

TELEFONICA BRASIL S.A.  
Form 20-F  
March 20, 2013

As filed with the Securities and Exchange Commission on March 20, 2013

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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, 2012

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

Date of event requiring this shell company report \_\_\_\_\_  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 001-14475

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TELEFÔNICA BRASIL S.A.  
(Exact name of Registrant as specified in its charter)

TELEFÔNICA BRAZIL S.A.  
(Translation of Registrant's name into English)

Federative Republic of Brazil  
(Jurisdiction of incorporation or organization)

Avenida Engenheiro Luis Carlos Berrini, 1376, 32º andar  
04571-936 São Paulo, SP, Brazil  
(Address of principal executive offices)

Paulo Cesar Pereira Teixeira  
Telephone +55 11 3430 8901  
Avenida Engenheiro Luis Carlos Berrini, 1376, CEP 04571-936, São Paulo, SP, Brazil  
Email: ir.br@telefonica.com

(Name, Telephone, Email and/or Facsimile and Address of Company Contact Person)  
Securities registered or to be registered pursuant to Section 12(b) of the Act:

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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 one share of Preferred Stock	New York Stock Exchange

\* 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 of each class as of December 31, 2012 was:

Title of Class	Number of Shares Outstanding
Shares of Common Stock	381,335,671
Shares of Preferred Stock	741,933,573

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:

U.S. GAAP  International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

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

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INTRODUCTION

References in this annual report to “Telefônica Brasil,” “we,” “our,” “us,” “our company” and “the company” are to Telefônica Brasil S.A. and its consolidated subsidiaries (unless the context otherwise requires). All references in this annual report to:

- “ADRs” are to the American Depositary Receipts evidencing our ADSs;
- “ADSs” are to our American Depositary Shares, each representing one share of our nonvoting preferred stock;
- “ANATEL” are to Agência Nacional de Telecomunicações – ANATEL, the Brazilian telecommunication regulatory agency;
- “BM&FBOVESPA” are to the BM&FBOVESPA S.A. – Bolsa de Valores, Mercadorias e Futuros, the São Paulo stock exchange;
- “BNDES” are to Banco Nacional de Desenvolvimento Econômico e Social, the Brazilian Development Bank;
- “Brazil” are to the Federative Republic of Brazil;
- “Brazilian Central Bank,” “BACEN,” “Central Bank of Brazil” or “Central Bank” are to the Banco Central do Brasil, the Brazilian Central Bank;
  - “Brazilian Corporate Law” are to Law No. 6,404 of December 15, 1976, as amended;
  - “CADE” are to Conselho Administrativo de Defesa Econômica, the Brazilian competition authority;
  - “CDI” are to Certificado de Depósito Interbancário, the Certificate for Interbank Deposits;
  - “Ceterp” are to Centrais Telefônicas de Ribeirão Preto;
- “Celular CRT” are to Celular CRT Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
  - “CMN” are to the Conselho Monetário Nacional, the Brazilian Monetary Council;
  - “Commission” or “SEC” are to the U.S. Securities and Exchange Commission;
- “Corporate Law Method” are the accounting practices to be followed in the preparation of our financial statements for regulatory and statutory purposes under 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 Brazilian Securities Commission;
  - “D.O.U.” are to the Diário Oficial da União, the Official Newspaper of the Brazilian Government;

- “Federal District” are to Distrito Federal, the federal district where Brasilia, the capital of Brazil, is located;
- “General Telecommunications Law” are to Lei Geral de Telecomunicações, as amended, the law which regulates the telecommunications industry in Brazil;

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- “Global Telecom” or “GT” are to Global Telecom S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;
  - “IASB” are to International Accounting Standards Board;
- “IBGE” are to Instituto Brasileiro de Geografia e Estatística, the Brazilian Institute of Geography and Statistics;
  - “IFRS” are to International Financial Reporting Standards, as issued by the IASB;
- “IOF” are to Imposto sobre Operações de Crédito, Câmbio e Seguros, or tax on credit, exchange and insurance;
- “IPCA” are to Índice Nacional de Preços ao Consumidor Amplo, the consumer price index, published by the IBGE;
  - “IST” are to Índice Setorial de Telecomunicações, the inflation index of the telecommunications sector;
- “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;
  - “NYSE” are to the New York Stock Exchange;
  - “Oi” are to Oi S.A., the mobile operator branch of Telemar;
- “PTAX” or “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 the Brazilian real, the official currency of Brazil;
  - “Speedy” are to broadband services provided by us through asymmetric digital subscriber lines, or ADSL;
- “TCO” are to Tele Centro Oeste Celular Participações, which includes TCO’s “B” band subsidiary and NBT, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
  - “TCP” are to TELESP Celular Participações S.A., Vivo’s predecessor company;
- “TLE” are to Tele Leste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
- “TSD” are to Tele Sudeste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
  - “Telebrás” are to Telecomunicações Brasileiras S.A.–Telebrás;
  - “Telemar” are to Telemar Norte Leste S.A. (controlled by Tele Norte Leste Participações S.A.);
  - “Telemig” or “Telemig Participações” are to Telemig Celular Participações S.A.;
    - “Telemig Celular” are to Telemig Celular S.A.;
  - “Telenorte” or “Tele Norte” are to Tele Norte Celular Participações S.A.;



- “TELESP Celular” and “TC” are to TELESP Celular S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;

- “Telpart” are to Telpart Participações S.A.;

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- “TJLP” are to Taxa de Juros de Longo Prazo, or long-term interest rate;
- “UMBNDDES” are to a monetary unit of the BNDES, consisting of a currency basket of BNDES debt obligations in foreign currencies, which are mostly denominated in U.S. dollars;
  - “U.S. dollar,” “U.S. dollars” or “US\$” are to U.S. dollars, the official currency of the United States;
- “Vivo” are to Vivo S.A., a wholly owned subsidiary of Telefônica Brasil, that conducts cellular operations including SMP (as defined in the “Glossary of Telecommunication Terms”), in the following areas:
  - “Areas 1 and 2,” the state of São Paulo (operations previously provided by TELESP Celular);
  - “Area 3,” the states of Rio de Janeiro and Espírito Santo (operations previously provided by Telerj Celular S.A., or Telerj, and Telest Celular S.A., or Telest);
    - “Area 4,” the state of Minas Gerais;
  - “Area 5,” the states of Paraná and Santa Catarina (operations previously provided by Global Telecom);
  - “Area 6,” the state of Rio Grande do Sul (operations previously provided by Celular CRT);
  - “Areas 7 and 8,” the central western and northern regions, including the states of Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul, Rondônia, Acre, Amapá, Amazonas, Maranhão, Pará and Roraima and in the Federal District (operations previously provided by Telegoias Celular S.A., or Telegoias, Telemat Celular S.A., or Telemat, Telems Celular S.A., or Telems, Teleron Celular S.A., or Teleron, Teleacre Celular S.A., or Teleacre, Norte Brasil Telecom S.A., or NBT and TCO);
  - “Area 9,” the states of Bahia and Sergipe (operations previously provided by Telebahia Celular S.A., or Telebahia, and Telergipe Celular S.A., or Telergipe); and
    - “Area 10,” the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.
- “Vivo Participações” are to Vivo Participações S.A. (formerly TCP) and its consolidated subsidiaries (unless the context otherwise requires); and
  - “Vivo brand” are to the brand used in Brazil in the operations of Telefônica Brasil;

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 134 provides the definition of certain technical terms used in this annual report.

On October 3, 2011, our shareholders approved the merger of Vivo Participações with and into us and the change of our corporate name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A.

As a result of such name change, the trade codes for our shares were also changed as of October 6, 2011 (inclusive), from TLPP3, for the common shares and TLPP4, for the preferred shares to VIVT3 and VIVT4, respectively, with the subsequent change of trading name to TELEF BRAZIL. The trade code for the ADRs, VIV, on New York Stock

Exchange was not changed.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENT

This annual report contains statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934, as amended, and the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The forward-looking statements in this Annual Report can be identified, in some instances, by the use of words such as “will,” “expect,” “aim,” “hope,” “anticipate,” “intend,” “believe” and similar language or the negative thereof or by the forward-looking nature of discussions of strategy, plans or intentions. These statements appear in a number of places in this Annual Report including, without limitation, certain statements made in “Item 3. Key Information—D. Risk Factors,” “Item 4. Information on the Company,” “Item 5. Operating and Financial Review and Prospects” and “Item 11. Quantitative and Qualitative Disclosures about Market Risk” and include statements regarding our intent, belief or current expectations with respect to, among other things:

- statements concerning our operations and prospects;
- the size of the Brazilian telecommunications market;
  - estimated demand forecasts;
  - our capital expenditure plan;
- 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;
    - the outcome of certain legal proceedings;
    - regulatory and legal developments;
  - quantitative and qualitative disclosures about market risk;
- other statements of management’s expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts; and
  - other factors identified or discussed under “Item 3. Key Information—D. Risk Factors.”

Forward-looking information involves risks and uncertainties that could significantly affect expected results. The risks and uncertainties include, but are not limited to:

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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, interest rate and exchange rate risks;
  - the Brazilian government's telecommunications policy;

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- 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 publicly update or revise any forward-looking statements as a result of new information, future events or otherwise. Because 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.

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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 International Financial Reporting Standards or IFRS.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgment in the process of applying our accounting policies. Those areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 3 to our consolidated financial statements.

Our financial statements prepared in accordance with IFRS were those as of and for the year ended December 31, 2012, December 31, 2011 and December 31, 2010 which were filed with the CVM, the local securities regulator in Brazil and made publicly available. The selected financial information for the Company included in “Item 3. Key Information—A. Selected Financial Data” should be read in conjunction with, and is qualified in its entirety by, the our financial statements and “Item 5. Operating and Financial Review and Prospects” appearing elsewhere in this annual report.

The consolidated financial statements as of December 31, 2012 and 2011 and for each of the three years in the period ended December 31, 2012 are in compliance with the IFRS, as issued by the International Accounting Standards Board (IASB) and also with the pronouncements, interpretations and guidance issued by Accounting Standards Committee (Comitê de Pronunciamentos Contábeis – “CPC”) in place on December 31, 2012, which include the new pronouncements, interpretations and amendments issued by the IASB and IFRIC which entered into force as of January 1, 2012.

Our first adoption of IFRS to consolidated financial statements was for the year ended on December 31, 2010. Our financial statements as of the transition date for applying IFRS as of January 1, 2009 and the comparative period as of and for the year ended December 31, 2009 have been restated to reflect adjustments made as a result of the adoption of IFRS.

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.

Results of Vivo Participações and Vivo are consolidated into our financial statements for nine months in 2011 and for the full year ended December 31, 2012, consequently our results of operations for the years ended December 31, 2011 and 2010 are not comparable with our results of operations for the year ended December 31, 2012.

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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

The selected financial data presented below should be read in conjunction with our consolidated financial statements, including the notes thereto included elsewhere in this annual report. Our consolidated financial statements included herein as of and for the years ended December 31, 2012, 2011 and 2010 have been audited by Ernst & Young Terco Auditores Independentes S.S. The report of Ernst & Young Terco Auditores Independentes S.S. on the consolidated financial statements appears elsewhere in this annual report.

On March 25, 2011, the boards of directors of Vivo Participações, our former subsidiary, and Telefônica Brasil approved the terms and conditions of the corporate restructuring of both companies, which was approved unanimously by the shareholders of both companies on April 27, 2011.

The transaction consisted of the unification of the share base of fixed and mobile operators of the Telefônica group in Brazil through the merger of all shares of Vivo Participações into Telefônica Brasil, with Telefônica Brasil as the surviving entity. Telefônica Brasil exchanged each share of Vivo Participações held by shareholders of Vivo Participações for shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. Upon closing of the merger and the share exchange, Vivo remained our wholly owned direct subsidiary. The Company assessed the fair value of the assets acquired and the liabilities assumed from Vivo Participações as of March 31, 2011 for purposes of applying the acquisition method to the transaction as a business combination we consolidated and included Vivo Participações in our results of operations as of April 1, 2011.

On April 27, 2011, we acquired 100% of Vivo Participações, for a total of R\$31.2 billion. See Note 1 and Note 4 to our consolidated financial statements. Our consolidated financial statements include Vivo Participações and Vivo as of April 1, 2011 through the full consolidation method. Because Vivo Participações and Vivo are consolidated into our financial statements for nine months in 2011 and for the full year ended December 31, 2012, our results of operations for the years ended December 31, 2011 and 2010 are not comparable with our results of operations for the year ended December 31, 2012.

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,			
Income Statement Data:	2012	2011	2010	2009



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IFRS	(in millions of reais, except for share and per share data)			
Net operating revenue	33,931	29,129	15,798	15,852
Cost of goods and services	(16,564 )	(15,040 )	(8,845 )	(9,236 )
Gross profit	17,367	14,089	6,953	6,616
Operating expenses, net	(10,155 )	(8,292 )	(3,391 )	(3,221 )
Equity in earnings (losses) of associates	-	-	3	19
Operating income before financial expense, net	7,212	5,797	3,565	3,414
Financial expense, net	(291 )	(140 )	(121 )	(189 )
Income before tax and social contribution	6,921	5,657	3,444	3,225
Income tax and social contribution	(2,469 )	(1,295 )	(1,046 )	(1,021 )
Net Income	4,452	4,362	2,398	2,204

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Income Statement Data:	Year ended December 31,			
	2012	2011	2010	2009
Attributable to:				
Controlling shareholders	4,453	4,355	2,398	2,204
Non-controlling shareholders	(1 )	7	—	—
Basic and diluted earnings per share:				
Common Shares	3.72	4.40	4.45	4.08
Preferred Shares	4.09	4.84	4.89	4.49
Cash Dividends per share in reais, net of withholding tax:				
Common Shares	2.57	4.78	3.62	2.56
Preferred Shares	2.82	5.26	3.98	2.81
Balance Sheet Data:	As of December 31,			
	2012	2011	2010	2009
IFRS	(in millions of reais, except where indicated)			
Property, plant and equipment, net	17,611	17,154	10,201	9,672
Total assets	70,255	65,490	19,966	20,643
Loans and financing—current portion	1,255	988	420	1,768
Loans and financing—noncurrent portion	3,756	3,959	1,405	1,752
Shareholders' equity	44,681	43,331	11,667	11,300
Attributable to:				
Controlling shareholders	44,681	43,326	11,667	—
Noncontrolling shareholders	—	5	—	—
Capital stock	37,798	37,798	6,575	6,575
Number of shares outstanding (in thousands)	1,123,269	1,123,884	505,841	505,841
Cash Flow Data:	Year ended December 31,			
	2012	2011	2010	2009
IFRS	(in millions of reais, except where indicated)			
Operating activities:				
Net cash provided by operations	9,733	8,141	4,532	4,449
Investing activities:				
Net cash used in investing activities	(3,397 )	(2,029 )	(1,658 )	(2,296 )
Financing activities:				
Net cash used in financing activities	(2,080 )	(4,729 )	(3,594 )	(1,618 )
Increase (decrease) in cash and cash equivalents	4,256	1,383	(720 )	536
Cash and cash equivalents at beginning of year	2,940	1,557	2,277	1,741
Cash and cash equivalents at end of year	7,196	2,940	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 may intervene in the exchange rate market.

Since 1999, the Central Bank has allowed the real/U.S. dollar exchange rate to float freely, and, since that time, the real/U.S. dollar exchange rate has fluctuated considerably. The real depreciated against the U.S. dollar by 15.7% in 2001 and 34.3% in 2002. Although the real appreciated by 22.3%, 8.8%, 13.4%, 9.5% and 20.7% against the U.S.

dollar in 2003, 2004, 2005, 2006 and 2007, respectively, in 2008, as a result of the international financial and economic crisis, the real depreciated against the U.S. dollar by 24.0%. In 2009 and 2010, the real appreciated against the U.S. dollar by 25.5% and 4.3%, respectively. In 2011, the real depreciated by 4.8% against the U.S. dollar. On December 31, 2011, the year-end real/U.S. dollar exchange rate was R\$1.8758 per U.S.\$1.00. In 2012, the real depreciated a further 8.94% against the U.S. dollar. On December 31, 2012, the year-end real/U.S. dollar exchange rate was R\$2.0429 per U.S. \$1.00.

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In the past, the Brazilian government has implemented various economic plans and utilized a number of exchange rate policies, including sudden devaluations, periodic mini-devaluations during which the frequency of adjustments ranged from a daily to a monthly basis, floating exchange rate systems, exchange controls and dual exchange rate markets. We cannot predict whether the Central Bank or the Brazilian government will continue to let the real float freely or intervene in the exchange rate market by returning to a currency band system or otherwise. The real may depreciate or appreciate substantially against the U.S. dollar.

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
2008	1.559	2.500	1.833	2.337
2009	1.741	2.378	1.990	1.741
2010	1.655	1.880	1.759	1.665
2011	1.535	1.902	1.671	1.876
2012	1.702	2.112	1.959	2.044

Source: Central Bank of Brazil, PTAX.

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

Month	Exchange Rate of R\$ per US\$			
	Low	High	Average(2)	Month-End
September 2012	2.014	2.039	2.027	2.031
October 2012	2.022	2.038	2.030	2.031
November 2012	2.031	2.107	2.069	2.107
December 2012	2.044	2.112	2.078	2.044
January 2013	1.988	2.047	2.018	1.988
February 2013	1.957	1.989	1.973	1.975
March 2013 (through March 19)	1.953	1.987	1.970	1.983

Source: Central Bank of Brazil, PTAX.

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

On March 19, 2013, the exchange rate was R\$1.983 to US\$1.00. The real/dollar exchange rate fluctuates and, therefore, the exchange rate at March 19, 2013 may not be indicative of future exchange rates.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

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Risks Relating to Brazil

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

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

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

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

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

The international economy remains subject to risks and adjustments arising from the international financial crisis. The international financial system remains susceptible to unfavorable credit and liquidity conditions. Foreign and national financial institutions, including some of the largest commercial banks, investment banks, mortgage lenders, guarantors and mortgage insurance companies, could continue to experience significant difficulties, including runs on their deposits and inadequate liquidity. Therefore, the prices of financial assets are likely to continue to reflect risk aversion, with increased volatility.

In an attempt to increase liquidity in the financial markets and prevent the failure of the financial system, various governments may continue to intervene in their financial systems, and perform tax adjustments. There is no assurance, however, that these measures will be successful in stabilizing conditions in international financial markets.

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

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

Political crisis in Brazil may affect the confidence 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 government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2012, inflation measured by the Consumer Price Index (Índice de Preços ao Consumidor), or IPCA, reached 5.8%, below the upper limit established by the CMN, of 6.5%, but above the central inflation target of 4.5%. In 2013, the Brazilian monetary policy will continue to use the IPCA as a reference for the inflation target. The inflation target for 2013 is set at 4.5%, similar to 2012. If inflation rises beyond this target, the basic interest rates may also rise, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2013, factors that may adversely affect consumer inflation are, among others, the international commodities prices, the impact of buoyant domestic economic activity on domestic prices and the indexation of prices and tariffs.

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

The fee rate increase authorized by ANATEL, which references the IST, is reduced by a factor of productivity and applied cumulatively after a period of 12 months. This may cause increases in costs and salaries above and below our revenues, 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, 2012, the basic interest rate was 7.25% per year, compared to 11% per year on December 31, 2011. Further increases in the basic interest rate may occur throughout 2013 with adverse effects on our business. According to current market consensus, inflation measured by the IPCA will be higher than the established inflation target of 4.50% for 2013. As a result, the Central Bank may increase the SELIC rate (the Central Bank's overnight rate) in 2013 to align inflation with the inflation target, which may adversely affect our business.

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

The exchange rate between the U.S. dollar and the Brazilian real has experienced significant fluctuations in recent years. Between 2000 and 2003, the real was devalued 67% against the U.S. dollar and gained 40% between 2004 and 2010, considering the annual average exchange rates. Between 2001 and 2012, the real appreciated by 11.9 % against the U.S. dollar.

As of December 31, 2012, 19.9 % of our R\$ 7.97 billion total financial debt was denominated in U.S. dollars and UMBNDES. As of December 31, 2012, 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 the euro, our commitments linked to fluctuations in exchange rates or payable in foreign currencies become more expensive. In return, our accounts receivable denominated in foreign currencies appreciate, which could adversely affect our revenue and expenses.

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However, 99.9% of the net balance of the transactions denominated in foreign currencies is covered by hedge transactions. Since May 2010, the company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures generated by invoices issued or received in foreign currencies, substantially reducing the company's risk to fluctuations in exchange rates. By periodically receiving invoices for the net balance coverage and determining the coverage of exposures, the company's corporate market risk department monitors its foreign exchange exposure and commitments linked to foreign currencies so as not to achieve a significant amount of exposure.

It should be noted that the IST, the current index applicable to telecommunication fees for fixed-line services, does not adequately reflect the true effect of exchange rate fluctuations. Thus, since 2006, telecommunication revenue, when converted to U.S. dollars, does not adequately reflect the true effect of exchange rate fluctuations, so that our results of operations could be adversely affected. See "—A. Selected Financial Data—Exchange Rates" for more information on exchange rates.

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

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

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

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

Risks Relating to the Brazilian Telecommunications Industry and Us

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

Our business is subject to extensive government regulation, including any changes that may occur during the period of our authorization to provide telecommunication services. ANATEL, which is the main telecommunications industry regulator in Brazil, regulates, among other things:

- industry policies and regulations;
- licensing;

- fees and tariffs;
- competition, including, therefore, our ability to grow by acquiring other telecommunications businesses;
- telecommunications resource allocation;
- service standards;

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- technical standards;
- quality standards;
- interconnection and settlement arrangements; and
- universal service obligations.

Brazil's telecommunications regulatory framework is continuously evolving. The interpretation and enforcement of regulations, the assessment of compliance with regulations and the flexibility of regulatory authorities are all marked by uncertainty. We operate under authorization from the Brazilian government, and our ability to retain this authorization is a precondition to our success. However, because of the regulatory framework, we cannot provide assurances that ANATEL will not adversely modify the terms of our authorization. Furthermore, according to the terms of our operating authorizations, we are obligated to meet certain requirements and to maintain minimum quality, coverage and service standards. Failure by us to comply with these requirements may result in the imposition of fines or other government actions, including the termination of our operating authorizations. Any partial or total revocation of any of our operating authorizations would have a material adverse effect on our business, financial condition, revenues, results of operations and prospects. In recent years, ANATEL has also been reviewing and introducing changes in the applicable regulation, especially regarding the interconnection fees among telecommunications service providers in Brazil. Interconnection fees, which are fees charged by telecommunications service providers to each other to interconnect to each other's networks, are an important part of our revenue base. To the extent that changes to the rules governing interconnection fees reduce the amount of interconnection fees we are able to collect, our businesses, financial conditions, revenues, results of operations and prospects could be materially adversely affected.

Therefore, our businesses, results of operations, revenues and financial conditions could be negatively affected by the actions of the Brazilian authorities, including, in particular, the following:

- the introduction of new or stricter operational and/or service requirements;
- the granting of operating licenses in our areas;
- delays in the granting of, or the failure to grant, approvals for rate increases; and
- antitrust limitations imposed by ANATEL and CADE.

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, 2012, the net book value of reversible assets is estimated at R\$6.7 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

The expiration date of the original concession agreements was December 31, 2005, but it has since been renewed as of December 22, 2005 for an additional 20-year term. The current concession agreements contain a provision allowing ANATEL to review the concession terms in 2015 and 2020. This provision permits ANATEL to

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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.

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

Some of the main telecommunication groups in Brazil went through a series mergers and acquisitions in 2012. In December 2011, Sky Brasil (a Brazilian subsidiary of DirecTV), announced the purchase of Acom Comunicações, a Brazilian television and internet company, which was approved by regulators in 2012. Along with the acquisition of Acom, Sky Brasil also acquired grants to operate new 4G spectrum areas in June 2012.

In May 2012, entrepreneur George Soros acquired Sunrise Telecomunicações, a Brazilian pay-TV provider that is now expanding into mobile services. Sunrise Telecomunicações spent US\$9.3 million to acquire two 4G spectrum licenses covering 134 cities in the state of São Paulo. Furthermore, during the last quarter of 2012, Vivendi S.A. decided to sell Global Village Telecom or GVT as part of a review of its business portfolio in the telecommunications industry, including videogames and music. GVT currently sells phone, video and broadband services in 120 cities in Brazil. On March 14, 2013 Vivendi decided to stop de process to sell GVT.

Mergers and acquisitions may change the market dynamic, cause competitive pressure and force small competitors to find partners and may impact our business, in terms of operations, financial condition, marketing strategies and offering of products and promotions.

We face increasing competition from telecom service providers.

The telecommunication industry in Brazil is growing rapidly, partly as a result of increased competition. Our competitors have been using aggressive promotion techniques to increase their client base and, as a result, market share. New marketing strategies stimulate clients to increase their voice and data usage, by offering unlimited network-to-network minutes and daily and prepaid data options. While in 2012 there has been an increase in growth of our mobile client base, there has been a decrease in the number of fixed services added.

Further, in 2012 there has also been an increase in competition regulation aimed at stimulating competition, increasing the adoption of services and reinforcing the quality of services delivered.

Brazilian antitrust regulation is based on Law No. 12,529 of November 30, 2011, which generally prohibits any practice or transactions aimed at restricting free competition, dominating the relevant market of goods or services, arbitrarily increasing profits, or abusively exercising a dominant market position. The new antitrust law has altered several practices in Brazil; particularly, it established a pre-merger notification regime with a new turnover thresholds and extended the maximum period for merger review procedures to 330 days from 240 days. We cannot continue to expand our growth through acquisition of other service providers given the antitrust objections of ANATEL along with the fact that we currently already render SMP service all over the country. Consolidation of other competitors in the telecommunications market will increase the competitive pressure on us due to the increase in their economies of scale and reduction of operational costs, and we may be unable to respond adequately to pricing pressures resulting from consolidation, which would adversely affect our business, financial condition and results of operations.

