIP. All of them are classified as swaps and do not require margin deposits.

Description	Index	Notional Value		Fair value		Accumulated effect in 2010	
		2010	2009	2010	2009	Amount receivable	Amount payable
<b>Swap Contracts</b>							
<b>Assets</b>							
<b>Foreign currency</b>							
(a)		19,608	26,351	17,306	23,010	-	-
BES	USD	3,155	3,155	2,654	2,718	-	-
Votorantim	USD	16,453	23,196	14,652	20,292	-	-
<b>Variable rates (b)</b>							
Banco do Brasil	CDI + Pre	-	500,000	-	504,748	-	-
Citibank	CDI + Pre	-	400,000	-	403,798	-	-
HSBC	CDI + Pre	-	400,000	-	403,798	-	-
Votorantim	CDI + Pre	-	200,000	-	201,899	-	-
<b>Variable rates</b>							
Banco do Brasil	CDI	86,954	-	86,537	-	166	-
Citibank	CDI	51,025	-	50,647	-	-	-
Citibank	CDI	22,047	-	22,048	-	-	-
Citibank	CDI	10,012	-	9,980	-	166	-
HSBC	CDI	3,870	-	3,862	-	-	-
<b>Liabilities</b>							
Variable rates (a)		(19,608 )	(26,351 )	(44,654 )	(54,681 )	-	(27.348 )

Edgar Filing: TELES P HOLDING CO - Form 20-F

BES	CDI	(3,155 )	(3,155 )	(7,185 )	(6,547 )	-	(4,531 )
Votorantim	CDI	(16,453 )	(23,196 )	(37,469 )	(48,134 )	-	(22,817 )
Variable rates (b)		-	(1,500,000)	-	(1,513,670)	-	-
Banco do Brasil	CDI	-	(500,000 )	-	(504,543 )	-	-
Citibank	CDI	-	(400,000 )	-	(403,657 )	-	-
HSBC	CDI	-	(400,000 )	-	(403,649 )	-	-
Votorantim	CDI	-	(200,000 )	-	(201,821 )	-	-
Foreign currency		(86,954 )	-	(87,068 )	-	-	(696 )
Bradesco	EUR	(51,025 )	-	(51,125 )	-	-	(478 )
Citibank	EUR	(22,047 )	-	(22,253 )	-	-	(205 )
Citibank	EUR	(10,012 )	-	(9,814 )	-	-	-
HSBC	USD	(3,870 )	-	(3,876 )	-	-	(13 )
Total recognized						166	(28,044 )

F-81

---

Table of Contents

- a) Swaps of foreign currency (USD) x CDI (R\$17,306) – swap operations in american dollars with several maturities until 2014, with the objective of hedging foreign exchange variation for loans and non-financial commitments, net (debt fair value of R\$17,644 and nonfinancial commitments of R\$ 17,304).
- b) CDI percentage Swap x foreign currency (Euro and Dollar) (R\$ 83,192 in Euro and R\$ 3,876 in U.S. Dollars) swap contracts with maturities until March 31, 2011, with objective of hedging exchange variation for amounts receivable in Euro (book value of R\$84,122) and Dollar (book value of R\$ 5,632).

The expected maturities of swap contracts as of December 31, 2010 is as follows

Swap contracts	Maturity				Amount payable/ receivable at 12/31/2010
	2011	2012	2013	2014 Thereafter	
Foreign Currency x CDI	(8,805 )	(7,933 )	(7,265 )	(3,344 )	(27,347 )
BES	(4,530 )	-	-	-	(4,530 )
VOTORANTIM	(4,275 )	(7,933 )	(7,265 )	(3,344 )	(22,817 )
CDI X Foreign Currency	(530 )	-	-	-	(530 )
CITIBANK	(39 )	-	-	-	(39 )
BRADESCO	(478 )	-	-	-	(478 )
HSBC	(13 )	-	-	-	(13 )

For purpose of preparing the consolidated financial statements, the Company adopted hedge accounting only for its foreign currency X CDI swap operations providing financial debt hedge. Under this methodology, both the derivative and the risk covered are stated at fair value.