Our results of operations may be negatively affected by the application of the SMP rules.

Under the SMP regime, our cellular subsidiaries receive payments for the use of their networks in accordance with a network usage payment plan, which includes outbound long-distance calls. Until June 30, 2004, SMP service providers were able to opt to establish a price cap or freely negotiate our interconnection charges. In early 2005,

ANATEL began permitting free negotiations for mobile interconnection, or VU-M, fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in mobile operators' fees). ANATEL approved that provisional agreement and, in March 2006, approved another provisional agreement of a 4.5% increase for VU-M fees for long-distance calls, or VC2, VC3, and international calls, among the same operators that had made the VC1 agreement in July 2005. The current rule is the free negotiation of fees, subject to ANATEL regulations. In July 2007, ANATEL approved a provisional agreement among us and the fixed-line operators Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of approximately 1.97% to interconnection fees in Region I (Telemar's Region)

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and an annual adjustment of approximately 2.25% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

ANATEL also issued Regulation No. 460/2007 regarding Number Portability, implementing and developing fixed and wireless Number Portability in Brazil effective as of March 2009, with most costs being borne by the operators. For SMP, Number Portability is applied for wireless codes of access of the same registration area. As of December 2011, there were 242.2 million cell phones in Brazil. From the period beginning in September 2008, when Number Portability became effective, until December 31, 2012, over 3.1 million users had transferred out of, and another 3.1 million users had transferred into, our subsidiaries as their mobile operator. For fixed service operators, Number Portability is applied for fixed codes of access of the same local area. There can be no assurance that this regulation will not have material adverse effects on the results of our operations.

On July 18, 2012, Vivo was notified by ANATEL that it would be required to present an improvement plan, subject to ANATEL's approval, for the improvement of SMP services provided. The plan is aimed to improve services, in particular: (1) call completions; (2) service interruptions; and (3) user satisfaction. Our competitors were also required to present their own improvement plans to ANATEL. Vivo presented its improvement plan to ANATEL and received approval on September 10, 2012.

We cannot predict whether the current regulatory regime will remain in place or whether any future regulatory change or requirements will have an adverse effect on our results of operations. We cannot assure you that our service plan will continue to be approved by ANATEL or that the interconnection rates we negotiated will be upheld or that future negotiations will be as favorable as those that were previously set by ANATEL. If the readjustments that we negotiated are cancelled or if freely negotiated interconnection fees in the future are less favorable to us, our business, financial condition, revenues, results of operations and prospects will be adversely affected.

If the inflation adjustment index currently applied to our prices is changed, the new index may not adequately reflect the true effect of inflation on our prices, which could adversely affect our results of operations.

The Brazilian government currently uses the General Price Index, or the IGP-DI (the Índice Geral de Preços Disponibilidade Interna), an inflation index developed by the Fundação Getúlio Vargas, a private Brazilian economic organization, in connection with the prices charged in the wireless telecommunications industry. ANATEL regulates the telecommunication industry based on an economic cost model that analyzes companies' total costs based on a theoretical company's costs and other factors. In connection with this model, the Brazilian government used a different inflation adjustment mechanism, the IST index. Under Resolution No. 438/2006, ANATEL will determine the reference cost of using mobile networks (RVU-M) for SMP providers who have significant market power, which will be used in the arbitration case by ANATEL to determine the VU-M fee. In addition, Resolution No. 600/2012, determined that RVU-M, which is calculated based on a cost model, will go into effect on February 24, 2016. As a result, we expect there to be a decrease in 2014 of 75% of VU-M, in effect on December 31, 2013 and in 2015 of 50% of the VU-M. The inflation adjustment of the RVU-M value uses the IST index. In the auctions by SMP of new radio frequency bands, ANATEL has been using the IST index for determining the value of the installments to be paid for the licenses. If this new inflation adjustment mechanism, or any other mechanism chosen by the Brazilian government in the future, does not adequately reflect the true effect of inflation on our prices, our results of operations could be adversely affected.

ANATEL's new regulation regarding interconnection and network usage fees could have an adverse effect on our results.

We are regulated by ANATEL, which issues new regulations every year affecting many of our areas of operations. Such new regulations could have an adverse effect on our results of operations because: (1) our interconnection



charges could drop significantly, thereby reducing our revenues; (2) ANATEL may allow more favorable prices for economic groups without significant market power; (3) the prices we charge in some regions in which we operate are higher than those in certain other regions, and consolidation of those prices, competitive pressures and other factors would reduce our average prices and thereby reduce our revenues; (4) the granting of new licenses may increase competition in our area from other operators, which could adversely affect our market share, thereby reducing our revenues; (5) the inclusion in the calculation of operating profits the remuneration received for the use of the SMP network will increase the cost of renewing licenses; and (6) in ANATEL's general plan of updating the telecommunications regulation, ANATEL targets several areas of vital importance for the mobile telecommunications business, such as regulation to improve the quality of services that can cause the rise of

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operational costs, regulation of the virtual mobile operation (MVNO) that can cause an increase in competitive pressure, regulation against significant market power (“Poder de Mercado Significativo–PMS”) arising from VU-M fee unification among SMP providers of the same economic group having significant market power, that can reduce our revenues, and regulation of multimedia communication (SCM), that can cause an increase in competitive pressure. For a detailed description of the regulations issued by ANATEL and their impact on our business, see “Item 4B. Business Overview—Regulation of the Brazilian Telecommunications Industry.”

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

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

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

We are subject to certain risks related to conditions and obligations that could be imposed by ANATEL for the participation in the spectrum auction for LTE services.

In August 2010, ANATEL established a new policy regulating the 2.5 GHz spectrum, which requires MMDS (Multichannel Multipoint Distribution Service) companies, including us, to return, by 2013, a significant portion of the spectrum we currently own and to offer cable TV on a primary basis.

On June 12 and 13, 2012, ANATEL held a public bidding for 273 4G lots in the 2,500 to 2,690MHz frequencies. We acquired the “X” band, with a nationwide coverage, for R\$1.05 billion. Given the rules of the public bidding process, which limited the total spectrum each service provider could hold within this frequency, we agreed to relinquish bands “P,” “T” and “U.” used for MMDS services within 18 months of obtaining the “X” band. Sky and TIM will have preferred rights for the acquisition of the “T” and “U” and for the “P” bands, respectively in the cities of Curitiba and Rio de Janeiro and Oi will have preferred rights for the acquisition of the “P” band in the cities of São Paulo and Porto Alegre.

In order to meet the coverage requirements in the 2.5 GHz frequency, cities will have the services available according to the following timetable:

- by April 30, 2013: cities that will be host to the Confederation Cup in 2013
- by December 31, 2013: host and sub-host cities to the World cup in 2014;
- by May 31, 2014: state capitals, the Federal District and cities with over 500,000 residents;
  - by December 31, 2015: cities with over 200,000 residents;
  - by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
  - by December 31, 2019: cities with fewer than 30,000

ANATEL also held a public bidding for the 450 MHz frequency, in order to meet voice and data demand with mobile technology in rural areas. In the absence of interested participants, those granted rights under the 4G bid were required to take over the infrastructure set up in rural areas, which will be regulated in 2013 according to the frequency acquired.

Under band “X,” which we acquired in the bidding process, we will be required to provide infrastructure in rural areas in the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and countryside of São Paulo, for a total of 2,556 municipalities. The timetable for providing infrastructure in the rural areas requires that 30% of municipalities have infrastructure set up by June 2014, 60% by December 2014 and 100% by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps. Service providers will be allowed to use other frequencies previously granted to it to meet these requirements.

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After receiving the ANATEL study on the occupation of the 700 MHz frequency, published in early January 2013, the communications minister, published Ordinance No. 14, with guidelines for accelerated access to the Brazilian System of Digital Terrestrial Television - SBTVD-T and to broaden the availability of the radio frequency spectrum for meeting the goals set forth by the National Broadband - PNBL. The ordinance also establishes that the FCC develop a proposal to regulate use of the band. The proposal will be put to public consultation, giving conditions for the bidding possibly occur in the second semester of 2013.

Also, targets established by ANATEL associated with a fast paced implementation of networks could impact (i) the ability to obtain municipal licenses for the construction of new sites at the speed necessary to achieve the coverage targets, (ii) the capacity of suppliers to deliver the equipment necessary for this expansion, with possible impact on their prices, subject to targets to acquire national technology, and (iii) lack of workers to meet the expected implementation pace.

Certain of our debt agreements contain financial covenants, and any default under such debt agreements may have a material adverse effect on our financial condition and cash flows.

Certain of our existing debt agreements contain restrictions and covenants and require the maintenance or satisfaction of specified financial ratios and tests. Failure to meet or satisfy any of these covenants, financial ratios or financial tests could result in an event of default under these agreements.

The telecom industry, including us, may be harmed by restrictions regarding the installation of new antennas for mobile services.

Currently, there are approximately 250 municipal laws that restrict the installation of new antennas for mobile service, which has been a barrier to the expansion of mobile networks. Those laws are meant to regulate issues related to urban aspects and the alleged effects of the radiation and radiofrequencies of the antennas. There are initiatives for the approval of a federal law establishing new guidelines to create a consolidated plan for the installation of antennas, however as long as the municipal laws remain unchanged, we will continue to run the risk of having limited quality of service in certain areas and may be unable to meet the quality and coverage targets provided for in regulations and service agreements with ANATEL.

The installation of additional antennas is also limited as a result of media and other reports, which have suggested that radio frequency emissions from base stations may cause health problems. These concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation. According to the World Health Organization (WHO), there is no evidence in the latest medical research that shows any relationship between radio frequency emissions of base stations and health concerns. However, expansion of our network may be affected by perceived risks if we experience problems in finding new sites, which in turn may delay expansion and may affect the quality of our services. On July 2, 2002, ANATEL published Resolution No. 303 that limits emission and exposure for fields with frequencies between 9 kHz and 300 GHz. In addition, the Brazilian government developed specific legislation for the deployment of radio frequency transmission stations that supersedes the existing state and municipal laws. In May 2009, the Brazilian government published Law No. 11934/2009 that limits the exposure for fields with frequencies up to 300 GHz. The new law uses the exposition limits determined by the International Commission on Non-Ionizing Radiation Protection (ICNIRP) and recommended by the WHO.

In May 2011, the specialized body of the WHO for research on cancer (IARC) classified electromagnetic fields of mobile telephony as “possibly carcinogenic,” a classification which also includes products such as coffee and pickled foods. The WHO subsequently indicated, in fact sheet no. 193, published in June 2011, that to date it cannot be confirmed that the use of a mobile telephone has adverse effects on health, although it also announced that in 2012 an official assessment of this risk will be conducted, taking into account all scientific evidence available.

New laws may create additional transmission regulations, which in turn, could have an adverse effect on our business. Also, health concerns may affect our ability to capture or retain customers, may discourage the use of the mobile telephone and may result in the adoption of new measures by governments or any other regulatory interventions, any of which could materially and adversely affect our business, results of operations and financial condition.

We face risks associated with litigation.

We are party to a number of lawsuits and other proceedings. An adverse outcome in, or any settlement of, these or other lawsuits could result in significant costs to us. In addition, our senior management may be required to devote substantial time to these lawsuits, which they could otherwise devote to our business. See “Item 8. Financial Information—A. Consolidated Statements and Other Financial Information—Legal Matters.”

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We may be required to record impairment charges relating to goodwill and long-lived assets in the future.

For IFRS purposes, we are required to test our goodwill for impairment at least annually. The excess of the book value of a company over its market value may indicate that impairment exists. This impairment test is described in Note 3 to our audited consolidated financial statements. The Company has substantial goodwill with a carrying value of R\$10.2 billion as of December 31, 2012. It is possible that we may be required to record impairment charges relating to our goodwill in future periods, and this would have an adverse effect on our results of operations.

In addition, we are required to record impairment charges on long-lived assets, including property, plant and equipment and finite-lived intangible assets (including licenses) if the carrying value of these assets exceeds the recoverable amount expected from their use. This impairment test is also described in Note 3 to our audited consolidated financial statements included in this annual report.

### Risks Relating to the Preferred Shares and the ADSs

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

We are organized under the laws of Brazil, and all of our executive officers and our independent public accountants reside or are based in Brazil. Also, eight of our fifteen directors reside or are based in Brazil. Substantially all of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of the ADSs to effect service of process upon us or these other persons within the United States or other jurisdictions outside Brazil or to enforce against us or these other persons judgments obtained in the United States or other jurisdictions outside Brazil. Because judgments of U.S. courts for civil liabilities based upon the U.S. federal securities laws may only be enforced in Brazil if certain conditions are met, holders may face greater difficulties in protecting their interests due to actions by us, our directors or executive officers than would shareholders of a U.S. corporation.

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

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

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

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

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

The ADSs benefit from the certificate of foreign capital registration, which permits Citibank N.A., as depositary, to convert dividends and other distributions with respect to preferred shares into foreign currency, and to remit the proceeds abroad. Holders of ADSs who exchange their ADSs for preferred shares will then be entitled to rely on the depositary's certificate of foreign capital registration for five business days from the date of exchange. Thereafter, they will not be able to remit non-Brazilian currency abroad unless they obtain their own certificate of foreign capital registration, or unless they qualify under Resolution No. 2,689 of the Central Bank of Brazil, dated January 26, 2000 and issued by BACEN, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration.

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

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

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

Based on the fact that the ADSs are issued and registered abroad, we believe that gains on the disposition of ADSs made outside of Brazil by nonresidents of Brazil to another non-Brazilian resident would not be subject to Brazilian taxation, since they would not fall within the definition of assets located in Brazil for purposes of Law 10,833. However, considering the general and unclear scope of Law No. 10,833 and the absence of judicial court rulings in respect thereto, we cannot be assured that such an interpretation of this law will prevail in the courts of Brazil. If the income tax is deemed to be due, the gains may be subject to income tax in Brazil at a rate of 15.0% (general taxation) or 25.0% (if the nonresident 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 nonresident 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 S.A., or Telefónica, our principal shareholder, currently owns directly and indirectly approximately 91.76% of our voting shares and 73.81% 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 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 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 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

We were incorporated on May 22, 1998, as a corporation (sociedade anônima) organized under the laws of the Federative Republic of Brazil, as a result of the restructuring and privatization of Telebrás, discussed below. We are incorporated under the name Telefônica Brasil S.A. (and, before our merger with Vivo Participações on October 3, 2011, under the name Telecomunicações de São Paulo S.A. – TELESP).



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We are registered with the CVM as a publicly held company and our stock is traded on the BM&FBOVESPA under the symbol “VIVT3” (formerly TLPP3) for common shares and “VIVT4” (formerly TLPP4) for preferred shares. 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 under the symbol “VIV” (formerly TSP). Our headquarters are located at Avenida Engenheiro Luis Carlos Berrini, 1376, 04571-936, São Paulo, SP, Brasil. Our telephone number is 55-11-3430-8901 and our website is [www.telefonica.com.br/ir](http://www.telefonica.com.br/ir). The information on our website is not part of this annual report on Form 20-F.

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As of December 31, 2012, we had 381,335,671 outstanding common shares, with no par value per share, and 741,933,573 preferred shares, with no par value per share. Our shareholders' equity was in the amount of R\$44.7 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 that 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, pursuant to which ANATEL also acknowledged the completion of our network expansion and achievement of universal service targets as of September 30, 2001.

We also provide multimedia communication services (serviços de comunicação multimedia), 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 Sector 33.

On 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, or 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 is pending review by CADE.

In 2008, we pioneered the launch of Internet access through fiber optic cables ("Fiber to the Home"), or FTTH to noncommercial customers. Aside from the offer of an Internet connection with high-speed capabilities 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 for the use of the spectrum frequencies associated with the MMDS in the cities of São Paulo, Curitiba, Rio de Janeiro and Porto Alegre through 2024.

According to data regarding market share published by ANATEL, we are among the leading providers of cellular telecommunications services in Brazil, with the help of our wholly owned direct subsidiary Vivo, the leading cellular operator in Brazil. Vivo provides cellular service in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (including the Federal District), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São Paulo, Sergipe, Tocantins and Minas Gerais.

As of December 31, 2012, our telephone network included 10,646 thousand fixed-lines in service, 76,137 thousand mobile accesses, 3,733 thousand broadband clients and 600 thousand Pay TV clients.

## 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.

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In May 1998, just before its privatization under the General Telecommunications Law, the Telebrás System was restructured to form, in addition to Telebrás, 12 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 TelespPar 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 TelespPar.

### The Reorganization of TelespPar

On November 30, 1999, the shareholders of TelespPar approved a reorganization involving a series of mergers, whereby TelespPar became the telecommunications services company operating under our current name, Telefônica Brasil S.A. (formerly Telecomunicações de São Paulo S.A. – TELESP prior to our merger with our direct subsidiary, Vivo Participações).

### 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, of 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.

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

On August 3, 2000, our 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 in July 2006. See “—The SCM Restructuring.”

### Attainment of ANATEL Targets

Our 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.

On January 29, 2003, the board of directors of ANATEL granted us the authorization to provide SCM service nationwide. We 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, or CSP that enables customers to choose the long-distance carrier for each domestic long-distance call (VP2 and VP3) or

international call, in accordance with the SMP rules. As a result, the company, having acknowledgment 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 3, 2004, were implemented to carry out the reconfiguration of the local areas for the 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 Greater São Paulo (Grande São Paulo).

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### 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 Telefónica Data S.A. (formerly T-Empresas), one of the companies of the Telefónica 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.

### 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 “T-Companies”), approved the restructuring of the T-Companies’ SCM and data transmission activities, or the SCM Restructuring.

The terms and conditions of the SCM Restructuring are set forth in an agreement among the T-Companies dated as of 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, the shareholder of Telefónica Empresas S.A., which is the company, resolved to change Telefónica Empresas S.A.’s corporate name 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, we 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.

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On October 31, 2007, the board of directors 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 on November 19, 2007. Antitrust clearance is still pending from ANATEL and CADE competition authorities.

On November 23, 2007, our shareholders ratified the Agreement, its amendments and annexes, and approved the implementation of the deal and the signing of all documents necessary for its complete formalization.

As a result of this transaction, Navytree Participações S.A., or Navytree became a wholly owned subsidiary of TELESP, and our provision of broadband services became centralized.

On June 10, 2008, our shareholders approved a change in the corporate name of Navytree to Telefônica Televisão Participações S.A., or TTP.

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., or Ajato. As a result of the merger of TTP into the company on November 11, 2008, Ajato's shares are currently held by TST and us.

Corporate Reorganization involving DABR and TTP

On October 21, 2008, our board of directors and the shareholders of TTP and Telefônica Data Brasil Participações Ltda., or 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 shareholders. As a result of this restructuring, TTP and DABR were dissolved and we assumed all the rights and obligations of TTP and DABR.

The reorganization allowed us 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 our cash flows. The reorganization and the goodwill amortization were structured so as to avoid any assumption of indebtedness by us and to minimize any negative impact on our future results.

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 to all of the assets and liabilities of TS Tecnologia.

Corporate Restructuring involving A.TELECOM S.A.

On December 9, 2009, our 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., or A.TELECOM, and the subsequent merger of the spun-off part of A.TELECOM into us.



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 us. On the same date, our 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.

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### Corporate Restructuring involving Brasilcel

#### Acquisition of Brasilcel N.V. stocks by Telefónica S.A.

On July 28, 2010 Telefónica S.A. and Portugal Telecom SG SGPS, S.A. entered into an agreement for the acquisition by Telefónica of 50% of shares of Brasilcel N.V., or Brasilcel, owned by Portugal Telecom. As a result, Telefónica indirectly acquired the shares of Vivo Participações held by Portugal Telecom. Prior to this agreement, Brasilcel's shares were held by Telefónica (50%) and by Portugal Telecom (50%) and, in 2002, it was used for the joint venture between both shareholders to jointly hold shares and control of Vivo Participações and other mobile phone companies which were later added under Vivo Participações and in Vivo.

On December 21, 2010, Brasilcel was merged into Telefónica, which held direct and indirect stakes in Vivo Participações' capital stock representing approximately 60%.

Due to the acquisition of control of Vivo Participações and pursuant to the terms provided for in Article 254-A of Brazilian Corporate Law and the procedures established in article 29 of CVM Instruction 361 applicable to tender offers (OPA) by sale of control, as defined by item III of article 2 of CVM Instruction 361, on February 17, 2011 Telefónica through its subsidiary SP Telecomunicações Ltda., or SPTelecom, launched a public tender offer for the shares with voting rights of Vivo Participações (common shares) held by noncontrolling interests. Those shares were acquired at 80% of the value paid by Telefónica to Portugal Telecom SG SGPS S.A., for each common share with voting rights of Vivo Participações owned by Brasilcel.

On March 18, 2011, when the public tender offers were made, SP Telecom acquired 10,634,722 common shares of Vivo Participações, representing 2.65% of its shares, resulting in the Telefonica group's ownership of 62.1% of Vivo Participações.

#### Introduction of the Vivo Brand

In April 2003, Brasilcel launched in Brazil the brand name "Vivo," under which TCP, TCO, TLE, TSD and Celular CRT operate. The creation of the Vivo brand constituted a consolidation of the commercial models throughout the entire country into a common commercial strategy and replaced the different brands under which the different companies offered their services in their respective states. The commercial strategy of Vivo is to increase its customer base as well as revenues by retaining customers and maintaining their distribution channels. The launching of the Vivo brand was accompanied by customer loyalty programs and other measures designed to contribute to the success of the commercial strategy. Guided by a common management team, Vivo designs marketing, promotional and other initiatives common to all companies in the Vivo group and then tailors those activities to the particular markets of those companies.

#### Agreement with Telefónica and Telecom Itália

In October 2007, TELCO S.p.A. (a company in which Telefónica holds a corporate interest of 42.3%) acquired 23.6% of the capital stock of Telecom Itália. Telecom Itália also holds an interest in the capital stock of TIM. However, Telefónica did not acquire any right to directly participate in the operations of TIM as a result of the acquisition of the corporate interest in Telecom Itália by TELCO S.p.A.

As a result, any transaction involving us and TIM is considered an ordinary mobile network business transaction, which is regulated by ANATEL, as provided in the Act 68,276, dated October 31, 2007 and in the Act 3,804, dated July 7, 2009, both issued and published by ANATEL.

Corporate Restructuring involving Vivo Participações

On 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 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 (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).

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On December 27, 2010, the company and Vivo Participações, jointly announced the approval by their respective boards of directors of a proposal for corporate restructuring involving the merger of shares of Vivo Participações into us, aiming for the consolidation of the shareholding positions of both companies.

Other than the concentration of the shareholding position herein mentioned, the purpose of the corporate restructuring was to simplify the organizational structure of the companies, both of which were publicly held companies and listed on BM&FBOVESPA and with American Depositary Receipts traded in the United States. The restructuring allowed 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 provided for the rationalization of the cost structure of the two companies and facilitated the integration of businesses and the generation of synergies, thus positively impacting both companies.

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:

Upon completion of this corporate restructuring, Telefónica, S.A. held the shares of the Brazilian holding companies previously held indirectly by Telefónica, S.A., through the holding of Brasilcel, N.V., as a result of a transaction implemented abroad. The merger of shares did not change the composition of the ultimate control of the companies involved.

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The corporate structure after the merger is as follows:

Vivo Participações was merged into us, and the holders of the merged shares of Vivo Participações received new shares to which they were entitled in the company. In accordance with Brazilian Corporate Law, as well as the bylaws of both companies, financial advisors and specialized companies were retained for the preparation of studies regarding the transaction and the subsequent preparation of valuation reports of the companies that were 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 Brazilian Corporate Law regarding the exchange ratio between the shares.

The corporate restructuring was approved by ANATEL on March 24, 2011. Before the corporate restructuring, the Brazilian entities, TBS Celular Participações Ltda., Portelcom Participações S.A. and PTelecom Brasil S.A. (jointly, the “Holdings BR”), were merged into Vivo Participações. The Holdings BR had as its main asset the shares of Vivo Participações and were controlled by Brasilcel. The merger of Holdings BR did not result in any change in the number and the composition of classes of shares of Vivo Participações, and did not affect the participation of the shareholders of Vivo Participações.

Acquisition of Vivo Participações by Telefônica Brasil and corporate restructuring

In order to unify the shareholder base of the companies in our group, simplify the organizational structure, rationalize costs, integrate businesses and, consequently, generate synergies provided for in the strategy of Telefônica, on December 27, 2010, the boards of directors of Vivo Participações and Telefônica Brasil approved the terms and conditions of a restructuring, which provided for the merger of Vivo Participações into Telefônica Brasil. Following recommendations of the CVM, independent special committees were created to negotiate the exchange ratio of shares and determine the other conditions of the corporate restructuring proposal, which was later submitted along with its recommendations to the boards of directors of both companies.

The proposal was submitted to ANATEL for authorization and was approved at a meeting of the board of directors of ANATEL on March 24, 2011.

On March 25, 2011, the boards of directors of Vivo Participações and Telefônica Brasil approved the terms and conditions of the corporate restructuring, which were approved unanimously by the shareholders of the two companies on April 27, 2011.

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Before the start of the corporate restructuring, the holding companies (composed of TBS Celular Participações Ltda., Portelcom Participações S.A. and Brazil PTelecom S.A.), controlled by Telefónica S.A. and whose main purpose was to hold shares of Vivo Participações, were merged into Vivo Participações as a preliminary phase for the first stage of the restructuring.

The first stage of the transaction consisted of the unification of the share base of the fixed and mobile operators of the Telefonica group in Brazil, through the merger of shares of Vivo Participações into Telefônica Brasil. Vivo Participações was merged in its entirety into Telefônica Brasil and holders of shares of Vivo Participações received the new shares of Telefônica Brasil. The exchange of shares of Vivo Participações for shares of Telefônica Brasil was based on the exchange share ratio of 1.55 shares of Telefônica Brasil for each share of Vivo Participações. This followed the recommendations of the independent special committees.

Due to the merger of Vivo Participações into us, our capital was increased by R\$31.2 billion, reflecting the economic value of the shares issued as a result of the merger, based on an economic value appraisal of Vivo Participações prepared by Planconsult Consultoria Ltda., or Planconsult.

Telefónica's strategy in the first stage of the corporate restructuring was to maximize the potential of its operations in Brazil. Therefore, Telefônica Brasil became the direct shareholder of Vivo Participações, and indirect shareholders of Vivo. Through the creation of this umbrella investment structure, the noncontrolling shareholders of both companies were equally benefited by the added values generated by the combination of the telecommunications business. This is a basic movement in business so as to improve its converging market strategy, including combined mobile and fixed-line offers. This reorganization created the necessary conditions to begin the process of obtaining operational and financial synergies.

Additionally, as a consequence of this merger, on July 6, 2011, Vivo Participações filed a statement with the SEC in order to cancel the registration American Depositary Shares, or ADS, program since all its ADSs were converted into ADSs of Telefônica Brasil, plus payment currency in lieu of fractional Telefônica Brasil ADSs. The SEC approved the deregistration on July 7, 2011.

The second and third stages of the corporate restructuring, disclosed to the market on June 15, 2011, sought to continue the simplification process of the organizational structure of the companies, so as to: (i) focus all authorizations for the rendering of SMP services (originally held by Vivo Participações and Vivo), and (ii) simplify the current corporate structure, eliminating the structure of Vivo Participações, which due to the concentration of commitments, became a holding company.

In the second stage, held on October 1, 2011, assets, rights and obligations of Vivo Participações relating to mobile operations in Minas Gerais were awarded to Vivo, a subsidiary of Vivo Participações. As a result, Vivo became the only mobile operator in the group.

After ANATEL's approval of the third stage of corporate restructuring, on August 16, 2011, Telefônica Brasil absorbed Vivo Participações' equity, extinguishing Vivo Participações on October 3, 2011, which simplified and rationalized our cost structures.

### SMP Authorizations and Corporate Restructuring

On June 14, 2011, the board of directors of Vivo Participações approved a proposal for the merger of authorizations to provide SMP services (then owned by Vivo Participações in the State of Minas Gerais and Vivo in other Brazilian States). As a result, the operations and authorizations for the provision of SMP services were unified under Vivo. On the same date, the proposal for merger of SMP authorizations as well as for simplifying the corporate structure was

filed with ANATEL. The form proposed for this simplified corporate structure was the transfer of businesses, including property, rights and obligations related to provision of SMP services, as well as the authorizations for the provision of SMP in the State of Minas Gerais held by Vivo Participações, to Vivo, which would result in Vivo being a wholly owned direct subsidiary of the company and the mobile operator group that owns the SMP authorizations in other Brazilian states. After the transfer, Vivo Participações was to become a holding company and immediately merge into us, thus simplifying and rationalizing the cost structure of the companies involved and subsequently extinguish its corporate existence. On August 16, 2011, ANATEL approved the corporate restructuring pursuant to Act. No. 5,703, published on August 18, 2011.

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On September 12, 2011, in compliance with Brazilian Corporate Law, an independent firm prepared a valuation report of Vivo Participações' net assets based on its book value as of August 31, 2011 containing part of Vivo Participações' assets relating to the operations of SMP in the state of Minas Gerais that were transferred to Vivo and the assets of Vivo Participações merged into us. Vivo Participações' valuation as of August 31, 2011 was R\$10.3 billion.

On September 13, 2011, the board of directors of Vivo Participações approved, ad referendum of the shareholders: (i) the valuation report of Vivo Participações, containing part of the assets corresponding to the SMP operations in the State of Minas Gerais, which led to a capital increase in Vivo in the amount of R\$833.0 million, through the subscription of shares of Vivo Participações; and (ii) the Protocol of Merger and Instrument of Justification of Vivo Participações into Telecomunicações de São Paulo S.A. – TELESP, for the merger of Vivo Participações into us, preceded by the transfer of commercial establishments, including the assets, rights and obligations related to provision of SMP, as well as authorizations for the provision of SMP in the state of Minas Gerais held by Vivo Participações.

On October 1, 2011, our shareholders approved the valuation report of Vivo Participações. The net assets of Vivo Participações in Minas Gerais transferred to Vivo amounted to R\$833.0 million, which were used for the capital increase in Vivo through the subscription of shares by Vivo Participações, paid via the transfer of assets.

On October 3, 2011, our shareholders approved the merger of Vivo Participações into us. On the same date, we changed our name from Telecomunicações de São Paulo S.A. – TELESP to Telefônica Brasil S.A., to reflect its nationwide operations.

On October 18, 2011, ANATEL approved transfer of the authorization for the provision of SMP services in the state of Minas Gerais to Vivo.

Provision of STFC outside the state of São Paulo by Vivo

On August 18, 2011, ANATEL approved the authorization for Vivo to provide STFC services to the general public. On October 7, 2011, Vivo began providing fixed-line services through mobile technology, or FWT outside the state of São Paulo.

On August 18, 2011, ANATEL consented to the transfer of our authorization for STFC services in local, domestic long-distance and international long-distance modes outside the state of São Paulo in Regions I and II to Vivo, which authorization was published on September 8, 2011. As a result, Vivo began to offer STFC across its area, except for the state of São Paulo, using the network elements and some radio frequencies that support the provision of SMP.

Plan for the purchase of shares issued by the company.

On August 11 and 15, 2011, the company informed its shareholders and the market in general, respectively, of approval by the Board of Directors, of the acquisition of preferred and common shares issued by the company for subsequent cancellation, disposal or maintenance in treasury, without capital reduction, in order to add value for shareholders. For this repurchase, there was use of part of the capital reserve existing as of June 30, 2011, excepting the reserves mentioned in article 7, letter (a) to (d) of CVM Rule No. 10/80.

The repurchase started on the date of the resolution, and remains effective until October 20, 2011, and acquisitions are on BM&FBOVESPA, at market prices. The Executive Board was responsible for establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, as well as the definition of the parameters to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 2,700,000 preferred shares and 2,900,000 common shares.



On November 5, 2012, the company announced to its shareholders and the market in general that its board of directors had approved a plan for repurchase of preferred and common shares issued by the company, without a capital reduction, to add value to shareholders. On June 30, 2012, we used a portion of our capital reserves for this repurchase, pursuant to Article 7 sections (a)-(d) of CVM Rule No.10/80.

The repurchase started on the date of the resolution, and remained effective until November 4, 2013, and acquisitions were on BM&FBOVESPA, at market prices. Our board of executive officers was responsible for

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establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, and defining the parameters used to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 24,257,777 preferred shares and 2,894,534 common shares.

### Call option of the remaining shares of Lemontree and GTR-T

On June 6, 2012, the company exercised its call option in relation to (1) the remaining 71,330,508 common shares corresponding to 51% of the voting capital of Lemontree Participações S.A., or Lemontree, which holds Commercial Cabo TV São Paulo S.A., a company engaged in cable TV services in the state of São Paulo; and (2) the remaining 923,778 common shares of GTR Participações Ltda., or GTR-T, which holds 50.9% of the common shares of TVA Sul Paraná S.A., a company engaged in cable TV services outside the state of São Paulo, these shares were previously held by the Abril Group.

The call option represents the closing of the acquisition process of the remaining shares of Lemontree and GTR-T, which started with the partial exercise of the option on September 29, 2011 and the acquisition of the common shares of Lemontree, representing 49% of its voting capital.

The call option was provided for in the Private Agreement for Convergence, Purchase and Sale of Businesses, Assets, Shares and Other Covenants, entered into on October 29, 2006 between us and the Abril Group, which approved by our shareholders on November 23, 2007. The exercise of the call option was subject to the reduction or elimination of the regulatory restrictions applicable to the company, which was granted along with the revocation of the concession agreement limitations in order to have the company and its subsidiaries authorized to provide cable TV services in the same concession area as those for which it provides STFC services in the São Paulo region.

Following the exercise of the call option, Telefônica Brasil S.A. holds 100% of Lemontree and GTR-T and, indirectly, of the companies engaged in cable TV services located in São Paulo, Curitiba, Foz do Iguaçu and Florianópolis.

### Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

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ON: common shares.

PN: preferred shares.

### Restructuring Telefônica Brasil's subsidiaries

On March 15, 2012, our board of directors approved a corporate restructuring of our wholly owned subsidiaries to rationalize the provision of services rendered by these subsidiaries and the concentration of the provision of telecommunication services into a single company.

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The restructuring will be implemented by a process of partial division and merger, involving only our wholly owned subsidiaries, A. TELECOM, TData, TST, Ajato and Vivo. As a result of the restructuring, value added services provided by several wholly-owned subsidiaries of the company will be unified under Telefonica Data S.A. and other telecommunications services will be unified under the company, which, as a final step to the corporate restructuring, will merge these subsidiaries. Following the merger, value added service will be provided by Telefonica Data S.A. and the company will provide other telecommunication services.

In addition to streamlining services, the corporate restructuring (now possible because of legislative changes applicable to STFC providers) aims to simplify our current organizational structure and assist the integration of business and the generation of synergies arising therefrom.

This corporate restructuring can only be implemented with consent from ANATEL. As of the date of this annual report, there is no expected date for ANATEL's consent.

## Capital Expenditures

Year ended December 31, 2012

In 2012, we invested R\$6,117.1 million in projects that sustain our current annual results and competitive position in the medium-term. A significant portion of resources was allocated to allow quality growth in our services. The investments in maintaining quality and expanding our client base represented 87% of the total amount invested by us in 2012 (excluding the purchase of new licenses).

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of our fixed and mobile data users or dedicated high speed services for our corporate clients. We continue to invest in expanding the backbone of national data transmission to meet the increase in mobile data traffic throughout the country.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2012.

Telefônica Brasil	Year ended December 31,		
	2012	2011	2010
	(in millions of reais)		
Network	3,845.8	3,381.0	2,039.7
Technology / Information Systems	562.3	612.5	266.1
Others(1)	1,709.0	1,408.0	135.6
Total capital expenditures	6,117.1	5,401.5	2,441.4

(1) Consists primarily of free handset rentals, network construction, furniture and fixtures, office equipment and store layouts and an amount of R\$811.8 million in 2011 and R\$1,050.2 million in 2012 related to the acquisition of licenses.

Year ended December 31, 2011

In 2011, we invested in projects that support our current results and prepare the company for the competitive landscape in the medium-term. A significant proportion of resources were allocated to enable growth associated with the services we provide.

To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of data customers, whether fixed and mobile data services or dedicated high-speed services to the corporate market, as well as the increase in capillarity of our fiber optics network in São Paulo. We also invested in the expansion of the national data transmission backbone to meet increasing demand for mobile data traffic nationwide.

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Year ended December 31, 2010

In 2010, 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 were expanding, modernizing and upgrading our ADSL network and improving our systems and processes of customers' relations, marketing and sales.

B. Business Overview

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 represents approximately 1.5% of total lines in service and 2.2% of the state's population. This concession is operated by CTBC Telecom.

Our concession region is Region III, which comprises 622 municipalities, including the city of São Paulo, with an aggregate population of approximately 41.3 million. Of the municipalities in Region III, 72 have a population in excess of 100,000. The city of São Paulo has a population of approximately 11 million. According to a 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 before the reorganization), 32 (the area corresponding to Ceterp before our acquisition), 33 (corresponds to the portion of the state of São Paulo that we do not service) and 34 (area corresponding to CTBC Borda do Campo before 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 concessions for Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. On November 21, 2008, the Federal government combined the three sectors for which we hold concessions into a single sector, designated as Sector 31.

On May 7, 2002, we began offering international long-distance services 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, representing a long-distance operator) would 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 make 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" to use our services. See "—Network Services."

Since our merger with Vivo Participações, we provide mobile telecommunications services in all of the Brazilian states and in the Federal District, representing a total of approximately 8.5 million square kilometers and a population of approximately 194 million people. Our wholly-owned subsidiary, Vivo, became a national operator when, on September, 2007, it acquired a license to operate within 6 states located in the Northeast region (Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte) and when it acquired Telemig.

According to data regarding market share published by ANATEL, we are among the leading providers of mobile telecommunication services in Brazil, through our subsidiary Vivo, the leading mobile service operator in Brazil. Vivo is a cellular operator in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (also encompassing the area of Federal District), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São

Paulo, Sergipe, Tocantins and Minas Gerais.

#### Areas of Operation

In Areas 1 and 2, Vivo uses a frequency range known as “A,” “L” and “J” bands that covers 100% of the municipalities in its authorized areas in the state of São Paulo. On December 31, 2012, Vivo had 20.5 million mobile lines in service in these areas, which represented a 4.4% net increase from December 31, 2011, and a market share of approximately 32.5% in São Paulo.

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In Area 3, Vivo uses a frequency range known as “A,” “L” and “J” bands that covers 100% of the municipalities and 100% of the population in the states of Rio de Janeiro and Espírito Santo. On December 31, 2012, Vivo had 10.4 million mobile lines in service in this area, which represented a 3.3% net increase from December 31, 2011, and a market share of approximately 37.7% in those states.

In Area 4, Vivo uses a frequency range known as “A,” “E” and “J” bands that covers 71.6% of the municipalities and 92.4% of the population in the state of Minas Gerais. On December 31, 2012, Vivo had 8.3million mobile lines in service in this area, which represented a 4.4% net increase from December 31, 2011, and a market share of approximately 32.4% in Minas Gerais.

In Area 5, Vivo uses a frequency range known as “B” band that covers 67.1% of the municipalities in the states of Paraná and Santa Catarina and 93.9% of the population of Paraná and Santa Catarina. On December 31, 2012, Vivo had 4.6million mobile lines in service in this area, which represented a 0.8% net increase from December 31, 2011, and a market share of approximately 20.1% in those states.

In Area 6, Vivo uses a frequency range known as “A,” “L” and “J” bands that covers 82.5% of the municipalities and 97.7% of the population in the state of Rio Grande do Sul. On December 31, 2012, Vivo had 6.4million mobile lines in service in this area, which represented a 5.9% net increase from December 31, 2011, and a market share of approximately 41.0% in that state.

In Areas 7 and 8, Vivo is the leading mobile operator, by number of customers, in its authorization area and uses a frequency range known as “A,” “B,” “L” and “J” bands that covers 61.2% of the municipalities in the states of Acre, Federal District, Goiás, Mato Grosso, Mato Grosso do Sul, Rondônia, Tocantins, Amazonas, Amapá, Maranhão, Pará and Roraima which covers 87.2% of the population in these states. On December 31, 2012, Vivo had 17.0 million mobile lines in service in these areas, which represented a 10.4% net increase from December 31, 2011, and a market share of approximately 34.8% in those states.

In Area 9, Vivo uses a frequency range known as “A,” “L” and “J” bands that covers 69.1% of the municipalities and 89.3% of the population in the States of Bahia and Sergipe. On December 31, 2012, Vivo had 5.9 million mobile lines in service in this area, which represented a 8.1% net increase from December 31, 2011, and a market share of approximately 29.8% in those states.

In Area 10, Vivo a frequency range known as “L” and “J” bands that covers 37.9% of the municipalities and 73.4% of the population in the States of Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte. On December 31, 2012, Vivo had 3.1 million mobile lines in service in this area, which represented a 24.1% net increase from December 31, 2011 and a market share of approximately 8.1% in those states.

On September 18, 2007, with ANATEL’s approval, Vivo acquired the “L” band lots, except for lot 16 (area of Londrina, Paraná, in Region V) and lot 20 (area of Northern Brazil in Region VIII). The “L” band comprises lots in frequency ranges 1895 to 1900 MHz and 1975 to 1980 MHz, with 5 + 5 MHz bandwidth. As a result, Vivo managed to complete its last coverage gap and will soon be operating in the entire Brazilian territory. On December 20, 2007, with ANATEL’s approval, Vivo acquired the “J” band lots with 10 + 10 MHz bandwidth, with the exception of the lots in the state of Minas Gerais then acquired by Telemig Celular and now operated by Vivo.

On December 14 and 15, 2010, Vivo acquired 23 lots in the remaining SMP band auction. Vivo acquired lots in almost all regions of Brazil, which allowed us to reach spectrum capacity of 70 Mhz or higher in all regions where we operates (excluding 23 municipalities in and around Franca in the state of São Paulo, where the spectrum is 50 Mhz). On the same date, Vivo also acquired 23 lots in the “H” band. As a result, Vivo improved its capacity to provide services throughout the national territory and now operates in the 900 MHz and 1,800 MHz frequencies in a broad

way.

On June 12 and 13, 2012, Vivo acquired the “X” band lot in an auction held by ANATEL, for a total amount of R\$1.05 billion. As a result, Vivo will enhance its ability to provide service with 4G technology in all of Brazil and will be operating in the frequency range of 2,500 MHz with band of 20 + 20 Mhz. In addition to the 2,500 MHz band, the lot also includes the 450 MHz band for the rural areas of the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, São Paulo and Sergipe.

The following table sets forth population, gross domestic product, or GDP, and per capita income statistics for each state in Vivo’s service regions at the dates and for the years indicated:

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Area	Frequency Range (MHz)	On December 31, 2012		Last Available IBGE Data from 2010			
		Population (in thousands)(1)	Percent of Brazil's population(1)	GDP (in millions of reais) (2)	Percent of Brazil's GDP (2)	Per capita income (in reais) (2)	
São Paulo State	450, 850, 900, 1800, 1900, 2100 and 2500	41,262	21.63 %	1,247,596	33.09 %	30,243	
Paraná State	850, 900, 1800, 1900, 2100 and 2500	10,445	5.48 %	217,290	5.76 %	20,814	
Santa Catarina State	850, 900, 1800, 1900, 2100 and 2500	6,248	3.28 %	152,482	4.04 %	24,398	
Goiás State	850, 900, 1800, 1900, 2100 and 2500	6,004	3.15 %	97,576	2.59 %	16,252	
Tocantins State	850, 900, 1800, 1900, 2100 and 2500	1,383	0.73 %	17,240	0.46 %	12,462	
MatoGrosso State	850, 900, 1800, 1900, 2100 and 2500	3,035	1.59 %	59,600	1.58 %	19,644	
Mato Grosso do Sul State	850, 900, 1800, 1900, 2100 and 2500	2,449	1.28 %	43,514	1.15 %	17,766	
Rondônia State	850, 900, 1800, 1900, 2100 and 2500	1,562	0.82 %	23,561	0.62 %	15,098	
Acre State	850, 900, 1800, 1900, 2100 and 2500	734	0.38 %	8,477	0.22 %	11,567	
Amapá State	850, 900, 1800, 2100 and 2500	670	0.35 %	8,266	0.22 %	12,361	
Amazonas State	850, 900, 1800, 2100 and 2500	3,484	1.83 %	59,779	1.59 %	17,173	
Maranhão State	850, 900, 1800, 2100 and 2500	6,575	3.45 %	45,256	1.20 %	6,889	
Pará State	850, 900, 1800, 2100 and 2500	7,581	3.97 %	77,848	2.06 %	10,259	
Roraima State	850, 900, 1800, 2100 and 2500	450	0.24 %	6,341	0.17 %	14,052	
Federal District	850, 900, 1800, 1900, 2100 and 2500	2,570	1.35 %	149,906	3.98 %	58,489	
Bahia State	850, 900, 1800, 1900, 2100 and 2500	14,017	7.35 %	154,340	4.09 %	11,007	
Sergipe State		2,068	1.08 %	23,932	0.63 %	11,572	

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	450, 850, 900, 1800, 1900, 2100 and 2500							
Rio de Janeiro State	850, 900, 1800, 1900, 2100 and 2500	15,990	8.38	%	407,123	10.80	%	25,455
Espírito Santo State	850, 900, 1800, 1900, 2100 and 2500	3,515	1.84	%	82,122	2.18	%	23,379
Rio Grande do Sul State	850, 900, 1800, 1900, 2100 and 2500	10,694	5.61	%	252,483	6.70	%	23,606
Alagoas State	450, 900, 1800, 1900, 2100 and 2500	3,120	1.64	%	24,575	0.65	%	7,874
Ceará State	450, 900, 1800, 1900, 2100 and 2500	8,452	4.43	%	77,865	2.07	%	9,217
Pernambuco State	450, 900, 1800, 1900, 2100 and 2500	8,796	4.61	%	95,187	2.52	%	10,822
Piauí State	450, 900, 1800, 1900, 2100 and 2500	3,118	1.63	%	22,060	0.59	%	7,073
Paraíba State	450, 900, 1800, 1900, 2100 and 2500	3,767	1.97	%	31,947	0.85	%	8,481
Rio Grande do Norte State	450, 900, 1800, 1900, 2100 and 2500	3,168	1.66	%	32,339	0.86	%	10,208
Minas Gerais State	450, 850, 900, 1800, 2100 and 2500	19,597	10.27	%	351,381	9.32	%	17,932
Vivo		190,756	100.00	%	3,770,085	100.00	%	19,766

(1) According to Censo 2010 published by IBGE in 2011 (latest data available).

(2) According to the most recent IBGE data (2010). Nominal Brazilian GDP was R\$3,770,085 million as of December 2010 calculated by IBGE, subject to revision.

As of December 31, 2012, we had 318 of our own sales outlets throughout Brazil, which also provide customer support for our existing customers. In addition, we also have 11,720 sales outlets run by authorized dealers. As of December 31, 2012, we had the highest number of sales outlets among all our competitors.

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We aim to increase our services in strategic cities and locations where there is currently no sales outlets for our services. As of December 31, 2012, we had 50 partners, including Telesales and Door to Door services, with approximately 1,200 salespeople reaching out to potential customers, in particular for Vivo fixed-line, post-paid and data services.

We also have an on-line store and an authorized e-commerce operation for the sale of services over the Internet.

In 2012, prepaid mobile service customers counted on approximately 600 thousand points of sale to purchase credit, including our own stores, authorized agents, lottery stores, post offices, bank branches and small retailers, such as pharmacies, newspaper stands, libraries, bakeries, gas stations, bars and restaurants. Pre-paid phones can be charged by purchasing cards with credit or digitally. Recharge is also offered through credit and debit cards, call center, Vivo PDV (M2M using a cell phone for transferring the recharge credit), personal recharge (recharge of the cell phone itself), as well as certain accredited Internet websites.

## Overview

Our services consist of:

- voice services, including activation, monthly subscription, measured service and public telephones;
- interconnection charges (or network usage charges), which are amounts we charge other cellular and fixed-line service providers for the use of our network;
  - intraregional, interregional and international long-distance voice services;
  - data services, (including broadband services) and mobile value added services;
- Pay TV services through DTH (direct to home), satellite technology and land based wireless technology MMDS (multichannel multipoint distribution service) and cable;
  - the sale of wireless devices and accessories;
  - network services, including rental of facilities, as well as other services.

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 Telefónica 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 fixed 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.

We also provide mobile services for voice, internet and value-added services, including voicemail, voice mail translation in a speech-to-text service ("Vivo Torpedo Recado"), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones ("Vivo Som de Chamada"), data services

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through WAP protocol and 3G (with a pre-paid data plan special to smartphones), and innovative services such as multi-media backup and cloud based services to save the short messages (“Vivo Torpedo Center”). We also offer direct Internet through data plans for Smartphones, Tablets and other data enabled devices. We developed a new interface—Vivo Services Store (“Loja de Serviços Vivo”) to sell all the services provided by Vivo, from bundles of SMS to content download such as music, video and games.

We offer wireless roaming services through agreements with local mobile service providers throughout Brazil and other countries, allowing our subscribers to make and receive calls while outside of our concession areas. We provide reciprocal roaming rights to the customers of the mobile service providers with which we have such agreements.

### Local Service

Fixed 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 its 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.”

We became the first telephone service concessionaire in Brazil to offer fixed 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 fixed 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 fixed 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 fixed 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 fixed local telephone services in Brasília (Federal District) 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, Federal District, Goiás, Rio Grande do Sul, Paraná and Santa Catarina.

### Intraregional Long-Distance Service

Intraregional long-distance services 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 services 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, Oi and GVT.

### Interregional and International Long-Distance Fixed Service

On March 1, 2002, ANATEL acknowledged that we had satisfied its network expansion and universal service targets two years before 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 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 services in May 2002 and interregional long-distance services in July 2002. Interregional long-distance services consists of state-to-state calls within Brazil. International long-distance services consists of calls between a point in Brazil and a point outside Brazil.

Data Services—Fixed Broadband

The fixed 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.

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Currently, the product portfolio of broadband speeds on ADSL range from 256 Kbps (kilobytes per second) up to 8 Mbps (mega bits per second). In 2011, 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 2011, Speedy reached the milestone of 3.6 million subscribers.

In 2010, Telefonica Brasil 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 has a speed of 1 Mbps.

In 2011, the company and the Ministry of Communications signed the National Broadband Plan (Plano Nacional de Banda Larga) commitment which defines conditions for the provision of broadband retail and wholesale customer, as well as the conditions of communication, quality and supervision.

Broadband services provided under the National Broadband Plan can be provided starting with 90 days after it becomes effective. However, the company voluntarily launched its services under the National Broadband Plan in July 2011 in municipalities where Vivo's 3G network was already available. On September 28, 2011, the company began providing fixed broadband services for retail and wholesale customers. The Company also agreed to offer retail broadband for a price of up to R\$35.00 to the consumer or a broadband and fixed telephony package for a price of up to R\$65.00 to the consumer. Broadband services offered under the National Broadband Plan for retail customers have a minimum speed of 1 Mbps and may have limits on the amount of downloads available. Wholesale services were available in 350 municipalities and can be used by local governments and companies registered under the tax system called "SIMPLES." Broadband services offered under the National Broadband Plan for wholesale customers are available in multiples of 2 Mbps, limited to 8 Mbps for local governments and 20 Mbps for corporate users.