For the year ended December 31, 2010, derivative operations generated a net consolidated loss of R\$2,179 (note 25). At December 31, 2010, currency hedge transactions generated a net consolidated loss of R\$2,260. On June 30, 2010 the Company settled its operations involving swap – CDI + spread vs %CDI, in the principal amount of R\$1,500,000, to cover fixed debentures spread, which generated gains of R\$80.

At December 31, 2010, the balance of R\$166 is recorded as assets and R\$28,044 as liabilities, recognizing the position of derivatives as of that date.

Table of Contents

Sensitivity analysis of the Company's risk variables

CVM Deliberation 604/09 requires listed companies to disclose, in addition to the provisions of Technical Pronouncement CPC No. 40 Financial Instruments: Disclosure (equivalent to IFRS 7), a table showing the sensitivity analysis of each type of market risk inherent in financial instruments considered relevant by management and to which the Company is exposed at the closing date of each reporting period, including all operations involving derivative financial instruments.

In compliance with the foregoing, all the operations involving derivative financial instruments were evaluated considering a probable scenario and two scenarios that may adversely impact the Company.

The assumption taken into consideration under the probable scenario was to keep the maturity date of each transaction, what has been signaled by the market through BM&FBovespa market curves (currencies and interest rates). Accordingly, the probable scenario does not provide for any impact on the fair value of the derivative financial instruments mentioned above. For scenarios II and III, risk variables contemplated 25% and 50% deterioration, respectively, pursuant to the applicable CVM instruction.

Considering that the Company has derivative instruments only to cover its assets and liabilities in foreign currency, the changes in scenarios are offset by changes in the related hedged items, thus indicating that the effects are practically null. For these operations, the Company reported the value of the hedged item and of the derivative financial instrument on separate rows in the sensitivity analysis table in order to provide information on the Company's net exposure for each of the three mentioned scenarios, as shown below:

Table of Contents

## Sensitivity analysis – Net exposure

Operation	Risk	Probable	25% Decrease	50% Decrease
Hedge (Assets)	Derivatives (Risk of USD decrease)	17,306	21,887	26.578
USD-denominated debt	Debts (Risk of USD increase)	(17,304 )	(21,885 )	(26.577 )
	Net Exposure	2	2	1
Hedge (Liabilities)	Derivatives (Risk of EUR increase)	(83,192 )	(104,130 )	(125.125 )
Non-financial assets in EUR	Asset (Risk of EUR decrease)	84,122	105,153	126.183
	Net Exposure	930	1,023	1.058
Hedge (Liabilities)	Derivatives (risk of USD increase)	(3,876 )	(4,847 )	(5.818 )
Non-financial assets in USD	Asset (Risk of USD decrease)	5,632	7,041	8.449
	Net Exposure	1,756	2,194	2.631
Hedge (Assets - CDI)	Derivatives (Risk of CDI decrease)	41,886	40,317	38.653
	Net Exposure	41,886	40,317	38.653
Total net exposure in each scenario		44.574	43,535	42,344
Effect on changes in fair value, net		-	(1,039 )	(2,230 )

## Assumptions for analysis of sensitivity

Risk variable	Probable	25% Decrease	50% Decrease
USD	1.6662	2.0828	2.4993
EUR	2.2264	2.7830	3.3396
CDI	10.64%	13.30%	15.96%

To determine the net exposure of the sensibility analysis, all derivatives were considered at market value and only (hedged elements) classified under accounting method were also considered at fair value.

The fair values shown in the table above are based on the status of the portfolio as of December 31, 2010, not reflecting an estimated realization in view of the market dynamics, always monitored by the Company. The use of different assumptions may significantly impact estimates.

\*\*\*\*\*

Milton Shigueo Takarada

Accountant

CRC - 1SP138816/O-8

\*\*\*\*\*

F-84

---