We also provide fixed broadband services using coaxial cable at speeds ranging from 8 Mbps to 30 Mbps through cable internet (allowing for speeds from 2 Mbps to 16 Mbps) and optical fiber (FTTH). Optical fiber is the most advanced technology currently available and it allows for speeds of up to 100 Mbps.

### 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. We began offering pay TV services on August 12, 2007.

On October 31, 2007, ANATEL's council approved, from a regulatory perspective, the agreement between us and the Abril Group, which involved, among other transactions, the acquisition by us of all of the Abril Group's MMDS operations (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. In November 2012, ANATEL authorized our provision of conditional access services to subscribers of our TV services. The provision of conditional access service to TV subscribers and the revisions to the concession agreement for such services were ratified by the Brazilian government on February 5, 2013.

As of December 31, 2012, we reached 600 thousand pay TV users, through both DTH and MMDS technologies. We currently offer DTH to the entire state of São Paulo, and MMDS in the cities of São Paulo, Rio de Janeiro, Curitiba and Porto Alegre.

### 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 us 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.



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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 2011, 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, we had networks in fourteen cities in these regions.

We have continuously adapted and expanded our 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 our wholesale services.

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

Competition for long-distance services has continuously increased and by the end of 2012 there were a total of 40 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora), or CSP. Satellite services for providing circuits in remote areas for wholesale and large customers have been also implemented.

### Other Services

Currently, we provide a variety of other telecommunications services that extend beyond basic telephone service, including extended maintenance, caller identification, voicemail, cell phone blockers, computer support, antivirus software 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 had been amended following negotiations with providers and changes in the services rendered and regulatory requirements. We have 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, we 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.

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

According to SMP regulations, the VU-M price is subject to free negotiation between parties and once an agreement is reached it must 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.

On May 7, 2012, the Brazilian government published Resolution No. 588/2012, which approved the new Regulation Compensation Network. Among the main changes compared to its predecessor resolution include the change in collection of the TU-RL on time considering the low incidence of 2 minutes per call TU-RL, changes in the interconnection regime for the partial Bill & Keep 25 % to 75% through December 31, 2013 and integral Bill & Keep beginning on January 1, 2014 and change in value of the TU-RIU to 25% of the fare LDN step 4 in 2012 and 20% after 2013.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for 2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

At the end of 2012, Telefonica had 210 local and long-distance interconnection agreements and 102 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.

### 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 agreement 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 MMDS. The approval was granted on November 19, 2007 and the transaction continues to be reviewed for antitrust issues by CADE.

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

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In November 2012, ANATEL approved the adoption of service licenses for subscription television by the Telefonica group to the conditional access service.

The STFC Concession Agreement

The company is authorized to provide STFC services to render local and domestic long-distance call originated in Region III, which comprises the State of São Paulo, except for Sector 31, established in the General Plan of Grants.

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 No. 559 published on December 27, 2010. Resolution No. 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 June 30, 2011, the company renewed its concession agreement and entered into new contracts for local and long-distance services with ANATEL pursuant to the concession agreement, with new conditions imposed on the company to change the basis of calculation of the biannual concession costs. The most relevant modifications discussed by ANATEL's board include: (i) suppression of clause 14.1 which prohibits service providers 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; (iii) broadening of ANATEL's supervisory powers; (iv) the possibility of off-setting cost of universalization in the calculation of the concession burden; (v) the inclusion of the AICE tariff adjustment formulas; (v) the possibility of remote monitoring of services; (vi) limiting the price of AICE subscription to 60% of the basic subscription; and (vii) free price determination.

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 of the previous year, 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, the second payment occurred on April 30, 2009, based on 2008 revenue and the third payment occurred on April 30, 2011, based on 2009 revenue. The next payment is scheduled for 2013 based on 2012 revenue. See Note 1 to our Consolidated Financial Statements.

On April 8, 2008, we 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.

ANATEL granted on August 18, 2011 consent to the transfer from the company to Vivo of the concessions for the provision of local STFC services, domestic long-distance and international long-distance services in Regions I and II of the General Plan of Grants (outside São Paulo). On September 8, 2011, the extract of the authorization term was published on the D.O.U. for the transfer of STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC through the GSM technology across its area, except for the State of São Paulo.

In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, which are authorizations to provide wireless communication services through SMP, personal mobile service, to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunication services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands which were denominated as the “C” band (which was later transformed into extension bands), the “D” band, “E” band and “M” band. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002, in September 2004, in March 2006, in September 2007, in December 2007 and in December 2010.

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### Services for Corporate Customers

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.

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.
- 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

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.



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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
- 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.
- Individual Special Class Access (AICE) – plan created specifically for families enrolled in the Brazilian government’s social program.

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
Monthly Basic Assignment		
Allowance (minutes included in the Residential Assignment)	200 minutes	400 minutes
Commercial Assignment Allowance (minutes included in the Commercial Assignment)	150 minutes	360 minutes
Local Call Charges		
Regular Hours		
Completing the call (minutes deducted from the allotment)	–	4 minutes
Completing the call after the terms of the allotment Sector 31	–	R\$0.15980
Local Minutes–charges in excess use of the allotment Sector 31	R\$0.10423	R\$0.03994
Minimum time billing	30 seconds	–
Reduced Hours		
Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R\$0.20847	R\$0.15980

The fees for Local Basic Plan Service were approved by ANATEL’s Act No. 5,834 of August 24, 2011 and readjusted through Act 8401 of December 21, 2011. 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 the company’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 D.O.U. on November 21, 2008. 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.

Resolution No. 586 established that families enrolled in the Brazilian government's social program may have access to fixed telephone services under the special class individual access plan. The subscription to the plan costs R\$13.65 and allows for 90 minutes of local fixed line calls. Any exceeding fixed calls or calls to mobile or long distance phones may be made once pre-paid credits are purchased. The price of mobile and long distance calls are determined pursuant to a standard plan.

Besides the Basic Service Plans, the company may offer alternative plans with any pricing design it chooses. However, ANATEL must be notified of these alternative plans before the publication and implementation of any such plan.

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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 No. 507/08). The Mandatory Alternative Plan (PASOO) follows the same readjustment formula as the Local Basic Plan. Other alternative service plans are readjusted based on the IST.

On December 24, 2011, ANATEL’s Act No. 8,401 approved new local tariffs for our areas of concession. 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\$41.38;
- Commercial clients and nonresidential customers (PBX) were charged a monthly subscription fee for the provision of service of R\$70.76;
  - Local minute tariffs were charged at R\$0.10423 per minute in Sector 31; and
  - Activation fees of R\$113.81 were charged in Sector 31.
- On February 5, 2012, ANATEL published new amounts for basic fixed telephone calls and long distance calls. The rates were adjusted by the Telecommunication Services Index, resulting in a 0.568% adjustment applied linearly to all rates for national long distance and local calls.

### Intraregional and Interregional Long-Distance Rates

Intraregional long-distance services 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 call charges 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.”

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

- Fee for the use of our local network—we charge long-distance services providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network.
- 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 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 May 7, 2012, ANATEL published Resolution No. 588/2012, which approved the change in TU-RL rate during the reduced rate period and considering the 2-minute TU-RL per call, in addition to the change in TU-RIU value to 25% of the LDN rate in 2012 and 20% in 2013. Furthermore, through December 31, 2013, rates will only be charged on calls that exceed the 75% limit of traffic between networks. Beginning in 2014, service providers' will no longer pay other companies for calls made between networks.

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 trucking 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.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for

2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

#### Data Transmission Rates

We receive revenue from charges for data transmission, which includes our broadband service “Speedy,” the rental of dedicated analog and digital lines for privately leased circuits to corporations and others that were provided by us 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.”

#### 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 from 7% to 35% on certain revenues from the sale of goods and services, including telecommunication services.

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- Federal Social Contributions: Contribuição para o Programa de Integração Social or “PIS,” and Contribuição para o Financiamento da Seguridade Social or “COFINS,” are 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 amount of 0.65%) and 9.25% for other services (consisting of the COFINS amounts of 7.6% and PIS amount 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, to 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 are 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 excluding ICMS, PIS and COFINS), and it may not be passed on to customers.
- Contribution to the Fund of Telecommunications Technological Development—“FUNTTEL.” FUNTTEL is a federal social contribution and was established in 2000, 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 is due at the tax rate of 0.5% of gross operating telecommunications services revenue (except interconnection revenue and excluding canceled sales, discounts, ICMS, PIS and COFINS), and it may not be passed on to customers.
- Contribution to the Fund for Telecommunications Regulation—“FISTEL.” FISTEL is a federal tax applicable to telecommunications transmission equipment which serves to provide funds to cover the expenses incurred by the Federal Government in performing inspections of telecommunication services and in developing the means and improving the techniques necessary for carrying out these inspections. 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

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.

We have a billing and collection system with respect to local, national and international long-distance voice, subscriptions, broadband, data, IT services, outsourcing, television and third-party services. Payments of bills are effected under agreements with various banks. The types of payments are by debit the customer's account, direct payment to a bank, Internet and other collection agencies (including lottery-playing facilities, drugstores and supermarkets). We aim to avoid losses in the implementation of new processes and the roll-out of new products through the monitoring of billing, collection and recovery controls. The billing process is audited by the Associação Brasileira de Normas Técnicas (Brazilian Association of Technical Standards), or ABNT, under the applicable rules of the Sarbanes Oxley Act. 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.

Our subsidiary Vivo uses Atlys, a billing solution that combines software and hardware resources, from the supplier company Netcraker as the billing system for centralized billed invoicing in the city of São Paulo. The billing system operates through batch processing concept using Vivo customers' voice and data traffic. This system functions by segregating voice and data traffic on a daily basis, according to which of seven total billing preferences a customer elects. Each cycle has a specific due date for each of the consumer and corporate segments.



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For prepaid services, Vivo uses the Next Generation Intelligence Network (NGIN) platform, a prepaid platform, from the supplier company Eisa, which also works in a centralized way in the city of São Paulo. In order for the NGIN platform to process correctly, the same system for billed invoicing is used. This system separates the module for customer information, called Care, which is a services platform, from the Voice and Data traffic processing module used, called Core, which is a tariff platform.

In November 2011, Vivo began developing a project to optimize its operational processes and reduce the period between the cut and due date of bills, and this project was concluded in April 2012, reducing billing cycles to six months cycles.

In 2012, we started several initiatives to integrate fixed and mobile processes and systems. The first was part of our organizational structure when in the first quarter of 2012, we combined both fixed and mobile departments optimizing and focusing resources. In that year we also certificated mobile billing processes by the ABNT. Another strong initiative related to process and system integration is the traffic mediation system project. Started during the last semester of 2012, that project will transfer, through the second quarter of 2013, all fixed lines traffic to the same platform as the mobile lines, reducing the risk of revenue loss, achieving better operational levels and unifying best practices.

### Co-billing

In accordance with the Brazilian telecommunications regulations, we use a billing method called “co-billing” for both services, fixed and mobile. 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 phone service companies. We have co-billing agreements (“co-billing in”) with national and international long-distance phone service providers. Similarly, we use the same method of co-billing to bill our services on the invoices of other fixed and mobile providers. This service is charged to the Long-distance Operator, per CDR (Call Detail Record) placed in invoice.

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.

### Value Added Services (VAS)

Entertainment, information and online interactivity services are available to all Vivo customers through agreements with content suppliers. These agreements are based on a revenue-sharing model through the processes of billed and prepaid categories, with all divergences between these categories being demonstrated to the content suppliers.

### Third-party Services

In fixed as well as mobile billing process is made inclusion third-party services into the bill, collection and transfer. This service is charged to the contractor.

### Collection

We have policies dealing with accounts of defaulting customers according to each ANATEL regulation. For mobile service, we apply the SMP regulation, for fixed service we apply the STFC and for TV we apply Resolution No. 488 “Protection and defense of the rights of subscription TV service subscribers.”

For mobile customers, as a general rule, if the payment is more than 15 days overdue, service can be partially suspended by blocking calls that generate costs to the user. If payment is more than 30 days overdue after the partial suspension, the service can be fully suspended, disabling all call services, until payment is made. We offer an installment payment plan for those clients with past due balances. However, if accounts are not paid after 45 days after the total suspension, the contract can be cancelled and reported to credit protection agencies.

For fixed customer, as a general rule, if the payment is more than 30 days overdue, service can be partially suspended. If payment is late for more than 30 days after the partial suspension, service can be fully suspended until payment is made. We offer an installment payment plan for those clients with past due balances. However, if

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accounts are not paid after 30 days of total suspension, the contract can be cancelled and reported to credit protection agencies.

For TV customer, as a general rule, if the payment is late, service can be fully suspended 15 days after the customer is notified of the overdue bill. If payment is more than 15 days overdue, after the suspension, service can be cancelled and reported to credit protection agencies.

After the cancellation of the contract, for mobile and fixed services, the accounts are directed to independent collection agencies.

The amounts receivable overdue by 105 days, except for accounts receivables from interconnection fees, government and corporate customers, are considered provisions for doubtful accounts. The write-offs are made in accordance with Brazilian regulations, which permits a bad debt write-off for late payments of R\$0 to R\$5,000 if they are over 180 days late or R\$5,001 to R\$30,000 if they are over 365 days late. Write-offs of late payments of over R\$30,001 that are open for more than 365 days require the commencement of a lawsuit.

During 2012, the monthly average of partial suspensions, for both mobile and fixed services, was 2,338,142 lines and the monthly average of total suspensions was 474,447 lines. For TV services, the monthly average of suspension was 18,797 terminals. The provision for doubtful accounts in 2012 was 1.30% of the total gross revenue.

## 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 and for the year ended December 31,									
	2012		2011		2010		2009		2008	
Wireline access lines	2012		2011		2010		2009		2008	
Installed access lines (millions)	14.8		14.7		14.6		14.5		14.7	
Access lines in service (millions) (1)	10.5		11.0		11.3		11.3		11.7	
Average access lines in service (millions)	10.7		11.1		11.3		11.5		11.8	
Access lines in service per 100 inhabitants	25.1		26.5		27.5		27.1		28.7	
Percentage of installed access lines connected to digital switches	100.0	%	100.0	%	100.0	%	100.0	%	100.0	%
Number of public telephones (thousands)	199.2		215.8		250.7		250.5		250.3	
Broadband access lines (millions)	3.7		3.6		3.3		2.6		2.5	

	Year ended December 31,				
	2012	2011	2010	2009	2008
Mobile access lines	2012	2011	2010	2009	2008
Cellular lines in service at year-end (in millions)	76.1	71.5	60.3	51.7	44.9
Contract customers (in millions)	18.8	16.1	12.6	9.8	8.6
Prepaid customers (in millions)	57.3	55.4	47.7	42.0	36.4

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Growth in cellular lines in service during year	6.4	%	18.7	%	16.5	%	15.1	%	20.2	%
Churn(2)	41.9	%	34.2	%	32.0	%	30.5	%	31.3	%
Estimated covered population (in millions)(3)	193.9		192.4		190.7		191.5		189.6	
Penetration at year-end(4)	132.7	%	123.9	%	104.6	%	90.5	%	79.1	%
Market share(5)	29.1	%	29.5	%	29.7	%	29.78	%	29.8	%

(1)Data includes public telephone lines.

(2)Churn is the number of customers that leave us during the year, calculated as a percentage of the simple average

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(3)Number of people within our region that can access our cellular telecommunications signal.

(4)Number of cellular lines in service in our region, including those of our competitors, divided by the population of our Region.

(5)Percentage based on all lines in service in our region at year-end.

Technology

In order to offer a greater variety of integrated services, we have incorporated a series of new technologies in our voice and data networks.

Voice network is being modernized with the use of new generation technology that enables redundancy and reliability needed to meet all voice services for both fixed and mobile terminals. In addition, we are deploying IMS Core and allowing the inclusion of new convergent services.

An example of this evolution is a new service called “Hosted Voice,” in which customers will have basic features and advanced PBX and also Unified Communication through the data network (IP/VPN). This solution reduces the amount of equipment in the customer environment by centralizing control and intelligence service.

There are great market opportunities for service convergence in Brazil. Products like cellular based residential phones were the first step towards seamless interactions among mobile, landlines, data services and television. As almost every service is evolving to IP Technology, IP Backbones became a strategic asset to support convergence initiatives.

To reach this goal, the integration of mobile and fixed Backbones IP were essential. We have designed a very robust architecture, unifying our mobile and fixed IP/MPLS infrastructures, using two physically distinct Backbones to guarantee service reliability to our clients. Moreover, absorbing other existing networks into both backbones, we have been able to simplify the network and reduce operational costs.

As internet traffic evolves to heavier content and users become more demanding about quality, a content delivery network was the answer to improve user experience in an environment as unreliable as the wide web. Telefonica Brasil’s CDN was a global initiative to offer delivery nodes in several countries and help clients deliver video, application updates, live events and other data with much better quality. In Brazil, CDN has already been deployed and transmitted London Olympics through Terra Provider, with great success. The delivery networks have the potential to bring us closer to a very valuable point on the Internet market value chain: the content.

A new design of Local Area Network (LAN) , using Top of Rack implementations, is currently being deployed and has the potential to reduce the quantity of equipment on site and drastically remove cabling. Top of Rack architecture reaches those goals by placing small switches inside server racks, where cables are kept confined. From the rack to the site’s Core Switches, only one pair of fiber is sufficient.

During 2012, we were faced with various security threats, particularly from the Anonymous group. We were able to protect our services and infrastructures through several security solutions deployed in the network. Some expanded capacity of protection mechanism already in place; others gave a more detailed vision to Security Office acts when an attack breaks. Simultaneously, we worked to integrate different security solutions in place in fixed and mobile operations, to simplify the environment, improve security and reduce costs.

Particularly destructive were denial of service attacks, or DDOS, pursuant to which hackers attempt to shut down services by consuming all resources. Several Brazilian websites, mainly financial institutions and government, pages

were seriously affected by these attacks. We were able to protect both our infra-structure through the use of an Anti-DDOS solution that was already being deployed, as well as offer the same protection to our clients, which created great value. Today, Anti-DDOS is a commercial product, offered to the corporate market.

In the Value Added Services, we have been adopting new technologies to increase the speed with which we market new and enhanced services. Since 2009, we have deployed a new Service Delivery Platform (SDP) into the network, to evolve our environment through a secure and scalable solution that offers the most different value added services, including eHealth and Financial services. In 2011, we gave another step towards the evolution of our value added services environment, with the implementation of the Next Generation Intelligent Network platform (ngIN),

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enabling voice call notification and call handling based services. Through the exposure of WebServices and APIs (Application Programming Interfaces), we introduced the Telecommunications market to Service Providers that have no Telecom specific knowledge, which explains the increasingly rapid growth of the quantity and quality of our Value Added Service offering. In addition, for the delivery of valued added services into the enterprise market, also offer another platform named Torpedo Empresas, which allow the Brazilian Banks and Financial Entities to deliver their own services, such as bank accounts notifications, financial transaction notifications and the delivery of access tokens to their customers.

In 2007, we initiated the implementation of the FTTH network (available through fiber optic cables running to the subscriber's home – GPON technology) with a coverage of 1.2 million Home Passed offering. Actually, a range of different speeds up to 100Mbps, and high definition IPTV service (HDTV). In December 2012, we surpassed the mark of 3.1 million xDSL broadband clients connected in service, 45% 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 FTTH network using a new platform that is a reference in the world (Global Video Platform). We made several improvements in the platform, such as the inclusion of Instant Channel Change (ICC), Picture in Picture (PiP) providing a better user experience. In 2013, we will continue the improvements started in Global Video Platform aiming to increase competitiveness in the ITS market. Additional services, such as pay-per-view and video on demand (VOD), are also available. This platform consists of pay TV with video broadcast offered through the use of the IP protocol.

The IPTV platform also offers games, interactive and connectivity services through third party contents, furthermore offers Over The Top (OTT) contents, for the broadband users, through the applications developed for smart TVs, smart phones with Google's Android and Apple's iOS, besides STBs and PCs.

We also offer digital television service via satellite (DTH) to the subscribers in the State of São Paulo that receive broadcast/PPV content through a Ku band antenna and standard Set Top Box (with Smart Card), also available with a Personal Video Record (PVR) service.

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 xDSL, FTTH (GPON), NGN, DWDM, ROADM and retransmittal technologies of TV over IP protocol (IPTV), satellite (DTH), and the continuous evolution of TV services.

Since 2012, "Speedy" is also offered under the Very-High-Speed Digital Subscriber Line technology (VDSL2), which allows broadband accesses of up to 25Mbps. These technologies provide high-speed Internet access through regular telephone lines. Yet in 2012, we started the implementation of Multi-Service Access Nodes (MSAN) in order to modernize the wireline network of some distant areas, integrating voice, broadband and data services on a single cabinet.

In 2012, we had a breakthrough in the M2M market, with the deployment of a new and revolutionary solution within the Brazilian market, introducing an M2M Global Platform that allows our B2B customers to have access to a Management Web Portal user interface in the internet to access online and real-time information regarding their devices. Some of the competitive advantages of the deployed solution against our previous service and the competition's are the Self-management of the acquired SIM Cards, to control, assign plans and tariffs or even block the use of the network by the device. In 2013, we will continue to evolve the offer, adding new functionalities.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus. This technology was firstly commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11) but now is offered in 100% across our WCDMA coverage, allowing customers who have compatible terminals to achieve up to three times the value of traditional 3G's rate.

We began construction of the LTE system in a brand new spectrum and toward a data-centric network.

#### Competition

In 2012, competition continued to increase in the market for small/medium enterprises and in the residential market due to an expansion of the coverage area of the main competitors, improvements on their portfolios, and also



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due to an increase in their commercial activity and offers for both fixed and mobile services, adding downward pressure to prices and pushing for higher discounts.

We face intense competition in all the areas in which we operate, principally from other cellular service providers and also from fixed-line operators. Many of these competitors are part of a large, national or multinational group and therefore have access to financing, new technologies and other benefits that are derived from being a part of such a group.

Our main mobile service competitor in the states of São Paulo, Paraná and Santa Catarina is TIM Celular or TIM. The main fixed-line operator in this area is Brasil Telecom S.A. (in 2008, the Brazilian Government published Decree No. 6654/2008 of revision of the fixed-line general concession plan (Plano Geral de Outorgas, or PGO), allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A. to buy Brasil Telecom.

In the state of Espírito Santo service area, the principal cellular competitor is Oi and in the Rio de Janeiro service area, the principal competitor is Claro. Claro is controlled by a consortium led by the Telecom Américas Ltd. (controlled by América Móvil S.A. de C.V.). Claro began providing cellular telecommunications services in this Region at the end of 1998. The principal fixed-line operator in this area is Telemar Norte Leste S.A. Oi is the third competitor and is integrated with Telemar (a fixed-line operator) and TIM is the fourth competitor.

In the Central, Western and Northern region the principal competitors are: Claro, in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District, and TIM, in the region encompassing the states of Amazonas, Roraima, Pará and Amapá. In the state of Maranhão the principal cellular competitor is Oi. The main fixed-line operators in this area are: Brasil Telecom S.A., in the region encompassing the states of Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Rondônia and Acre and the Federal District, and Telemar Norte Leste S.A.—Telemar, in the region encompassing the states of Amazonas, Roraima, Pará, Amapá and Maranhão.

In the Bahia service areas, the principal cellular competitor is Claro and in the Sergipe, the main competitor is Oi. Other cellular competitors are Oi and TIM, which also operate in the state of Minas Gerais. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In the Ceará, Pernambuco, Paraíba, Alagoas, Rio Grande do Norte and Piauí service areas, the principal cellular competitor is TIM. Other cellular competitors are Oi and Claro. The principal fixed-line competitor in this area is Telemar Norte Leste S.A.

In Rio Grande do Sul, the principal cellular competitor is Claro, which operates in several regions in Brazil, including Vivo-Rio Grande do Sul's region. Other cellular competitors are Brasil Telecom S.A. and TIM. The main fixed-line competitor in this area is Brasil Telecom.

In Minas Gerais, currently, there are four other wireless service providers operating within the authorization area of Vivo. Our subsidiary Vivo faces competition from the following operators: (a) TIM, the "B" band frequency range operator that launched its services in December, 1998 (TIM is primarily owned by Telecom Italia and operates in the entire State of Minas Gerais using GSM and WCDMA technologies); (b) Oi, the "D" band operator that launched its services in June 2002 (Oi is a subsidiary of Tele Norte Leste Participações S.A. (Telemar) and operates in the entire State of Minas Gerais using GSM and WCDMA technology); (c) Claro, the "E" band operator that launched its services in the fourth quarter of 2005 (Claro is controlled by América Móvil and operates a GSM and WCDMA technology network); and, (d) CTBC Celular, an "A" band and 3G band operator (CTBC Celular is controlled by CTBC, a fixed-line operator and uses GSM and WCDMA technologies).

Our subsidiary Vivo also compete with certain other wireless telecommunications services in specific segments, such as mobile radio (including digital trunking technology, offered by Nextel), paging and beeper services, which are used by some operators in the areas of Vivo as a substitute for cellular telecommunications services. These competing wireless telecommunications services are generally less expensive than mobile telecommunications services. In December 2010, through the auction 002/2010/ANATEL, NEXTEL was awarded 12 SMP licenses (11 spectrum licenses in “H” band (3G band) and 1 spectrum license in “M” band (1800 MHz band)).

Satellite-operated services which provide nationwide coverage, are also available in Brazil. Although these services have the advantage of covering much larger areas than those covered by the cellular telecommunications

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services, they are considerably more expensive than the cellular telecommunications services we offer and do not provide competitive coverage inside buildings.

Our main competitors for the provision of fixed services are: America Móvil / Telmex group (which includes NET, Claro and Embratel), TIM (which includes Intelig and Tim Fiber) and GVT. Our competitors employ varied strategies to gain market share. For instance, GVT expanded its operations to other major cities in the State of São Paulo, with a strategy based on ultra-broadband services, low price, high-quality customer service, and a new TV product, targeting high-income residential clients and small and medium businesses. NET improved its TV portfolio with a new on-demand video product (NOW) and continued its strategy of aggressive broadband prices, offering promotionally 10 Mb for the price of 1 Mb, which increased our churn up to 7% in some regions, against an average of 2.3%. TIM acquired a large optical-fiber network from AES (Atimus), and constituted a new company called TIM Fiber, which is expected to begin to offer high-speed fixed broadband in the city of São Paulo and other 11 cities nearby, making this market even more competitive. In the segment of low-income customers, we face competition from Embratel in TV services and NET in both TV and broadband services.

At Telefonica, 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. Speedy maintained its position as market leader in the State of São Paulo with more than 3.7 million customers as of December 31, 2012 and over 2.8% growth compared with the same date in 2011. Additionally, our broadband service over high-speed optical fiber reached over 112 thousands households, a growth over 100%, contributing to lower churn with a high trend of bundling.

The strategy of low cost long-distance calls initiated by TIM for on-net calls on a “billing per call” basis continued the success already observed in 2010, and led Claro and our subsidiary Vivo to start making similar offers. These low-cost mobile long-distance rates contribute to the losses of fixed-lines of the incumbents. Nevertheless, the total market of fixed-lines grew 2% compared to the previous year, supported by FWT offers in locations not covered by copper networks and by the growth of fixed-lines provided by non-incumbent companies sometimes bundled for free.

Our subsidiary Vivo has also launched a FWT service which offers fixed-phones using the wireless network. With Vivo’s FWT service, we aim to leverage the fixed-phones sales, mainly outside the state of São Paulo, where we have reduced fixed network capacity. This solution can also reduce the cost of providing this service to enterprises located nationwide, such as banks, which we already have in our portfolio of clients.

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 security), completed its third year in 2012.

### 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 from the Brazilian government. Any proposed regulation by ANATEL

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is subject to a period of public comment and, occasionally, 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.

Our current concession agreements contain a provision, amended by ANATEL on June 30, 2011, providing that they may be amended on 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 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 power to authorize private regime companies to provide local and intraregional long-distance services 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 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.

In accordance with the General Telecommunications Law, a concession relates to the provision of telecommunication services under the public regime, as determined by the public administration. A concession may only be granted upon a prior auction bidding process. As a result, regulatory provisions are included in the relevant concession agreements and the concessionaire is subject to public service principles of continuity, changeability and equal treatment of customers. In addition, ANATEL is empowered to direct and control the performance of the services, to apply penalties and to declare the expiration of the concession and the return of assets of the

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concessionaire to the government authority upon termination of the concession. Another distinctive feature is the right of the concessionaire to maintain certain economic and financial standards. The concession is granted for a fixed period of time and is generally renewable only once.

An authorization is a permission granted by the public administration under the private regime, which may or may not be granted upon a prior auction bidding process, to the extent that the authorized party complies with the objective and subjective conditions deemed necessary for the rendering of the relevant type of telecommunication service in the private regime. The authorization is granted for an indeterminate period of time. Under an authorization, the government does not guarantee to the authorized company the economic-financial equilibrium, as is the case under concessions.

## SMP Licenses

Before January 2000, ANATEL had only authorized two mobile service providers in each of the ten franchise areas under “A” band and “B” band. “A” band and “B” band mobile service providers were granted concessions pursuant to the Lei Mínima, or the Minimum Law. Each concession was a specific grant of authority to supply cellular telecommunications services, subject to certain requirements contained in the applicable list of obligations appended to each concession. If a mobile service provider wishes to offer any telecommunications services other than those authorized by its authorized concession, it may apply to ANATEL for an authorization to offer such other services.

In November 2000, ANATEL adopted certain regulations for the issuance of new licenses, which are authorizations to provide wireless communication services through SMP, personal mobile service, to compete with the then existing cellular operators in the various regions of Brazil. These regulations divided Brazil into three main regions covering the same geographic area as the concessions for the fixed-line telecommunication services. ANATEL organized auctions for three new licenses for each of those regions. The new licenses provided that the new services would be operated in the 1800 MHz radio frequency bands which were denominated as the “C” band (which was later transformed into extension bands), the “D” band, “E” band and “M” band. These new licenses were auctioned by ANATEL and awarded during the first quarter of 2001, at the end of 2002, in September 2004, in March 2006, in September 2007, in December 2007 and in December 2010. In September 2007, ANATEL organized auctions for 15 new licenses in the 1900 MHz radio frequency bands which were denominated Band “L.” Vivo acquired 13 spectrum licenses in band “L.” In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses) which were denominated bands “F,” “G,” “I” and “J.” Vivo acquired seven spectrum licenses in Band “J” and Vivo Participações acquired two spectrum licenses in Band “J.” In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands).

On February 3, 2003, TCO replaced its SMC Concession Contracts for Personal Mobile Service Agreements (Termos de Autorização do Serviço Móvel Pessoal) in Regions I (subrange of “B” frequencies) and II (subrange of “A” frequencies) of the General Plan of Grants. On December 10, 2002, Telerj Celular, Telest Celular, Telebahia Celular, Telergipe Celular, Celular CRT, Global Telecom and TELESP Celular replaced its SMC Concession Contracts for Personal Mobile Service Agreements, or SMP, in Regions I (subrange of “A” frequencies), II (subrange of “A” and “B” frequencies) and III (subrange of “A” frequencies) of the General Granting Plan. On July 27, 2006, ANATEL published Act 59867 authorizing the incorporation of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC by GT, as well as the transfer of the respective SMP service authorization titles and of the SMP radio-frequency rights-of-use titles. Act 59867 also provides for the automatic termination of the authorizations for Multimedia Communication Services (Serviços de Comunicação Multimídia, or SCM) of TCO, Teleacre, Telegoiás, Teleron, Telems, Telemat, NBT, Telerj, Telest, Telebahia, Telergipe, Celular CRT and TC, upon each of their respective incorporations.

In order to transfer our services to SMP, we were required to comply with several technical and operational conditions, including, among other things, the adoption of a carrier selection code for long-distance calls originating from our network.

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Our authorizations consist of two licenses—one to provide mobile telecommunications services, and another to use the frequency spectrum for a period of 15 years. The frequency license is renewable for another 15-year period upon the payment of an additional license fee.

Our new SMP licenses include the right to provide cellular services for an unlimited period of time but restrict the right to use the spectrum according to the schedules listed in the old licenses (Vivo-Rio Grande do Sul (“A” band) until 2022 (renewed in 2006); Vivo-Rio de Janeiro (“A” band) until 2020 (renewed in 2005); Vivo-Espírito Santo (“A” band) until 2023 (renewed in 2008); Vivo-Bahia (“A” band) and Vivo-Sergipe (“A” band) until 2023 (renewed in 2008); Vivo-São Paulo (“A” band) until 2023 or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2008); Vivo-Paraná/Santa Catarina (“B” band) until 2013; Vivo-Federal District (“A” band) until 2021, (renewed in 2006); Vivo-Acre (“A” band), Vivo-Rondnia (“A” band), Vivo-Mato Grosso (“A” band) and Vivo-Mato Grosso do Sul (“A” band) until 2024 (renewed in 2008); Vivo-Gois/Tocantins (“A” band) until 2023 (renewed in 2008); Vivo-Amazonas/Roraima/Amap/Par/Maranho (“B” band) until 2013; Vivo (Minas Gerais) (“A” band) until 2023 (renewed in 2007) and Vivo (for the cities where CTBC Telecom operates in the state of Minas Gerais) (“E” band) until 2020). Spectrum rights may be renewed only once over a 15-year period.

In September 2007, ANATEL organized auctions of new SMP licenses in the remaining radio frequency bands “D” and “E,” in the 1.8 GHz frequency band “M,” and fifteen licenses in the 1.9 GHz frequency band “L,” previously allocated to fixed operators. Vivo acquired 13 spectrum licenses in band “L.” The following Terms of Authorization for band “L” have been signed: Vivo-Rio Grande do Sul (“L” band) until 2022 (renewed in 2006) or 2022 for the cities of the metropolitan area of Pelotas; Vivo-Rio de Janeiro (“L” band) until 2020 (renewed in 2005); Vivo-Espírito Santo (“L” band) until 2023 (renewed in 2008); Vivo-Bahia (“L” band) and Vivo-Sergipe (“L” band) until 2023 (renewed in 2008); Vivo-So Paulo (“L” band) until 2023 or 2024, for the cities of Ribeiro Preto and Guatapar (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of So Paulo; Vivo-Paran (excluding the cities of Londrina and Tamarana)/Santa Catarina (“L” band) until 2013; Vivo-Federal District (“L” band) until 2021, (renewed in 2006); Vivo-Acre (“L” band), Vivo-Rondnia (“L” band), Vivo-Mato Grosso (“L” band) and Vivo-Mato Grosso do Sul (“L” band) until 2024 (renewed in 2008) or 2022 for the city of Paranaba of Mato Grosso do Sul; Vivo-Gois/Tocantins (“L” band) until 2023 (renewed in 2008) or 2022 for the cities where CTBC Telecom operates in the state of Gois and Vivo-Alagoas/Cear/Paraba/Piaui/Pernambuco/Rio Grande do Norte (“L” band), until 2022. Spectrum rights may be renewed only once over a 15-year period.

In December 2007, ANATEL organized auctions for 36 new licenses in the 1900-2100 MHz radio frequency bands (3G licenses), denominated as bands F, G, I and J. Vivo was awarded seven spectrum licenses in band “J” and Vivo Participaes was awarded two licenses. The following Terms of Authorization for “J” band have been signed: Vivo-Rio Grande do Sul (including the cities of the metropolitan area of Pelotas) (“J” band) until 2023; Vivo-Rio de Janeiro (“J” band) until 2023; Vivo-Esprito Santo (“J” band) until 2023; Vivo-Bahia (“J” band) and Vivo-Sergipe (“J” band) until 2023; Vivo-So Paulo (including the cities of Ribeiro Preto and Guatapar and the cities where CTBC Telecom operates in the state of So Paulo) (“J” band) until 2023; Vivo-Paran (including the cities of Londrina and Tamarana)/Santa Catarina (“J” band) until 2023; Vivo-Federal District (“J” band) until 2023; Vivo-Acre (“J” band), Vivo-Rondnia (“J” band), Vivo-Mato Grosso (“J” band) and Vivo-Mato Grosso do Sul (including the city of Paranaba) (“J” band) until 2023; Vivo-Gois (including the cities where CTBC Telecom operates in the state of Gois)/Tocantins (“J” band) until 2023; Vivo-Alagoas/Cear/Paraba/Piaui/Pernambuco/Rio Grande do Norte (“J” band), until 2023; Vivo-Amazonas/Roraima/Amap/Par/Maranho (“J” band) until 2023; Vivo (including the cities where CTBC Telecom operates in the state of Minas Gerais) (“J” band) until 2023. Spectrum rights may be renewed only once over a 15-year period.

In December 2010, ANATEL organized auctions for 165 new licenses in the “H” band, extension bands, and available frequencies at “A,” “D,” “E,” “M” and TDD bands. Vivo was awarded 23 licenses (14 spectrum licenses in 1800 MHz bands (“D,” “E,” “M” and extension bands) and 9 spectrum licenses in 900 MHz extension bands):

- “M” band (1800 MHz) of the Federal District and the states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia and Acre;
  - 1800 MHz extension band of the state of São Paulo;
- “D” band (1800 MHz) of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu in the state of Rio Grande do Sul;

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- “E” band (1800 MHz) of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
  - 900 MHz extension band of the state of Rio de Janeiro;
  - 900 MHz extension band of the state of Espírito Santo;
- 900 MHz extension band of the states of Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District, with the exception of the cities of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- 900 MHz extension band of the state of Rio Grande do Sul, with the exception of the cities of Pelotas, Morro Redondo, Capão do Leão and Turuçu;
- 900 MHz extension band of the cities of the registration area number 43 of the state of Paraná, with exception of the cities of Londrina and Tamarana;
- 900 MHz extension band of the states of Paraná and Santa Catarina, with exception of the cities of the registration area number 43 of the state of Paraná and the cities of Londrina and Tamarana;
  - 900 MHz extension band of the state of Bahia;
  - 900 MHz extension band of the state of Sergipe;
- 900 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the state of São Paulo, with exception of the cities of the metropolitan region of São Paulo and the cities where CTBC Telecom operates in the state of São Paulo;
  - 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
  - 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul;
- 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
- other 1800 MHz extension band of the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
  - 1800 MHz extension band of the states of Rio de Janeiro, Espírito Santo, Bahia and Sergipe;
  - 1800 MHz extension band of the states of Amazonas, Amapá, Maranhão, Pará and Roraima;
- 1800 MHz extension band of the states of Alagoas, Ceará, Paraíba, Piauí, Pernambuco and Rio Grande do Norte;
- 1800 MHz extension band of the city of Paranaíba, in the state of Mato Grosso do Sul, and the cities of Buriti Alegre, Cachoeira Dourada, Inaciolândia, Itumbiara, Paranaiguara and São Simão, in the state of Goiás;
  - 1800 MHz extension band of the cities of Londrina and Tamarana, in the state of Paraná; and

- 800 MHz (Band A in the North), 1800 MHz (extension subbands in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (National coverage).

On December 1, 2011 ANATEL carried out the bidding of frequency blocks (Notice No. 001/2011/PVCP/SPV-ANATEL), divided into 54 lots, in the bands: 800 MHz (Band A in the North), 1800 MHz (subbands extension in Region II, within the states of São Paulo and Espírito Santo, Ceará and Pernambuco) and TDD (national coverage),

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totaling approximately R\$592 million, considered the minimum bidding price. This auction offered remaining lots from Notice No. 002/2010/SPV-ANATEL, held in December 2010, in which Vivo was one of the largest winners in the auction by acquiring radio frequency bands 900 MHz and 1,800 MHz.

Of the 54 lots under auction, 15 were sold, totaling revenue of R\$237 million to the government, representing a premium of 0.69%.

Our subsidiary Vivo was unable to participate in this auction because it has already reached maximum spectral capacity in most concession areas. As a result, if Vivo had purchased any lot in these areas, it would have exceeded its spectrum cap as established by applicable regulations. Under these new licenses:

- services are to be provided using the 1800 MHz frequency bands (“D” band, “E” band and “M” band), 1900 MHz frequency bands (“L” band), 1900–2100 MHz frequency bands (“F” band, “G” band, “H” band, “I” band and “J” band) and extension bands;
  - each operator may optionally provide domestic and international long-distance services in its licensed area;
- existing cellular service providers as well as new entrants into the Brazilian telecommunications market can bid for “D” band, “E” band, “M” band, “L” band, “F” band, “G” band, “I” band and “J” band licenses;
- according to the Invitation Document 002/2010/ANATEL, a single SMP operator in one geographic area will only be authorized to have radio frequency bands up to the total maximum limit of 80 MHz or 85 MHz, depending on the circumstances, while observing the following limits for each band:

I – (12.5 + 12.5) MHz, for the 800 MHz bands;

II – (2.5 + 2.5) MHz, for the 900 MHz bands;

III – (25 + 25) MHz, for the 1800 MHz bands;

IV – (15 + 15) MHz, for the 1900 MHz and 2100 MHz bands;

V – 5 MHz, for the TDD extensions of 1900 MHz band;

- as a result, Nextel and other new 3G operators were given preferential status in the “H” band ((10 + 10) MHz) segment of the auction. Vivo, TIM and Claro were eligible to enter bids for the remaining SMP frequencies. Oi acquired the band “H” lot 8 (for the cities in the states of Mato Grosso do Sul and Goiás). CTBC acquired the band “H” lot 5 (for the cities in the state of Minas Gerais) and Nextel acquired the other band “H” lots; and
- a cellular operator, or its respective controlling shareholders, may not have geographical overlap between licenses.

On June 12 and 13, 2012, ANATEL held a public bidding for 273 4G lots in the 2,500 to 2,690MHz frequencies. We acquired the “X” band, with a nationwide coverage, for R\$1.05 billion. Given the rules of the public bidding process, which limited the total spectrum each service provider could hold within this frequency, we agreed to relinquish bands “P,” “T” and “U.” used for MMDS services within 18 months of obtaining the “X” band. Sky and TIM will have preferred rights for the acquisition of the “T” and “U” and for the “P” bands, respectively in the cities of Curitiba and Rio de Janeiro and Oi will have preferred rights for the acquisition of the “P” band in the cities of São Paulo and Porto Alegre.

In order to meet the coverage requirements in the 2.5 GHz frequency, cities will have the services available according to the following timetable:

- by April 30, 2013: cities that will be host to the Confederation Cup in 2013
- by December 31, 2013: host and sub-host cities to the World cup in 2014;
- by May 31, 2014: state capitals, the Federal District and cities with over 500,000 residents;

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- by December 31, 2015: cities with over 200,000 residents;
- by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
- by December 31, 2019: cities with fewer than 30,000 residents.

ANATEL also held a public bidding for the 450 MHz frequency, in order to meet voice and data demand with mobile technology in rural areas. In the absence of interested participants, those granted rights under the 4G bid were required to take over the infrastructure set up in rural areas, which will be regulated in 2013 according to the frequency acquired.

Under band “X,” which we acquired in the bidding process, we will be required to provide infrastructure in rural areas in the states of Alagoas, Ceará, Minas Gerais, Paraíba, Pernambuco, Piauí, Rio Grande do Norte, Sergipe, and interior of São Paulo, for a total of 2,556 municipalities. The timetable for providing infrastructure in the rural areas requires that 30% of municipalities have infrastructure set up by June 2014, 60% by December 2014 and 100% by December 2015, with a transmission rate of 256Kbps and by December 31, 2017, all of these municipalities will be expected to have 1Mbps. Service providers will be allowed to use other frequencies previously granted to it to meet these requirements.

After receiving the ANATEL study on the occupation of the 700 MHz frequency, published in early Jan/2013, the communications minister, published Ordinance No. 14, with guidelines for accelerated access to the Brazilian System of Digital Terrestrial Television - SBTVD-T and to broaden the availability of the radio frequency spectrum for meeting the goals set forth by the National Broadband - PNBL. The ordinance also establishes that the FCC develop a proposal to regulate use of the band. The proposal will be put to public consultation, giving conditions for the bidding possibly occur in the second semester of 2013.

On July 18, 2012, ANATEL notified us that we would be required to present an improvement plan for SMP services. We presented our plan and it was approved by ANATEL on September 10, 2012.

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 (PGO), 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. Before this decree, telecommunications provider groups holding STFC concessions could offer STFC services in only one region under the public regime.

Any breach by the companies of telecommunications legislation or of any obligation set forth in their authorizations may result in a fine of up to R\$50 million.

The mobile service authorizations of our subsidiary Vivo involve obligations to meet quality of service standards the system’s ability to make and receive calls, call failure rates, the network’s capacity to handle peak periods, failed

interconnection of calls and customer complaints. ANATEL published the method for collecting these quality service standards data on April 23, 2003 (ANATEL Resolution No. 335/03 and 317/02). In July 2010, ANATEL published Public Consultation No. 27/2010, revising the General Plan of Standards of Quality of the SMP.

To restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to check the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ).



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The new Regulation provides for the assessment of the network connection and their respective data transmission rate, assessing aspects of availability, stability and connection speed for the data network. In addition, the rule established the formation of GIPAQ (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the “Instant Transmission Rate Guarantee “and “Average Transmission Rate Guarantee.”

The methodology and procedures regarding the collection of data connection indicators will be defined by a group composed of providers, ANATEL and Quality Authority (EAQ), which shall be responsible for implementing these processes and which will be hired by the mobile operators, as a group, starting with February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be borne by the providers of SMP services. The impacts of the regulations are still being evaluated, particularly its financial aspects.

### 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 No. 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.

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 2011, 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.

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).

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.

### General Plan for the Universalization of the Fixed Switched Service (PGMU III)

On June 30, 2011 the Brazilian government published Decree No. 7,512 related to the General Plan for the PGMU III. The PGMU III sets new targets for Telefone de Uso Público (public phones) density in rural and poor areas and goals related to AICE and bidding for the 450 MHz and 2500 MHz spectrum ranges (to, respectively, meet the needs of

rural regions and develop fourth generation mobile telephony). Also according to the new PGMU, the backhaul used to meet the commitments of universalization was characterized as a reversible asset.

On October 25, 2012, ANATEL published Resolution No. 598/2012, which addresses population density, setting deadlines to meet access requests and benchmarks for use of the public telephone plant and the establishment of a list of agencies that can request access to its location. Review of deadline for proposing service plans and the establishment of universal obligations disclosure.

ANATEL approved other resolutions and consents in 2012:

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- Resolution No. 581/2012: Regulates conditioned services, cable television services, multichannel, multipoint, signal distribution, satellite television and audio services, and subscription television services.
- Resolution No. 582/2012: Aims to adopt the Model Authorization Form conditioned services (SeAC)
- Resolution No. 586/2012: Revokes Regulation No. 427 and sets forth new rates for low income families of R\$13.65, including taxes, for fixed line services including 90 minutes for local calls between fixed lines. This new plan went into effect on June 8, 2012.
- Resolution No. 588/2012: Regulates network compensation for the STFC. This regulation revised the method of charging for TU-RL during the reduced time period for calls under two minutes of duration, and the change in Bill & Keep regime.
- Resolution No. 589/2012: Approves administrative sanctions for service providers violating concession agreements and other grants of service from governmental authorities.
- Resolution No. 590/2012: Regulates the use of industrial dedicated lines and sets forth new rules for providers with significant market power and reduces the standard circuit reference rate by approximately 30%. These reference rates are used in instances arbitration or other forms of alternative dispute resolutions. In addition, ANATEL granted service providers a four month period during which to adopt these rules. We have filed a claim against ANATEL to question the legality of retroactively applying this new regulation and to address ANATEL's definition of significant market power as we understand there to be competition in the areas indicated by them.
- Resolution No. 596/2012: Regulates limits, procedures and criteria for the review of services provided, the implementation of network infrastructure as well as the use of resources for numbering radio frequencies. This regulations sets forth access to on-line systems, technological advancements by service providers in order to obtain information.
- Resolution No. 600/2012: Approved the competition goals plan (PGMC). The main goals of PGMC are focused on the wholesale marked and network infrastructure sharing, including: (1) passive infrastructure for transport and access networks; (2) call termination in mobile networks; (3) roaming (4) fixed network infrastructure for the transmission of data through copper cables in transmissions of 10mbps; and (5) wholesale fixed network infrastructure for local and long distance transmission of data under 35mbps.
- Resolution No. 604/2012: Approved the change to the SMP regulation for successive calls made to the same mobile number to be considered one single call for billing purposes. Successive calls are those made within 120 seconds of each other to and from the same phone numbers.

Other Regulatory Issues

On November 21, 2008, the Brazil Government published decree 6,654/2008, for the revision of the fixed-line General Plan of Grants, allowing fixed-line concessionaires to operate in more than one region of the country. This change allowed Telemar Norte Leste S.A.—Telemar or Oi—to acquire Brasil Telecom.

In 2007, ANATEL published Resolution No. 477/2007, effective on February 13, 2008, relating to alterations in the regulation of SMP, which has contributed to an increase in our operating costs. In the new regulation, ANATEL notes areas of vital importance for mobile business, such as the necessity for retail stores in the cities within an operator's coverage areas, increases in the validity periods of prepaid cards and places limits on the period of time during which customers may not leave service plans. These new regulations may have an adverse effect on our revenues and results

of operations. To minimize the impacts resulting from these regulatory changes, we had already prepared ourselves during the last quarter of 2007, to meet and comply with the terms set forth by the new regulation, mainly those related to the customer service which affect procedures and required significant changes to our systems. In 2009, we continued establishing retail stores in the cities within our coverage areas, pursuant to the provisions of Resolution No. 477/2007. In 2009, we also established mediation centers to attend to users with hearing and speech impediments, pursuant to the provisions of Resolution No. 477/2007. Our plans for achieving the goals set by this new regulation was extend to August 13, 2011 and all goals relating to Resolution No. 477/2007 were achieved by the company and certified by ANATEL. Because ANATEL considers Vivo to be affiliated with Telefônica Brasil, which already provides wire line long-distance services in the state of São Paulo and was awarded a license to provide these services nationwide, ANATEL will not award a wire line long-distance license to Vivo. Though we and other mobile operators have requested that ANATEL revise the current SMP regime, there can be no assurance it will do so.

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ANATEL granted on August 18, 2011 prior consent to the company to transfer to Vivo its authorizations for STFC service in local mode, domestic long-distance and international long-distance in Regions I and II of the General Plan of Grants (outside of São Paulo). On September 8, 2011 the Extract of the Authorization Term was published in the D.O.U. with the transfer of the STFC licenses in Regions I and II to Vivo. As a result, Vivo began to offer the STFC across its area, except for the State of São Paulo, using basically the network elements and some radio frequencies that support the provision of the SMP.

Under the SMP regime, we receive revenues from interconnection fees paid to us by wire line long-distance operators due to long-distance traffic originating and terminating on our network. While Vivo is not obligated to use Telefônica Brasil's fixed-line network due to the affiliation relationship, it also cannot receive its own fixed-line license in the event of disagreements with Telefônica Brasil since Telefônica Brasil has the fixed nationwide license and an affiliate cannot have the same type of license in the same area. Since Vivo is not permitted to have a fixed license, Vivo is only able to receive interconnection fees from wireline carriers that have traffic originating or terminating on their network but not from wireless carriers using their fixed-line network. Some of our wireless competitors are also unable to earn such a fixed license due to their affiliations. For example, Oi cannot have a fixed license because it is affiliated with Telemar and Claro cannot have a fixed license because it is affiliated with Embratel. Tim has a fixed license because is not affiliated with any fixed operator, but in July 2009, ANATEL published Act No. 3804/2009 determining the conditions to be followed to guarantee total separation between Tim (Telecom Italia) and our subsidiaries.

On March 24, 2011, ANATEL approved the corporate restructuring of Vivo Participações and Vivo, which are now controlled by the company and not by Brasilcel. The operation resulted in the final merger of shares of Vivo Participações into the company. See "Item 4. History and Development of the Company—A. Historical Background—Corporate Restructuring Involving Vivo Participações"

On August 18, 2011, through Act 5,703/2011, dated August 16, 2011, ANATEL approved the merger of Vivo Participações into the company, with the transfer of the SMP authorizations and respective authorizations terms held by Vivo Participações to Vivo, as well as the resignation by Vivo of its SCM authorization.

In October 2012, the board of directors of ANATEL approved the inclusion of interconnection, facilities, operational and other commodity revenues to the basis for calculating the amount owed in the renewal of the authorization terms for radio frequencies. In addition, according to the concession agreements for fixed line services, we are required to pay an amount equal to 2% of our net revenues for basic and alternative service plans, every two years.

In July 2012, we received notice that a cost model was being revised for fixed-line as well as mobile operations. Concurrently, ANATEL published a request for comments and suggestions regarding the preparation and implementation of the cost model.

**New Regulations for Restricted Access Services— SeAC**

On September 12, 2011, the Brazilian Congress adopted Law 12,485/2011 as a result of Bill 116, which establishes a new legal framework for audiovisual communication with restricted access. This law opens the Pay TV market by enabling telecom operators to offer audiovisual content to subscribers through their networks, creating a new service called Restricted Access Services (Serviço de Acesso Condicionado, or SeAC). The absence of restrictions on foreign capital to be invested in SeAC providers, as well as the elimination of restrictions for the provision of other telecommunications services through STFC, allow us to provide Pay TV services, as well as other telecommunication services previously limited under the General Telecommunications Law.

According to Law 12,485/2011, the SeAC service will replace current cable subscription TV services, subscription TV, MMDS and DTH and will be regulated by ANATEL. As a result of this law, ANATEL introduced in December 2011 the proposed regulations for Pay TV services through Public Consultation No. 65/2011, including license grants, installation and licensing of stations and mandatory distribution programming channels. The Public Consultation was finalized on February 2, 2012 and resulted in Resolution No. 581, issued by ANATEL on March 28, 2012, as well as the new Authorization Terms of the SeAC (which were subject to Public Consultation No. 5/12 and were available for comments until the first week of February).

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Law No. 12,485/2011 also established an annual payment to Condecine (Contribuição para o Desenvolvimento da Indústria Cinematográfica) to be made by providers of telecommunication services and amended Law No. 5,070/1966 by revising the amount due as Inspection Fee (Taxa de Fiscalização de Funcionamento) for telecommunication stations from 45% to 33% of the Installation Fee (Taxa de Fiscalização de Instalação). The amount due to Condecine is approximately 12% of the Installation Fee for telecommunication services and must be paid yearly by March 31 of each year.

As a result of Law No. 12,485/2011, the National Cinema Agency (Agência Nacional do Cinema, or Ancine) issued one public consultation by the end of 2011 and one public consultation in 2012 to regulate the registration of economic agents before Ancine. Both public consultations remain under Ancine's review and are expected to be issued in 2012, as they will become the regulatory framework for the SeAC.

## Interconnection Regulation

Under the General Telecommunications Law, all mobile telecommunications service providers must provide interconnection upon the request of any other mobile or fixed-line telecommunications service provider. More specifically, telecommunications service providers are classified as providers of either collective or restricted services. All cellular operators, including SMP service providers, are classified by ANATEL as collective service providers. All providers of collective services are required to provide interconnection upon request to any other collective service provider. Since 2005, telecommunications service providers have been permitted to freely negotiate the terms and conditions upon which interconnection will be provided, subject to price caps and other rules established by ANATEL. For example, providers must enter into agreements regarding, among other things, tariffs, commercial conditions and technical issues with all parties on a nondiscriminatory basis and starting in 2005, to have a more homogeneous system and to accelerate the negotiation of interconnection contracts, ANATEL has required a standard interconnection network from STFC and SMP Operators through an offer made publicly and equitably.

If parties to an interconnection agreement cannot agree upon the terms and conditions of interconnection, ANATEL may determine those terms and conditions by arbitration. Interconnection agreements must be approved by ANATEL and may be rejected if they are contrary to the principles of free competition and the applicable regulations. ANATEL has adopted, from time to time, various regulations governing interconnection rules. The following are the material regulations currently applicable to our business:

- the new General Regulation of Interconnection (“Regulamento Geral de Interconexão”–Resolution No. 410/2005, or “RGI”);
  - the Regulation of Separation and Allocation of Costs (Resolution No. 396/2005);
- Resolution No 590/2012 – Regulates the use of industrial dedicated lines and sets forth new rules for providers with significant market power and reduces the standard circuit reference rate by approximately 30%. These reference rates are used in instances arbitration or other forms of alternative dispute resolutions. In addition, ANATEL granted service providers a four month period during which to adopt these rules. We have filed a claim against ANATEL to question the legality of retroactively applying this new regulation and to address ANATEL's definition of significant market power as we understand there to be competition in the areas indicated by them.
- the Regulation of Remuneration of Use of SMP Providers Networks (Resolution No. 438/2006). In November 2010, ANATEL published Resolution No. 549/2010 modifying Resolution No. 438/2006 and providing that the groups that include SMP operators with participation rates lower than 20% in the market of mobile telephony combined in each one of the regions of the General Plan of Authorizations of SMP (PGA-SMP), are considered groups who lack

significant market power in the offer of mobile interconnection, in their respective areas of authorization;

- the Regulation of Fixed and Wireless Number Portability (Resolution No. 460/2007, effective March 2009);
  - the new Regulation of SMP (Resolution No. 477/2007, effective February 13, 2008);
- the Regulation of Terms of Separation and Allocation of Costs (Resolutions No. 480/2007, 483/2007 and 503/2008);



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- the general plan of update of the regulation of the telecommunications in Brazil (“Plano Geral de Atualização da Regulamentação das Telecomunicações do Brasil” – Resolution No. 516/2008, or “PGR”);
- the general norms of customer interaction service by telephone, with the objective of improving the quality of services (Decree No. 6523/2008);
  - the Methodology of the Calculation of the WACC (Resolution No. 535/2009);
- amendment of the regulation of the 3400 MHz to 3600 MHz band, allowing it to apply additionally to mobile services (Resolution No. 537/2010);
- the regulation of the Broadband Power Line (BPL), allowing this service to apply to multimedia communication (SCM) (Resolution No. 527/2009);
- related Invitation Document No. 002/2007/SPV-ANATEL regarding the auction organized in December 2007 of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses), denominated bands “F,” “G,” “I” and “J,” which stated that, within a maximum allowed period of eighteen months from the publication of the Terms of Authorization (it occurred on April 30, 2008), the authorizations resulting from this auction would be combined with the existing SMP authorizations of the bid winners when pertaining to the same region of the general authorization plan of SMP. In accordance with this Invitation Document, in January 2010, ANATEL published an act determining the unification of our SMP authorizations in Regions II (states of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with only one SMP authorization for each of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010, for Region II and III, respectively). Vivo acquired spectrum licenses in band “J” in regions where it possesses SMP licenses. Moreover, the Invitation Document modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- related Invitation Document No. 002/2010/ANATEL, regarding the auction organized in December 2010 of new licenses for the 1900-2100 MHz radio frequency band denominated the “H” band, for extension bands and for available frequencies at “A,” “D,” “E,” “M” and TDD bands, which modified the rule for the renewal of radio frequency licenses and requires the inclusion in the calculation of the operating profits both the profits arising from remuneration for the use of the SMP network and the profits of the service plans;
- the regulation for the exploration of SMP by means of Virtual Network, which makes possible the creation of the “agent” and the Authorized of Mobile Virtual Network (Resolution No. 550/2010). In accordance with this regulation approved by ANATEL, Mobile Virtual Network Operators may operate either as agents or as virtual network licensees. An agent represents the personal mobile service provider through the establishment of a representation agreement, which must be ratified by ANATEL. The agent’s activity is not defined as a “telecommunications service” so this is of significant interest to companies that operate in other sectors such as large retailers, banks and football teams. However, the activity of the virtual network licensee does fall within the definition of “telecommunications service” and is thus subject to all applicable rules;
- the assignment of the bands of 451 MHz to 458 MHz and 461 MHz to 468 MHz to the Personal Mobile Service, Fixed Switched Telephone Service and to the Multimedia Communication Service, for access to the services of telephony and data in broadband, particularly in rural areas (Resolution No. 558/2010);
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the assignment of the bands of 2500 MHz to 2690 MHz to the Personal Mobile Service and Fixed Switched Telephone beyond Multimedia Communication Service and Pay Television by means of Multichannel Multipoint Distribution Service (MMDS) for which it was previously assigned (Resolution No. 544/2010);

- the regulation for evaluation of the efficiency of use of the radio frequency spectrum (Resolution No. 548/2010);  
and
- the addition of a ninth digit in the numbers of the mobile telephones of area 11, raising the capacity of numeration in the metropolitan region of São Paulo and eliminating definitively the problem of scarcity of numeration in this area (Resolution No. 553/2010).

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- Resolution No. 588/2012 – Regulates network compensation for the STFC. This regulation revised the method of charging for TU-RL during the reduced time period for calls under two minutes of duration, and the change in Bill & Keep regime.
- Resolution No. 600/2012 – Approved the competition goals plan (PGMC). The main goals of PGMC are focused on the wholesale market and network infrastructure sharing, including: (1) passive infrastructure for transport and access networks; (2) call termination in mobile networks; (3) roaming (4) fixed network infrastructure for the transmission of data through copper cables in transmissions of 10mbps; and (5) wholesale fixed network infrastructure for local and long distance transmission of data under 35mbps.
- with an aim to restructure the process of assessing the quality of mobile service, with the inclusion of new processes and measurement of new indicators to verify the quality of mobile broadband and the quality perceived by the user, and the modernization of existing indicators, ANATEL issued on October 28, 2011 (published in the D.O.U. on October 31, 2011), Resolution No. 575/2011, which approved the Regulation for the Management of Quality of Provision of Personal Mobile Service (SMP-RGQ). The new Regulation innovates by providing assessments of the network connection and their respective data transmission rate, especially aspects of availability, stability and connection speed data network. In addition, the resolution established the formation of “GIPAQ” (Group Deployment Process Quality Measurement), which will be responsible for implementing the processes on the quality indicators for the “Guaranteed Instant Transmission Rate” and “Guaranteed Average Transmission Rate.” The methodology and procedures regarding the collection of indicator data for data connections will be defined by this group, composed of providers, ANATEL and a “Quality Measurement Authority” (EAQ), which shall be responsible for implementing these processes and will be hired by the service providers until February 29, 2012. All costs associated with implementing the new procedures for measuring quality will be paid by providers of the SMP and the impacts of the Regulations are still being evaluated, mainly its financial aspect. Also, through the issuance of Resolution No. 574/2011, which approved the Rules of Quality Management (SCM-SCM RGQ) on October 28, 2011 (published in the D.O.U. on October 31, 2011), ANATEL set targets for service quality, as well as updated definitions for indicators and their calculation methods.
- the Regulation on criteria for adjustment of tariffs for calls from the STFC involving access the SMP or SME, approved by Resolution No. 576/2011, dated October 28, 2011, establishes criteria for the gradual readjustment of VCs until 2014. With respect to VU-M fees, for the period before the effectiveness of the cost model established by this Resolution, ANATEL defined transition rules if no pact is reached regarding the VU-M fees. A reduction factor (R) to be applied in the formula for readjustment of the calls involving the PSTN access the Personal Mobile Service.
- $VC_t \leq VC_{t0} \times (1-R-FA) \times (IST_t / IST_{t0})$ , where R corresponds to the “Reduction Factor” (Fator de Redução) and FA to the “Damping Factor” (Fator de Amortecimento), the percentage of which depends on inflation in the corresponding period.

The Reduction Factor to be applied in the next readjustment of the VC rate for fixed-mobile calls will follow the schedule below:

- for the first readjustment, ANATEL will apply a Reduction Factor of 18%;
- for readjustments to follow, ANATEL will apply a Reduction Factor of 12%; and
- if the cost model has not yet produced results, the third readjustment will be subject to a Reduction Factor of 10%.

The “Damping Factor” has the following scale: 0 if inflation is less than 10%; 0.01 if inflation is between 10% and 20% and 0.02 if inflation is above 20%.

For the VU-M fees, they remain freely negotiated and in case there is no agreement as a result of the new VC determined according the formula above, any reduction of these fees will be applied to the VU-M fee up to the VU-M / VC1 ratio to achieve 70%. From this level, the reduction will also be assessed in other components of the VCs, maintaining this ratio.

According to Resolution No. 600, ANATEL established that the RVU-M 2014 should be at most 75% of the amount applicable at the end of 2013 and the RVU-M 2015 should be at most 50% of the amount applicable at the end of 2013. Beginning in February 2016, VU-M will be measured based on cost modeling.

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### Rate Regulation

With respect to our Basic Plan and certain roaming charges incurred in connection with alternative service plans, our authorizations continue to provide for a price cap mechanism to set and adjust rates on an annual basis. The cap is the value with the rate of inflation deducted from the productivity estimated by ANATEL. The price cap is revised annually to reflect the rate of inflation as measured by the IGP DI. However, mobile operators are able to freely set the rates for alternative service plans.

The initial price cap agreed to by ANATEL and us in our authorizations had been based on the previously existing or bidding prices, and was adjusted annually on the basis of a formula contained in our authorizations. The price cap has been revised to reflect the rate of inflation as measured by the IGP DI.

Other telecommunications companies that interconnect with and use our network must pay certain fees, primarily an interconnection fee. The interconnection fee is a flat fee charged per minute of use. Since 2005, ANATEL has permitted free negotiations for mobile interconnection, or VU-M, fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in fees). ANATEL approved that provisional agreement, and in March 2006, approved another provisional agreement for VU-M fees for long-distance calls, VC2, VC3 and international, among the same operators that made the VC1 agreement.

In July 2007, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.97143% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of 2.25356% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

In January 2008, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, taking into consideration the period since January 2004, that provides for an annual adjustment of 4.5% as of March 2006 and an annual adjustment of 1.97143% or 2.25356% as of July 2007.

In July 2008, ANATEL approved a provisional agreement among the fixed-line operators Telefônica, Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of 1.89409% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region).

In March 2009, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2007 to 2008, that provides for an annual adjustment of 1.89409% in Region I (Telemar's Region) or 2.06308% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region) as of July 2008.

In September 2009, even though it had a provisional agreement between the fixed-line operators Telefônica, Telemar, Brasil Telecom and Sercomtel and the mobile operators, without CTBC Celular, ANATEL decided not to approve the readjustment of the local (VC1) and long-distance (VC2 and VC3) fixed-to-mobile calls. In February 2010, this readjustment of the VC1, VC2 and VC3, relative to the period from 2008 to 2009, was approved by ANATEL and the provisional agreement of VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC1) could be applied.

In June 2010, ANATEL approved a provisional agreement among the fixed-line long-distance operator Embratel and the mobile operators for interconnection fees for VC2 and VC3 calls, for the period from 2008 to 2009, for the

application of the VU-M fee readjustment (68.5% of the approved readjustment of approximately 0.97% for the VC2 and VC3).

By the end of 2011, our subsidiary Vivo entered into an agreement with Oi (Regions I and II) and us (Region III) for the recognition of the VU-M fee paid at the time and agreed to maintain this amount for an additional 24 months, based on the VC1 readjustment pleaded by both these companies to ANATEL. However, these fees were not approved by ANATEL due to the publication of ANATEL's Resolution No. 576/2011, which addresses the criteria for adjustment of fees for calls from fixed-lines involving access to the SMP or SME. On January 25, 2012,

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ANATEL published Act No. 486, with the new fees for VC1, VC2 and VC3 (with an average reduction of 10.78%) and, on February 22, 2012, ANATEL published Act No. 1,055 with new VU-M fees (with an average reduction of 14%). However, Oi obtained an injunction in Federal Court to have its readjustment request analyzed by ANATEL. This decision is subject to appeal. See “—Interconnection Regulation.”

Also, ANATEL published the Invitation Document No. 002/2007/SPV-ANATEL, which relates to the December 2007 auction of new licenses for the 1900-2100 MHz radio frequency bands (3G licenses). Under this Invitation Document, the authorizations resulting from the auction of will be combined with the existing authorizations belonging to the bid winners when pertaining to the same region of the general authorization plan of SMP (PGA-SMP) in the period of eighteen months from the publication of the Terms of Authorization (which occurred on April 30, 2008).

As a result, ANATEL published in January 2010 an act determining the merger of our SMP authorizations in Regions II (State of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and the Federal District) and III (state of São Paulo) of the PGA-SMP, with an SMP authorization for each one of these Regions (Terms of Authorization No. 005/2010 and 006/2010, signed in January 2010 for Regions II and III, respectively).

Moreover, ANATEL determined that the value of the VU-M fee should be unified for each Region of the PGA-SMP and freely negotiated beginning on November 1, 2009 (eighteen months from April 30, 2008). Until this date, mobile operators charged a VU-M fee for authorization of the SMP. In February 2010, ANATEL defined the VU-M fee to be paid for Oi (fixed and mobile operators) and Brasil Telecom (fixed and mobile operators) to Claro, TIM, Vivo and Vivo Participações (the latter being the result of the ANATEL-authorized merger of Telemig Celular S.A. into Vivo Participações in March 2010), for the region of the PGA-SMP, as a result of the unification of the SMP authorizations.

In 2007, ANATEL developed a new model which will be in use starting with a date yet to be determined by ANATEL to determine values of reference in connection with remuneration for use of mobile networks—RVU-M—of SMP providers having significant market power, which will be used in the case of arbitration by ANATEL of the value of VU-M. ANATEL did not implement this new model in 2010, as provided by Resolution No. 480/2007, and has not yet defined the new date expected for such implementation. See “—SMP Licenses” for more information on the status of this agreement.

ANATEL launched on August 25, 2011 the “Project Cost Model” (Projeto Modelo de Custos). The project is associated, among other things, with determining fees for the use of the fixed telephony network and the calculation of reference values of the VU-M fee and EILD (Industrial Use of Dedicated Lines) for telecommunications service providers.

At launch, ANATEL signed a US\$8.22 million agreement with the consortium of Advisia, Analysis Mason and Grant Thornton, which has two years to perform work in support of ANATEL. This consortium won the international bidding process conducted by the International Telecommunication Union (ITU).

The cost model is of great relevance to ANATEL in carrying out public sector policies, as its development will allow access to cost management information of the different business areas and product lines of telecommunications services providers, contributing to the improvement of regulation of the sector as a whole.

## Internet and Related Services in Brazil

In Brazil, Internet service providers, or ISPs, are deemed to be suppliers of value-added services and not telecommunications service providers. ANATEL’s Resolution No. 190 requires cable operators to act as carriers of third-party Internet service providers. The Brazilian House of Representatives is considering a law that would penalize

Internet service providers for knowingly providing services that allow illegal goods or services to be sold on the Internet, and would impose confidentiality requirements on Internet service providers regarding nonpublic information transmitted or stored on their networks.



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### Customer Service

In 2012 Telefônica Brasil expanded its differentiation customer service model by initiating a large segmentation process that recognizes customer decision of keeping both connections, fixed and mobile, into the same company, delivering a unique experience as soon as 2013 first semester.

Customer service segmentation model allows the company to improve its multichannel strategy. In 2012 there was a substantial progress regarding electronic channels adoption such as Vivo SMS, which was used by more than 2.5 million customers per month. Numbers kept on growing at the same speed of previous years, reaching 70% share of received contacts.

Concerning customer service quality, PROCON-SP's ranking demonstrated that Telefônica Brasil reached the best position among its largest competitors, which shows that the company is taking the right decisions to ensure customers' satisfaction. Moreover, in the last three years the company has been presenting meaningful improvements on internal processes that led to a positive impact on the volume of requests received by Market Regulatory Agencies, such as Fundação PROCON-SP. As a result, for the first time in the last five years, the operator was not ranked as the most complained company at PROCON's March report (based on 2011 numbers).

According to ANATEL's ranking, in 2012 Vivo managed to continue as the top telecommunications mobile company in Brazil by having the smallest complaint ratio, as well as reaching number 1 position in regards to Attendance Performance Index (IDA) – the company placed best in 43 out of 44 months of evaluation. Similar results were reported by SINDEC (National System of Consumer Protection Information), which gathers information of Procons from all over the country and that showed a 7.2% complaints reduction in comparison to the previous year. Not enough, it has the best KPIs among its competitors as stated by the second edition of the project “Consumer Defense Public Indicators”, published by Ministry of Justice. Furthermore, it was considered the company with the best resolution rate in relation to other players in the telecom industry reaching 83.7%, as well as the operator with the highest level of forum agreements with 80.1%.

All these results were supported by Telefônica Brasil actions towards quality and expansion of the customer service channels, aiming to improve customers experience and get closer to their needs, therefore keeping its leadership position in the telecom market.

### Marketing and Sales

During 2012, we integrate channels to offer standardized solutions and customer service along with innovation and best practices for the sale of fixed and mobile services.

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

- **Vivo Own Stores:** focused on individual clients and located on strategic points, our own stores provide a highly trained team built up to guarantee the best sales experience for the customer. The main drive of this channel is innovation. As a result, most stores have available self assistance services for value added services and recharges. We also offer special treatment for Premium clients with scheduled appointments via the Internet to assure “no waiting in line.”
- **Indirect channels:** are divided in two types: resale and retail. The resale channel is composed by certified companies in the telecommunications segments providing our full portfolio and an adequately sized network for our services to attend the geographic dimensions of the market. Our presence is also established in the retail channel especially for prepaid, recharges and data services.

- Recharge channels: are represented by small companies in various market sectors throughout the country. They became the largest channel for prepaid users and provide new means of virtual recharge for customers.
- Telesales: sales through active and passive telemarketing call centers, employing highly trained sales associates, focused on fixed and data services.

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- Internet: “Portal Telefônica,” with online 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.
- Online Store: currently offers mobile services to clients with home delivery, payment in installments and different prices of handsets. In 2012, we launch a new online store covering all the services portfolio of fixed and mobile, and offering improvements in navigation, quality purchase, reduction in SLA, etc. supported by a communications marketing strategy.
- Door-to-door sales: aiming to approach corporate and individual clients, we dispose physical channels of assistance, such as door-to-door sales of services by outsourced small companies and own team consultants. Main focus in fixed and data services.
- 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.

## Our Network

In 2012, the company continued the consolidation of a robust network, capable of delivering to the customer its expectation. Advanced in the migration of TDM to NGN core, reaching 41.1% of fixed traffic, modernization of switches and adaptation of the infrastructure of datacenters. For example, we began of the implementation of project that exchange optical cabinets (ARO) for MSAN.

The FWT is the result of the integration between the mobile and the fixed environments and allowed the company to explore the fixed telephony service in regions outside São Paulo region. It grew more than 500% in 2012.

During 2012, the number of broadband accesses in the fixed network increased by 300,000 customers. The company’s portfolio related to xDSL broadband products includes speeds from 250 kbps to 25Mbps. The product “Banda Larga Popular”, which is an initiative of the state of São Paulo, provides broadband at affordable prices to low-income population, with speeds that range from 250 kbps to 1Mbps. Last year, the product reached 1 million and 200 thousand clients. The company also offers broadband services provided via coaxial cable, with speeds that range from 8 Mbps to 100 Mbps.

Using the platform called DLM ASSIA, which improves the diagnosis and stability of our customers and to increase the index of assertiveness in recommending upgrade speed, were performed more than 300,000 upgrades for 2012, thus seeking the loyalty of the customer base and increase the revenue.

Another important characteristic of the network is the availability of FTTH, the most advanced optical fiber broadband technology available. It allows the use of data rates until 200Mbps. By the end of 2012, the company had over 115 thousand clients using this technology. From these, five thousand customers also use the IPTV service — a system through which television services are delivered using the Internet Protocol.

In 2012, the “Vivo Speedy” service reached 3.85 million customers. The service is provided using xDSL, optic fibers and coaxial cables.

In 2011, we launched the HSPA+ technology, commercially known as 3GPlus, working across our 3G network. This technology was commercially launched in November, 2011 in São Paulo (and its extended metropolitan area with area code 11). In 2012, the service was extended to national coverage 3G. The 3G Plus allowing customers who have

compatible terminals to achieve even higher transmission rates, reaching up to three times the value of traditional 3G's rate.

During the year 2012, we continue to expand strongly our 3G network, reaching around 3100 municipalities or 86.21% of the population covered by this technology. With 2G technology reaching 3,740 municipalities or about 90.96% of the population at the end of 2012

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Our advanced network management technology ensures global management and supervision of all our network processes and network performance. The network management centers are located in São Paulo, Brasília and Minas Gerais. These centers monitor all regions of the country, but with different functions.

The network management center of São Paulo monitors the critical network operational parameters of the countrywide transmission backbone, IP networks and broadband networks. The network management center in Brasília monitors the critical operational parameters of core networks and services platforms. The network management center in Minas Gerais monitors the critical operational parameters of the access network (radio network) and infrastructure. These centers are able to identify abnormalities in both our network and in third-part networks, using failure and signaling monitoring systems. In addition, quality and service standards are constantly monitored. The network management centers are integrated with maintenance and operations teams that maintain and operate cellular network elements, as well as cellular infrastructure and transmission, in addition to the radio network elements and computing bases, service platforms and communications backbones.

Our network is prepared to provide continuity of service for our customers in the event of network interruptions. We have developed contingency plans for potential catastrophes in our switching centers, power supply interruptions and security breaches.

Pursuant to the terms of our authorization to perform our services, we are obligated to meet certain requirements for service quality. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

### Contract Customers for Mobile Services

Since October 1994, cellular telecommunications service in Brazil has been offered on a “calling party pays” basis, under which customers pay only for calls that they originate. In addition, customers pay roaming charges on calls made or received outside their home registration area.

Customer charges are calculated based on the customer’s calling plan, the location of the party called, the place from which the call originates and certain other factors, as described below. Our Region is divided into areas designated for payment purposes, called registration areas, as follows:

- Areas 1 & 2: 9 areas in the state of São Paulo;
- Area 3: 5 areas, comprising 1 area in the metropolitan area of Rio de Janeiro, two areas in upstate Rio de Janeiro and two areas in the state of Espírito Santo;
  - Area 4: 7 areas in the state of Minas Gerais;
  - Area 5: 9 areas, comprising 6 areas in the state of Paraná and 3 areas in the state of Santa Catarina;
  - Area 6: 4 areas in the state of Rio Grande do Sul;
- Areas 7 & 8: 18 areas, comprising 9 areas in Brasília and the states of Goiás, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and Tocantins and 9 areas in the states of Amapá, Amazonas, Maranhão, Pará and Roraima;
  - Area 9: 6 areas, comprised of 5 areas in the state of Bahia and 1 area in the state of Sergipe; and
  - Area 10: 9 areas in the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.

### Interconnection Charges

We earn revenue from any call that originates from another cellular or fixed-line service provider network connecting to one of our customers. We charge the service provider from whose network the call originates a network usage charge for every minute that our network is used in connection with the call. See “—Operating Agreements—Interconnection Agreements.” Tariff adjustments are subject to agreement between the operators and then subject to approval by ANATEL.

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### Bill and Keep

ANATEL adopted partial “Bill and Keep” rules for interconnection charges in July 2003. The rules provided that an SMP operator paid for the use of another SMP operator’s network in the same registration area only if the traffic carried from the first operator to the second exceeded 55% of the total traffic exchanged between them. In that case, only those calls that surpassed the 55% level were subject to payment for network usage. Under Resolution No. 438 published in 2006, ANATEL eliminated the rule of the partial “Bill and Keep.” The current rule is “full billing,” in which the SMP operator pays the entire call termination fee of the other mobile network. The rule of the partial “Bill and Keep” was maintained between SMP and SME (trunking) networks.

On May 7, 2012, ANATEL approved a change in the interconnection service to a partial Bill and Keep model through the end of 2013 and an integral Bill and Keep model beginning in 2014.

On November 12, 2012, the Brazilian government published Resolution No. 600/2012 approving the General Competition Plan, or PGMC, which introduced the study of relevant markets in Brazil and applied asymmetric measures to the companies considered to have significant market power. It focused on the wholesale market, introducing new obligations regarding network desegregation, infrastructure sharing and interconnection. Particularly with regard to interconnection, the PGMC introduced a new tariff reduction schedule for use of mobile networks for 2014 (75% of value of 2013) and 2015 (50% of 2013), and programming the adoption of the RIC model in 2016. In terms of balancing traffic model, the PGMC kept the full Bill and Keep model with operators that have significant market power and established a partial Bill and Keep model with operators without significant market power through 2016, at which time all operators will follow the full Bill and Keep model.

### Roaming Fees

We receive revenue pursuant to roaming agreements with other cellular service providers. When a customer of another cellular service provider makes a call within our area, that service provider pays us for the call at the applicable rate. Conversely, when one of our customers makes a cellular call outside of our Region, we must pay the charges associated with that call to the cellular service provider in whose Region the call originates. See “—Roaming Agreements.”

### Wireless Device Sales

Through our stores and authorized dealers we sell only GSM and WCDMA devices such as handsets, smartphones, broadband USB modems and netbooks that are certified to be compatible with the Vivo network and service. We have special offers on smartphones, USB modems and other data devices for customers of bundled packages. Our current handset suppliers are Motorola, LG, Samsung, Nokia, Sony, Alcatel, ZTE, HTC, Apple, BlackBerry and Huawei.

### Operating Agreements

We have agreements with major fixed-line and mobile operators in Brazil to lease physical space, real estate, air conditioning, energy, security and cleaning services. We also lease transmission capacity necessary to complete the construction of our network infrastructure.

### Interconnection Agreements

The terms of our interconnection agreements include provisions with respect to the number of connection points and traffic signals. See “—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies” and “—Regulation of the Brazilian Telecommunications Industry—Interconnection Regulation.”

We believe that our subsidiaries have adequate interconnection agreements with necessary fixed-line operators to provide services. We also believe that our subsidiaries have all the necessary interconnection agreements with long-distance carriers.

#### Roaming Agreements

We provide international GSM roaming in over 200 destinations worldwide by means of over 500 roaming agreements.

#### Fraud Detection and Prevention

In 2012, we consolidated efforts to reach our target for reduction of amounts and financial loss expenses for our operations related to fraud in mobile operations, reaching a 20.1% reduction compared to the previous year.

During 2012, we continued our work in combating the two main types of fraud, as follows:



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- **Subscription fraud:** type of fraud that occurs when the emission of one or more qualifications without the consent of the real “owner” of documents with the main objective of not paying the phone bill. Fraud can occur through subscription data and information from individuals or companies obtained illegally.
- **Identity Fraud:** also known as “social engineering,” the term identity fraud characterizes in the mobile operation the use the service provider phone channels (Call Center) with the use of real data from clients for false identification, allowing undue changes to be made in the customer’s line.

For mobile operations in identifying fraud, we had a decrease of 86.1% compared to expenses in the previous year and we had a decrease of 16.4% in subscription fraud compared to our 2012 budget. In 2012, we had a decrease of 7.7% in costs with fraud, compared to the amount budgeted for the year.

## Disclosure Pursuant to Section 219 of the Iran Threat Reduction and Syria Human Rights Act

Section 219 of the Iran Threat Reduction and Syria Human Rights Act of 2012 added Section 13(r) to the Exchange Act. Section 13(r) requires an issuer to disclose in its annual or quarterly reports filed with the SEC whether the issuer or any of its affiliates has knowingly engaged in certain activities, transactions or dealings with the Government of Iran, relating to Iran or with designated natural persons or entities involved in terrorism or the proliferation of weapons of mass destruction during the period covered by the annual or quarterly report. Disclosure is required even when the activities were conducted outside the United States by non-U.S. entities and even when such activities were conducted in compliance with applicable law.

The following information is disclosed pursuant to Section 13(r). None of these activities involved U.S. affiliates of Telefónica.

## Roaming Agreements

Various subsidiaries of our controlling shareholder, Telefonica S.A., have entered into roaming agreements with Iranian telecommunication companies. Pursuant to such roaming agreements these subsidiaries’ customers are able to roam in the particular Iranian network (outbound roaming) and customers of such Iranian operators are able to roam in Telefonica S.A.’s relevant subsidiary’s network (inbound roaming). For outbound roaming, these subsidiaries pay the relevant Iranian operator roaming fees for use of their network by our customers, and for inbound roaming the Iranian operator pays the relevant subsidiary roaming fees for use of our network by its customers.

Telefonica Brasil S.A. and Vivo S.A. do not have any contractual relationship with these Iranian operators; however, as part of the Telefonica Group, they adhere to the roaming agreements with Telefonica S.A.’s subsidiaries described below.

Telefonica S.A.’s subsidiaries were party to the following roaming agreements with Iranian in 2012:

- (1) Telefónica Móviles España (“TME”), Telefonica S.A.’s Spanish directly wholly-owned subsidiary, has respective roaming agreements with (i) Mobile Telecommunication Company of Iran (“MTCI”), (ii) MTN Irancell (“Irancell”), (iii) Telecommunication Kish Company (“TKC”) and (iv) Taliya (“Taliya”).

During 2012, TME recorded the following revenues related to these roaming agreements: (i) 182,564 euros from MCI, (ii) 3,325 euros from Irancell, (iii) none from TKC and (iv) none from Taliya.

TME also holds a Roaming Hub through its 55% directly-owned subsidiary, Link2One, a.e.i.e. (“L2O”). Under this agreement, L2O provides a roaming hub service to Irancell enabling the latter to maintain a relationship with other

members of the hub. Some members of the hub are also entities of the Telefónica Group. Under this roaming hub service, for 2012, L2O has billed Irancell 115,462 euro but as of the date of this Annual Report TME has not yet received payment.

- (2) Telefónica Germany GmbH & Co. OHG (“TG”), Telefonica S.A.’s German 76.83% indirectly-owned subsidiary, has a roaming agreement with MCI. TG recorded 220,714 euros in roaming revenues under this agreement in 2012.
- (3) Telefónica 02 Ireland Limited (“TIR”), Telefonica S.A.’s Irish directly wholly-owned subsidiary, has a roaming agreement with MCI. TIR recorded 1,459 euros in roaming revenues under this agreement in 2012.
- (4) Telefónica Czech Republic, a.s. (“TCR”), Telefonica S.A.’s Czech 69.41% indirectly-owned subsidiary, has a roaming agreement with MCI. TCR recorded 29,629 euros in roaming revenues under this agreement in 2012.
- (5) Telefónica UK Ltd (“TUK”), Telefonica S.A.’s English directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded 131 euros in roaming revenues under this agreement in 2012.
- (6) Pegaso Comunicaciones y Sistemas, S.A. de C.V. (“TUK”), Telefonica S.A.’s Mexican directly wholly-owned subsidiary, has a roaming agreement with Irancell. TUK recorded US\$46 in roaming revenues under this agreement in 2012.

The net profit recorded by Telefonica S.A.’s subsidiaries pursuant to these agreements did not exceed the related revenues recorded thereunder.

The purpose of all of these agreements is to provide Telefonica Group’s customers with coverage in areas where the Group does not own networks. For that purpose, Telefonica S.A.’s subsidiaries intend to continue maintaining these agreements.

#### International Carrier Agreement

Telefónica International Wholesale Services, S.L. (“TIWS”), Telefonica S.A.’s Spanish indirectly wholly-owned subsidiary, has entered into an international carrier agreement with Telecom Infrastructure Company of Iran (“TICI”).

Pursuant to this agreement, both companies interconnect its networks to allow for international exchange of traffic. TIWS recorded 4,885 euros in revenues under this agreement in 2012. The net profit recorded by TIWS pursuant to this agreement did not exceed such revenues.

The purpose of this agreement is to allow exchange of international traffic. Consequently TIWS intends to continue maintaining this agreement.

#### C. Organizational Structure

On December 31, 2012, our voting shares were controlled by three major shareholders: SP Telecomunicações Participações Ltda. with 50.47%, Telefonica S.A. with 25.68% and Telefônica Internacional S.A. with 15.43%. Telefónica Internacional is the controlling shareholder of SP Telecomunicações and, consequently, holds directly and indirectly 43.36% of our common shares and 38.78% of our preferred shares. Telefónica 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 equipment 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 Telefônica Brasil, and began carrying out the activities formerly performed by Atrium. See “—B. Business Overview—Overview.”

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 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.

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Vivo is a company that provides mobile services in the states of Acre, Alagoas, Amapá, Amazonas, Bahia, Ceará, Espírito Santo, Goiás (also encompassing the area of Distrito Federal, or the Federal district), Maranhão, Mato Grosso, Mato Grosso do Sul, Pará, Paraíba, Paraná, Pernambuco, Piauí, Rio de Janeiro, Rio Grande do Norte, Rio Grande do Sul, Rondônia, Roraima, Santa Catarina, São Paulo, Sergipe, Tocantins and Minas Gerais. See “—A. History and Development of the Company.”

Ajato Telecomunicações Ltda. The corporate purpose of Ajato Telecommunications Ltd is to provide telecommunications and IT services, access to telecommunications network, internet and radio, including telemarketing, image and data services, trade lease, import, export, maintenance and repair for those equipment.

Aliança Atlântica Holding B.V. based in Netherlands, Amsterdam, with a 50% interest owned by Telefonica Brasil, holds cash from the sale of Portugal Telecom’s shares in June 2010 and a small interest in Zon Multimedia, a company of Portugal Telecom Group which provides pay-TV services, internet, distribution of audiovisual content, cinema and telecommunications services.

Companhia AIX de Participações. This company is engaged in the Refibra consortium, as a leader, as well as in both direct and indirect development of activities related to the construction, conclusion and operation of underground fiber optic networks. Currently, Telefônica Brasil holds a 50% interest in this company.

Companhia ACT de Participações is engaged in the Refibra consortium, as a leader, as well as in activities related to providing technical assistance for the preparation of the 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, Telefônica Brasil holds a 50% interest in this company.

GTR Participações e Empreendimentos S.A.’S business purpose is to hold equity interest in other companies, which are engaged in providing cable and pay-TV services, telecommunications services in general, the production, purchase, licensing, import and distribution of television programs, either its own or third parties’, spare parts and equipment, management and rendering of telecommunications and pay-TV service platforms.

TVA Sul Paraná S.A.’s business purpose is to provide cable and pay-tv services, telecommunications services in general, produce, purchase, license, import and distribute television programs, either its own or third parties’, spare parts and equipment, manage, update and exploit telecommunications and pay-TV service platforms and publish journals.

Lemontree Participações S.A.’s business purpose is to hold equity interest in other companies, which are engaged in providing cable and pay-TV services, telecommunications services in general, the production, purchase, licensing, import and distribution of television programs, either its own or third parties’, spare parts and equipment, management, updating and exploitation of telecommunications and pay-TV services platforms, and data management and trading.

Comercial Cabo TV São Paulo S.A.’s business purpose is to provide cable and pay-TV services, advisory and consultancy services in telecommunications in general, to produce, purchase, license, import and distribute television programs, either its own or third parties’, spare parts and equipment, manage, update and exploit telecommunications and pay-TV service platforms, and to engage in all types of marketing and advertisement.

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, 2012, we held a 50% share ownership in Aliança Atlântica Holding B.V. and Telefónica 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, 2012, 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

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consolidated financial statements included in this annual report starting at page F-12. We also consolidate on a proportionate consolidate, as required under the Brazilian Corporate Law Method and under IFRS, Companhia ACT de Participações, in which we hold a 50% interest.

From January 1, 2013 with the entry into force of IFRS 11, we will present all these investments in affiliates ("associates") in our consolidated financial statements by the equity method.

D. Property, Plants and Equipment

Our main physical properties for providing fixed 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, 2012, we used 2,174 properties in our operations, 1,414 of which we own, and we have entered into standard leasing agreements to rent the remaining properties.

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."

Our principal physical property for mobile services consists of transmission equipment, switching equipment, base stations, and other communication devices, such as voicemail, prepaid service, Short Message Service, Home Location Registers, Signaling Transfer Point, Packet Data Switching Network and gateways. All switches, cell sites, administrative buildings, administrative facilities, warehouses and stores are insured against damages for operation risks.

As of December 31, 2012, our subsidiary Vivo had 206 cellular switches and other equipment installed in 57 owned spaces, 10 leased spaces and 26 shared spaces. We lease most of the sites in which our cellular telecommunications network equipment is installed. The average term of these leases is five years (subject to renewal for additional five-year terms) and ten years in the Northeast. Our 27,044 base stations and other network equipment are installed in cell sites, administrative buildings and administrative facilities. In addition, our subsidiary owns 13 administrative building and we lease 35 administrative areas, 14 kiosks and 303 retail stores.

At December 31, 2012 the net book value of our property, plant and equipment amounted R\$17.6 billion (R\$17.2 billion at December 31, 2011).

ITEM 4A. UNRESOLVED STAFF COMMENTS

We received comments from the Staff of the SEC relating to our Annual Report on Form 20-F for the year ended December 31, 2010, and to the Form 6-K filed on August 14, 2012 for the six months ended June 30, 2012. As of the date of filing of this Annual Report, Staff comments regarding the accounting treatment of certain transactions entered into in 2010, 2011 and 2012, pursuant to which we assigned the right to operate and sold certain towers to third parties, and agreed to share the use of such towers thereafter, remain unresolved. We believe the transactions have been properly accounted for and we are working with the staff to resolve their comments.

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 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 IFRS.

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### 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 IBGE, the Brazilian GDP expanded 1% in 2012, compared to 2.7% in 2011.

Consumer prices, as measured by the IPCA, registered a variation of 5.8% in 2012. Accordingly, growth in consumer prices was higher than the inflation target established by the Central Bank, of 4.5%. In 2010 and 2011, the variations of IPCA were 5.9% and 6.5%, respectively. Inflation, as measured by the General Price Index, or the IGP-DI, calculated by Fundação Getúlio Vargas, which includes wholesale, retail and home-building prices, increased 11.3% and 5% in 2010 and 2011, respectively. In 2012, the IGP-DI increased 8.1%.

As a result of the deceleration of inflation and of the economic activity, Central Bank reduced the basic interest rate during 2012. As a result, the SELIC rate decreased to 7.25% by the end of 2012, from 11% in 2011.

Brazil finished 2012 with a trade balance surplus of US\$ 19.4 billion, compared to US\$ 29 billion in 2011. Exports decreased by 13.5% to US\$ 242 billion, and imports decreased 24.5% to US\$ 223 billion. Financial inflows into the country increased, with foreign direct investments of US\$ 65.3 billion, compared to US\$66.7 billion in 2011. Portfolio investments decreased to US\$ 8.3 billion in 2012, in comparison to US\$ 35.3 billion in 2011. The positive performance of external accounts allowed international reserves to increase by US\$ 26.6 billion to the record level of US\$378.6 billion.

Despite the worsening in domestic economic data, such as inflation, external accounts, and interest rates, increased risk aversion in the international capital markets led to a lower country risk in 2012. 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 142 basis points by the end of 2012 from 180 basis points at the end of 2011.

Despite this fact, the real depreciated against the U.S. dollar in 2012 by 8.94%. The exchange rate on December 31, 2012 was R\$2.044/US\$1.00, from R\$1.876/US\$1.00 on December 31, 2011.

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 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

Before 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 4.92% according to the last data published by ANATEL with reference to December 2011.



The table below shows the Brazilian general price inflation (according to the IGP-DI, IPCA and the IST) for the years ended December 31, 2008 through 2012:

	Inflation Rate (%) as Measured by IGP-DI(1)	Inflation Rate (%) as Measured by IPCA(2)	Inflation Rate (%) as Measured by IST(3)
December 31, 2012	8.1	5.8	4.9
December 31, 2011	5.0	6.5	4.9
December 31, 2010	11.3	5.9	5.6
December 31, 2009	(1.4 )	4.3	2.1
December 31, 2008	9.1	5.9	6.6

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- (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 2012. See “Item 4. Information on the Company—B. Business Overview.” The most important among these regulations were:

- Resolution no 581/2012 – Regulation of SeAC
- Resolution no 582/2012 – Model Authorization Form SeAC
- Resolution no 586/2012 – Regulation of AICE
- Resolution no 588/2012 – Network Payment Regulation STFC
- Resolution no 589/2012 – Regulation of Administrative Sanctions
- Resolution no 590/2012 – Regulation of EILD
- Resolution no 596/2012 – Regulation of Fiscalization
- Resolution no 598/2012 – Regulation of Universal Service Obligations
- Resolution no 600/2012 – Regulation of PGMC
- Resolution no 604/2012 – Regulation for Successive Calls

We expect the following issues to become effective as new regulations or to be subject of one or more Public Notices in 2013, with an exact timeline yet to be determined by ANATEL.

- New Regulation of STFC
- New Regulation of SCM

- RGQ STFC
- Regulation of Rural Area Service
- Review of the Regulation of Infrastructure Sharing
  - Review of Regulation of TUPs
  - New Regulation of SMP
- Public Consultation of the Fator X

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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:

- 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, 2012, 19.92% of our R\$7.967 billion of financial indebtedness was denominated in U.S. dollars and UMBNDES. See Note 18 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 of 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, most of our debt is exposed to long term interest rates. On December 31, 2012, R\$2.912 billion of our indebtedness was subject to the variations of the TJLP, which remained stable since July 2009, and R\$1.587 billion was subject to the variation of the U.S. dollar and UMBNDES. 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 the CDI. We invest our excess cash mainly in short-term instruments that earn interest based on the CDI. See Note 36 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 17.4% 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

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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 3 of our Consolidated Financial Statements includes methods used in the preparation of those financial statements and includes a summary of the significant accounting policies. To provide an 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, including goodwill, 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 fair value at their acquisition dates, particularly for assets acquired in business combinations and for determining the useful lives of the assets over which they are to be depreciated or amortized as well as their residual value. We believe that the estimates we make to determine an asset's useful life and residual value are "critical accounting estimates" because they require our management to make estimates about future technological developments and alternative uses for assets.

### Impairment of nonfinancial 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 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 flows as well as to the projected future cash flow and the expected future growth rate used for the purposes of determining terminal value. Furthermore, additional factors, such as technological obsolescence, the suspension of certain services and other circumstantial changes are taken into account.

### Post-retirement benefit plan

The cost of defined benefit retirement plans and other post-employment medical care benefits and the present value of pension obligations are determined using actuarial valuation methods. The actuarial valuation methods 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 year-end. 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 for Brazil.

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

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### 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.

The Company and subsidiaries evaluate the recoverability of deferred tax asset based on estimates of future results. This recoverability ultimately depends on the ability of the company and subsidiaries to generate taxable profits over the period in which the temporary difference is deductible. The analysis considers the reversal period of deferred tax liabilities, as well as estimates of taxable profits, based on updated internal projections reflecting the latest trends.

Determining the proper classification of the tax items depends on several factors, including an estimate of the period and the realization of the deferred tax asset and the expected date of payments of these taxes. The actual flow of receipt and payment of income tax could differ from estimates made by the company and subsidiaries, as a result of changes in tax laws or of unexpected future transactions that may impact tax balances.

### Provisions for tax, labor, civil and regulatory proceedings

We record provisions for tax, labor, civil and regulatory claims. 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 the amount of our provisions.

### Revenue recognition

#### Customer Loyalty Program

We have a customer loyalty program that allows customers to accumulate points when generating traffic for the use of our mobile services. The accrued points may be exchanged for handsets or services, provided the customer has a minimum stipulated balance of points. The consideration received is allocated to the cost of the handsets or services redeemed at their fair value. The fair value of the points is calculated by dividing the discount value granted as a result of the customer loyalty program by the amount of points needed to carry out the redemption. The fair value accrued on the balances of generated points is deferred and recognized as income upon redemption of points.

For determining the quantity of points to be recognized, we apply statistical techniques, which take into consideration assumptions such as estimated redemption rates, expiration rates, cancellation of points and other factors. These estimates are subject to variations and uncertainties due to changes in the redemption behavior of the customers.

A change in the assumptions regarding these factors could affect the estimated fair value of the points under the customer loyalty program and it could affect the apportionment of revenue among the elements and, as a result, revenues in future years.

### Multiple-element arrangements



Bundled offers that combine different elements are assessed to determine whether it is necessary to separate the different identifiable components and apply the corresponding revenue recognition policy to each element. Total package revenue is allocated among the identified elements based on their respective fair values.

Determining fair values for each identified element requires estimates that are complex due to the nature of the business.

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A change in estimates of fair values could affect the apportionment of revenue among the elements and, as a result, revenues in future years.

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:

- Telephony services

Includes revenues from fixed and mobile telephony highlighting:

- 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
  - Usage charges: which include measured service charges for calls, monthly fee and other similar charges;
- Data Transmission and value added services
  - Data Transmission: includes the sum of infrastructure rental revenues and data transmission; and
- Charges for call forwarding, call waiting, text messaging (SMS), call blocking and Data Services, such as WAP and ZAP, downloads and MMS services, which are charged only when the customer's plan excludes these services.

- Interconnection charges

- Interconnection charges (or network usage charges) are amounts we charge other cellular and fixed-line service providers for the use of our network;

- Pay TV

- Includes cable TV services, through satellite, cable or MMDS technology (multichannel multipoint distribution service);

- Sale of goods and equipment

- The sale of wireless devices and accessories; and

- Other Services

- Other services include integrated solution services offered to residential and corporate clients, such as Internet access, private network connectivity and leasing of computer equipment, and

- Other telecommunications services such as extended service, detects, voice mail, cellular blocker, among others.

#### Results of Operations

The following table sets forth certain components of our net income for each year ended December 31, 2012, December 31, 2011 and December 31, 2010 as well as the percentage change of each component. The Company acquired 100% of shares of Vivo Participações amounting to R\$31.2 billion. See Note 1 and Note 4 to our

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consolidated financial statements. The Company's consolidated financial statements include Vivo Participações and Vivo as of April 1, 2011. Vivo Participações and Vivo were included in the company's consolidated financial statements through the full consolidation method.

Because Vivo Participações and Vivo are included in our financial statements for nine months in 2011, our results of operations in 2012 are not fully comparable with our results of operations in 2011 and 2010. We have made certain changes to our accounting criteria and elected to apply these changes retroactively to part of our financial statements for the years 2011 and 2010 to make them comparable to our 2012 financial statements. Implementation of these accounting changes did not create any difference for our results of operations or shareholders' equity.

	Year ended December 31,			Percent		Percent	
	2012	2011	2010	change		change	
	(in millions of reais)			2012-2011		2011-2010	
Net operating revenue	33,931.4	29,128.7	15,798.3	16.5	%	84.4	%
Cost of services and goods	(16,564.4)	(15,039.7)	(8,844.8)	10.1	%	70.0	%
Gross profit	17,367.0	14,089.0	6,953.5	23.3	%	102.6	%
Operating expenses:							
Selling	(8,693.7)	(6,948.2)	(2,964.6)	25.1	%	134.4	%
General and administrative	(2,148.4)	(1,785.6)	(738.9)	20.3	%	141.7	%
Other operating revenues, net	687.4	442.2	312.4	55.5	%	41.5	%
Total operating expenses, net	(10,154.7)	(8,291.6)	(3,391.1)	22.5	%	144.5	%
Equity in earnings (losses) of associates	-	-	2.9	-		(100.0)	%)
Operating income before financial expense, net	7,212.3	5,797.4	3,565.3	24.4	%	62.6	%
Net financial expenses	(290.8)	(139.7)	(120.7)	108.2	%	15.7	%
Net income before income and social contribution taxes	6,921.5	5,657.7	3,444.6	22.3	%	64.2	%
Income and social contribution taxes	(2,469.3)	(1,295.5)	(1,045.8)	90.6	%	23.9	%
Net income	4,452.2	4,362.2	2,398.8	2.1	%	81.8	%
Net income attributable to:							
Shareholders of company	4,453.6	4,355.3	2,398.8	2.3	%	81.6	%
Noncontrolling interests	(1.4)	6.9	-	(120.3)	%)	100.0	%
Net income for year	4,452.2	4,362.2	2,398.8	2.1	%	81.8	%

## Net Operating Revenue

Net operating revenues increased by 16.5% to R\$33,931.4 million in 2012 from R\$29,128.7 million in 2011 mainly due to an increase in the voice service revenue, internet services consumption and use of messages. Net operating revenues increased by 84.4% to R\$29,128.7 in 2011 from R\$15,798.2 million in 2010. The increase in 2011 reflects the consolidation of R\$13,728.1 million of net operating revenues attributable to Vivo and Vivo Participações for the months of April through December 2011. Our net operating revenues excluding Vivo and Vivo Participações decreased by 2.5% to R\$15,400.6 million in 2011, from R\$15,798.2 million in 2010, primarily due to the reduction in the traffic originated by fixed-line and to the lower fixed-voice customer base, partially offset by the increased international long-distance revenue in comparison to 2010.

## Capital Expenditures (Capex)

In 2012, the company invested R\$6,117.1 million in projects that sustain its current annual results and position the company for competitive environment in the medium term representing an increase of 6.5% compared to 2011. As a percentage over net operating revenues the ratio was from 18.5% in 2011 to 18% in 2012. A significant portion of resources was allocated to allow growth quality in our services. The investments in quality maintenance and expansion of our client base represented 87% of the total amount invested by us in 2012 (excluding the purchase of new licenses).

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To meet the needs of an increasingly connected society, significant investments were made to support the strong growth of our data users, both fixed and mobile, or dedicated high speed services for our corporate clients. We are building the future of broadband by increasing the expansion of the optical fiber network in São Paulo. We are also investing in the expansion of the backbone for national data transmission to meet the increase in mobile data traffic throughout the country.

In 2013, as already announced through a material fact on March 7, 2013, Telefonica Brasil will invest R\$5.7 billion, excluding licenses and mergers and acquisitions, in line with the Company's strategy of ensuring quality in service provision.

## Results of Operations for the Year Ended December 31, 2012 Compared to the Year Ended December 31, 2011

## Operating Revenue

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 16.7% to R\$50,278.8 million in 2012 from R\$43,073.1 million in 2011, impacted by increase in telephony services and data transmission and value added services. The variations are explained as follows:

	Year ended December		Percent change	
	2012	31, 2011	2012-2011	
	(in millions of reais)			
Telephony services	26,555.1	24,254.2	9.5	%
Data transmission and value added services	14,389.8	10,929.3	31.7	%
Interconnection charges	4,453.4	3,785.0	17.7	%
Pay TV	805.3	865.4	(6.9)	%
Sale of goods and equipment	2,792.6	2,135.2	30.8	%
Other services	1,282.6	1,104.1	16.2	%
Gross operating revenue	50,278.8	43,073.2	16.7	%
Value-added and other indirect taxes	(16,347.4)	(13,944.5)	17.2	%
Net operating revenues	33,931.4	29,128.7	16.5	%

Telephony services. There was an increase of R\$2,300.9 million in revenue from telephony services, or 9.5%, explained by the increase in voice services revenue. The continued growth of prepaid recharges and increased in postpaid plans "Live Unlimited" part of that evolution.

Data transmission and value added services: Revenue from data transmission and value added services increased to R\$3,460.5 million, or 31.7% compared to 2011. This increase is a result of a significant increase in our customer base in the data access services, mainly due to strong performance in the corporate segment.

Interconnection charges: Revenue from interconnection charges increased to R\$668.4 million, a 17.7% increase in relation to 2011. This variation is mainly related to a rise in traffic of incoming calls to fixed lines especially mobile originated, as well as mobile to mobile calls.

Pay TV. Revenue from Pay TV totaled R\$805.3 million in 2012, a decrease of 6.9% in the Pay TV's gross revenue in relation to 2011. This variation is mainly due to the reduction in the commercial activity due to the launching on the new IPTV platform.

Sale of goods and equipment: Revenue from the sale of goods and equipment in 2012 totaled R\$657.4 million, an increase of 30.8% compared to 2011. The variation in 2012 is mainly a result of the increase in the sale of smartphones, a growth of postpaid customers over the course of the year and as a result of the change in the sales model for SME segment and foreign exchange. Revenues from sales of wireless devices and accessories are reported before commissions and promotional discounts, and include value-added taxes. In general, the purpose of wireless device sales is to encourage growth in customers and traffic (and not necessarily to generate profits). Accordingly, we subsidize part of the costs of wireless devices for post-paid customers.

Others services: Revenues from other services totaled R\$178.5 million, an increase of 16.2% compared to 2011. This increase is mainly a result of higher revenues from providing integrated solutions for the corporate segment.

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## Cost of Services and Goods

The following table sets forth the components of our costs of services and goods sold for 2012 and 2011, as well as the percentage change from the previous year.

	Year ended December		Percent change 2012-2011	
	2012	31, 2011		
	(in millions of reais)			
Cost of goods sold	(1,801.9 )	(1,284.3 )	40.3	%
Depreciation and amortization	(4,132.4 )	(3,582.6 )	15.3	%
Outside services and other	(3,379.6 )	(2,923.4 )	15.6	%
Interconnection charges	(4,012.1 )	(4,537.1 )	(11.6	%)
Rent, insurance, condominium fees, and leased lines	(968.7 )	(910.5 )	6.4	%
Personnel	(459.7 )	(380.1 )	20.9	%
Taxes and concession renewal fees	(1,810.0 )	(1,421.7 )	27.3	%
Cost of services and goods	(16,564.4)	(15,039.7)	10.1	%

Cost of services and goods increased by 10.1% to R\$16,564.4 million in 2012 from R\$15,039.7 million in 2011. The variations are explained as follows:

**Cost of goods sold:** Cost of wireless devices and accessories increased by 40.3% to R\$1,801.9 million in 2012, from R\$1,284.3 million in 2011. The increase in 2012 was mainly due to the increased sales of smartphones, which is linked to higher sales of postpaid and data plans, exchange and because of the change in the sales model for corporate segment.

**Depreciation and amortization:** Depreciation and amortization expenses increased by 15.3% to R\$4,132.4 million in 2012, from R\$3,582.6 million in 2011. The increase in 2012 was mainly due to investments in transmission infrastructure and network.

**Outside services and other:** Cost of third-party services and other increased by 15.6% to R\$3,379.6 million in 2012, from R\$2,923.4 million in 2011, mainly due to network maintenance and pay TV content.

**Interconnection charges:** Interconnection charges decreased by 11.6% to R\$4,012.1 million in 2012, from R\$4,537.1 million in 2011. The decrease in 2012 is mainly due to a decrease in the use of network for fixed-mobile traffic.

**Rent, insurance, condominium fees, and leased lines:** Rent, insurance, condominium fees, and leased lines increased by 6.4% to R\$968.7 million in 2012, from R\$910.5 million in 2011. The increase in 2012, was mainly due to expansion of 3G coverage.

**Personnel:** Personnel expenses increased by 20.9% to R\$459.7 million in 2012, from R\$380.1 million in 2011. The increase in 2012 was mainly explained by the collective wage increase granted in the period.

**Taxes:** Taxes increased by 27.3% to R\$1,810.0 million in 2012, from R\$1,421.7 million in 2011. The increase in 2012 was primarily attributable to growth of the customer base, reflecting the increase in Fistel spending.

## Operating Expenses



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The following table sets forth the components of our operating expenses for each of the years ended December 31, 2012 and 2011, as well as the percentage change from the prior year.

	Year ended December		Percent change 2012-2011	
	2012	31, 2011		
	(in millions of reais)			
Selling expenses	(8,693.7 )	(6,948.2 )	25,1	%
General and administrative expenses	(2,148.4 )	(1,785.6 )	20,3	%
Other net operating income	687.4	442.2	55.5	%
Total	(10,154.7)	(8,291.6 )	22.5	%

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Operating expenses increased by 22.5% to R\$10,154.7 million in 2012, from R\$8,291.6 million in 2011. The increase in 2012 reflects mainly due to an increase in selling expenses.

Selling expenses: Selling expenses increased by 25.1% to R\$8,693.7 million in 2012, from R\$6,948.2 million in 2011, mainly due to an increase in third party services is due to greater expenses with commissions, resulting from increases in data plans, which have a larger unit fee.

General and administrative expenses: General and administrative expenses increased by 20.3% to R\$2,148.4 million in 2012, from R\$1,785.7 million in 2011. The increase in 2012 reflects an increase in maintenance along with the opening of the new integrated office of the company.

Other net operating income: The net amount of other operating income increased by 55.5% to R\$687.4 million of other revenues in 2012, from R\$442.2 million of other revenues in 2011. The increase in 2012 is mainly due to revenue from sales of non-strategic assets in 2012.

**Financial Result**

For the year-end period ended on December 31, 2012, net financial expenses reached R\$290.8 million, increasing by R\$151.1 million or 108.18% when compared to the period ended December 31, 2011, mainly due to lower interest income on financial assets and the consolidation of Vivo and Vivo Participações as of April 2011. When compared with the financial expenses of the period ended December 31, 2011 including results of Vivo and Vivo Participações for the first quarter of 2011, net financial expenses for the year-end period ended on December 31, 2012 have increased R\$111.3 million or 62.0%.

**Income and Social Contribution Taxes**

We recorded expenses from income and social contribution taxes in the amount of R\$2,469.3 million in 2012, an increase of 90.6% from an expense of R\$1,295.5 million in 2011. The increase in 2012 was due to higher income before income and social contribution taxes. The effective rate of income tax and social contribution increased to 35.7% in 2012 compared with 22.9% in 2011, mainly due to lower interest on shareholders' equity payments made in 2012, which is deductible for income tax purposes.

**Results of Operations for the Year Ended December 31, 2011 Compared to the Year Ended December 31, 2010****Operating Revenue**

Our gross operating revenue is presented net of discounts granted.

Our gross operating revenue increased 90.5% to R\$43,073.2 million in 2011 from R\$22,609.1 million in 2010, impacted by the incorporation of Vivo Part and Vivo which we consolidated as of April 1, 2011. Excluding the effect of such acquisition, which totaled R\$20,349.8 million, gross operating revenue would be R\$22,723.4 million, an increase of 0.5%, or R\$114.3 million, compared to 2010. The variations are explained as follows:

	Year ended December		Percent change
	2011	31, 2010	2011-2010
	(in millions of reais)		
Telephony services	24,254.2	15,366.0	57.8
Data transmission and value added services	10,929.3	5,028.4	117.4

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Interconnection charges	3,785.0	523.8	622.6
Pay TV	865.4	587.4	47.3
Sale of goods and equipment	2,135.2	166.5	1,182.4
Other services	1,104.1	937.0	17.8
Gross operating revenue	43,073.2	22,609.1	90.5
Value-added and other indirect taxes	(13,944.4)	(6,810.8 )	104.7
Net operating revenues	29,128.7	15,798.3	84.4

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Telephony service. Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$9,237.8 million, there was a decrease of R\$349.6 million in the revenue, or, 2.3%, explained by the reduction in the traffic originated by fixed-line and to the lower fixed-voice customer base, partially offset by the increased international long-distance revenue in comparison to 2010.

Data transmission and value added services: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$5,421.0 million, the variation in 2011 totaled R\$479.9 million, an increase of 9.5% compared to 2010. This growth is explained by a significant increase in customer base in the data access services, mainly due to strong performance in the corporate segment.

Interconnection charges: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$3,375.9 million, the variation in 2011 totaled R\$409.1 million, which was a drop of 21.9% in relation to 2010. This variation is mainly related to reduction in incoming traffic, given the concentration in selling efforts by the operators for stimulating the on-net mobile traffic.

Pay TV. Revenue from Pay TV in 2011 totaled R\$865.4 million, an increase of 47.3% in the Pay TV's gross revenue in relation to 2010. This variation is related to consolidation of TVA's pay TV business results from the second quarter of 2011.

Sale of goods and equipment: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$1,953.6 million, the variation in 2011 totaled R\$181.6 million, an increase of 9.1% compared to 2010. Revenues from sales of wireless devices and accessories are reported before commissions and promotional discounts, and include value-added taxes. In general, the purpose of wireless device sales is to encourage growth in customers and traffic (and not necessarily to generate profits). Accordingly, we subsidize part of the costs of wireless devices for post-paid customers.

Others services: Excluding the consolidation effect of Vivo Participações and Vivo in the amount of R\$31.4 million, the variation in 2011 registered R\$135.7 million, an increase of 14.5% compared to 2010. This growth is mainly explained by the increased revenues from the supply of integrated solutions to the corporate segment.

#### Cost of Services and Goods

The following table sets forth the components of our costs of services and goods sold for 2011 and 2010, as well as the percentage change from the previous year.

	Year ended December		Percent change 2011-2010	
	31, 2011	2010		
	(in millions of reais)			
Cost of goods sold	(1,284.3 )	(155.7 )	724.9	%
Depreciation and amortization	(3,582.6 )	(1,687.4 )	112.3	%
Outside services and other	(2,923.4 )	(1,860.4 )	57.1	%
Interconnection charges	(4,537.1 )	(4,176.7 )	8.6	%
Rent, insurance, condominium fees, and leased lines	(910.5 )	(364.3 )	149.9	%
Personnel	(380.1 )	(257.4 )	47.7	%
Taxes and concession renewal fee	(1,421.7 )	(342.9 )	314.6	%
Cost of services and goods	(15,039.7)	(8,844.8 )	70.0	%

Cost of services and goods increased by 70.0% to R\$15,039.7 million in 2011 from R\$8,844.8 million in 2010. The increase in 2011 reflects the consolidation of R\$6,678.6 million of cost of services and goods attributable to Vivo and Vivo Participações for the months of April through December 2011. Our cost of services and goods excluding Vivo and Vivo Participações decreased 5.5% to R\$8,361.1 million in 2011 from R\$8,844.8 million in 2010. The variations are explained as follows:

Cost of goods sold: Cost of wireless devices and accessories increased by 724.9% to R\$1,284.3 million in 2011, from R\$155.7 million in 2010. The increase in 2011 reflects the consolidation of R\$1,178.7 million of cost of goods sold attributable to Vivo and Vivo Participações for the months of April through December 2011. Our cost of goods sold excluding Vivo and Vivo Participações decreased 32.2% to R\$105.6 million in 2011 from R\$155.7 million in

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2010 was mainly due to a decrease in expenses related to maintenance of terminals to access the network, among others.

**Depreciation and amortization:** Depreciation and amortization expenses increased by 112.3% to R\$3,582.6 million in 2011, from R\$1,687.4 million in 2010. The increase in 2011 reflects the consolidation of R\$1,290.0 million of depreciation and amortization attributable to Vivo and Vivo Participações for the months of April through December 2011. Our depreciation and amortization excluding Vivo and Vivo Participações increased 56.3% to R\$2,292.6 million in 2011 from R\$1,687.4 million in 2010 mainly due to expenses for higher investments in our network and amortization of licenses on acquisition of Vivo.

**Outside services, concession renewal fee and other:** Cost of third-party services increased by 57.1% to R\$2,923.4 million in 2011, from R\$1,860.4 million in 2010. The increase in 2011 reflects the consolidation of R\$527.5 million of outside services and other attributable to Vivo and Vivo Participações for the months of April through December 2011. Our outside services and other excluding Vivo and Vivo Participações increased 26.4% to R\$2,350.9 million in 2011 from R\$1,860.4 million in 2010 was mainly due to network maintenance and purchase of TV content.

**Interconnection charges:** Interconnection charges increased by 8.6% to R\$4,537.1 million in 2011, from R\$4,176.7 million in 2010. The increase in 2011 reflects the consolidation of R\$240.3 million of interconnection charges attributable to Vivo and Vivo Participações for the months of April through December 2011. Our interconnection charges excluding Vivo and Vivo Participações increased 2.9% to R\$4,296.8 million in 2011 from R\$4,176.7 million in 2010 mainly due to an increase in the use of the network for fixed-mobile traffic, among others.

**Rent, insurance, condominium fees, and leased lines:** Rent, insurance, condominium fees, and leased lines increased by 149.9% to R\$910.5 million in 2011, from R\$364.3 million in 2010. The increase in 2011 reflects the consolidation of R\$488.7 million of rent, insurance, condominium fees, and leased lines attributable to Vivo and Vivo Participações for the months of April through December 2011. Our rent, insurance, condominium fees, and leased lines excluding Vivo and Vivo Participações increased 15.8% to R\$421.8 million in 2011 from R\$364.3 million in 2010 mainly due to greater expenses with service fees for use of and towers and poles and insurance.

**Personnel:** Personnel expenses increased by 47.7% to R\$380.1 million in 2011, from R\$257.4 million in 2010. The increase in 2011 reflects the consolidation of R\$109.0 million of personnel expenses attributable to Vivo and Vivo Participações for the months of April through December 2011. Our personnel expenses excluding Vivo and Vivo Participações increased 5.3% to R\$271.1 million in 2011 from R\$257.4 million in 2010 mainly due to the collective agreement in this period under which we provided a salary readjustment in September 2011 of approximately 5%.

**Taxes:** Taxes increased by 314.6% to R\$1,421.7 million in 2011, from R\$342.9 million in 2010. The increase in 2011 reflects the consolidation of R\$1,070.1 million of taxes attributable to Vivo and Vivo Participações for the months of April through December 2011. Our taxes excluding Vivo and Vivo Participações increased 2.5% to R\$351.6 million in 2011 from R\$342.9 million in 2010 mainly due to expenses with the Fust and Funttel taxes, due to the growth in the number of new subscribers.

### Operating Expenses

The following table sets forth the components of our operating expenses for each of the years ended December 31, 2011 and 2010, as well as the percentage change from the prior year.

Year ended December		Percent change 2011-2010
2011	31, 2010	

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	(in millions of reais)			
Selling expenses	(6,948.2 )	(2,964.6 )	134.4	%
General and administrative expenses	(1,785.6 )	(738.9 )	141.7	%
Other net operating income	442.2	312.4	41.5	%
Total	(8,291.6 )	(3,391.1 )	144.5	%

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Operating expenses increased by 144.5% to R\$8,291.6 million in 2011, from R\$3,391.1 million in 2010. The increase in 2011 reflects the consolidation of R\$4,492.6 million of operating expenses attributable to Vivo and Vivo Participações for the months of April through December 2011. Our operating expenses excluding Vivo and Vivo Participações increased 12.0% to R\$3,799.0 million in 2011 from R\$3,391.1 million in 2010 mainly due to an increase in general and administrative expenses.

Selling expenses: Selling expenses increased by 134.4% to R\$6,948.2 million in 2011, from R\$2,964.6 million in 2010. The increase in 2011 reflects the consolidation of R\$3,869.5 million of selling expenses attributable to Vivo and Vivo Participações for the months of April through December 2011. Our selling expenses excluding Vivo and Vivo Participações increased 3.8% to R\$3,078.7 million in 2011 from R\$2,964.6 million in 2010 mainly due to amortization of trademarks and client portfolio on acquisition of Vivo and an increase in personnel expenses resulting from the consolidation of TVA's pay TV business and expenses with third-party services, mainly with use of the brand and publicity and advertising.

General and administrative expenses: General and administrative expenses increased by 141.7% to R\$1,785.6 million in 2011, from R\$738.9 million in 2010. The increase in 2011 reflects the consolidation of R\$1,051.5 million of general and administrative expenses attributable to Vivo and Vivo Participações for the months of April through December 2011. Our general and administrative expenses excluding Vivo and Vivo Participações generally remained stable, decreasing 0.6% to R\$734.1 million in 2011 from R\$738.9 million in 2010.

Other net operating income: The net amount of other operating income increased by 41.5% to R\$442.2 million of other revenues in 2011, from R\$312.4 million of other revenues in 2010. The increase in 2011 reflects the consolidation of R\$428.4 million of other net operating income attributable to Vivo and Vivo Participações for the months of April through December 2011. Our other net operating income excluding Vivo and Vivo Participações decreased 95.6% to R\$13.8 million in 2011 from R\$312.4 million in 2010 mainly due to an increase in amortization and other expenses.

## Financial Result

For the year-end period ended on December 31, 2011, net financial expenses reached R\$139.7 million, increasing by R\$19.0 million or 15.7% when compared to the period ended December 31, 2010, mainly due to higher net debt.

## Income and Social Contribution Taxes

We recorded expenses from income and social contribution taxes in the amount of R\$1,295.5 million in 2011, an increase of 23.9% from an expense of R\$1,045.8 million in 2010. The increase in 2011 was due to higher income before income and social contribution taxes. The effective rate of income tax and social contribution decreased to 22.9% in 2011 compared with 30.4% in 2010, mainly due to higher interest on shareholders' equity payments made in 2011, which is deductible for income tax purposes.

## 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, capital markets or development banks. As of December 31, 2012, we had R\$7.2 billion in cash and cash equivalents. Our principal cash requirements include:

- the servicing of our indebtedness;



- capital expenditures; and
- the payment of dividends.

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## Sources of Funds

Our cash flow from operations was R\$9.7 billion in 2012 compared to R\$8.1 billion in 2011. The increase in cash flow from operating activities of 19.75% in 2012 compared to 2011 was due primarily to Vivo's consolidation effect that occurred in April 2011 and increase in mobile market.

## Uses of Funds

Our cash flow used in investing activities was R\$3.4 billion in 2012 compared to R\$2 billion in 2011. The increase in cash flow used in investing activities of 70% in 2012 compared to 2011 was primarily due to consolidation of Vivo's cash and cash equivalents in April 2011, in the amount of R\$2 billion.

Our cash flow used in financing activities was R\$2.1 billion in 2012 compared to R\$4.7 billion in 2011. The decrease in cash flow used in financing activities of 55% in 2012 compared to 2011 was due primarily to lower payment of dividends in 2012 compared to 2011, partially offset by an increase of 0.7 billion in new loans obtained and debenture issued in 2012 in the amount of R\$2.8 billion compared to R\$2.1 billion in 2011.

## Indebtedness

As of December 31, 2012, our total debt was as follows:

Debt	Currency	Annual interest rate payable	Maturity	Principal amount outstanding (in thousands of reais)
Loan and Financing BNDES	R\$	TJLP + 0% to TJLP + 9.0%	2019	2,911.8
Loan and Financing BNDES	R\$	4.5% to 8.7%	2020	173.8
Loan and Financing BNDES	UMBNDDES	5.97%	2019	455.3
Loan and Financing BNB	R\$	10.0%	2016	338.6
Mediocreredito	US\$	1.75%	2014	9.3
EIB	US\$	4.18% to 4.47%	2015	795.6
Resolução 4131	US\$	4.10%	2013	326.3
Debentures	R\$	100% of the CDI + 0,75% to 112% of the CDI	2013	2,787.5
Debentures	R\$	IPCA+ 0.5% to IPCA+7.0%	2021	168.4
Others	R\$		2014	0.6
Total debt				7,967.3
Current				1,957.5
Long term				6,009.7

Interest and principal payments on our indebtedness as of December 31, 2012 due in 2013 and 2014 total R\$1,957.5 million and R\$1,300.1 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, 2012, 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, R\$2.8 billion and R\$2.4 billion for the years ended December 31, 2012, 2011 and 2010, respectively. 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 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.”

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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 are entitled to receive cash dividends that are 10% higher than those attributable to common shares.

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\$ 3.6 billion, R\$5.4 billion and R\$1.9 billion in 2012, 2011 and 2010, respectively.

Our management expects to meet 2013 capital requirements primarily from cash provided from our operations. Net cash provided by operations was R\$9.7 billion, R\$8.1 billion, and R\$4.5 billion in 2012, 2011 and 2010, respectively.

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, 2012, the Board of Directors Meeting held on February, 21 decided to submit to the shareholders meeting a proposal to pay dividends in the amount of R\$1.4 billion, which, together with the interim dividend and interest on own capital payments made in 2012, 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 April 16, 2013. 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 Pronouncement

### Recently Adopted Standards

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

We adopted all the standards, revisions of standards and interpretations issued by IASB, which entered into force as of January 1, 2012 including:

**Amendments to IAS 12, Income Tax – Recovery of Underlying Assets:** This amendment provided clarification on how to calculate deferred taxes on investment properties measured at fair value. It introduced the rebuttable presumption that deferred taxes on investment properties measured at fair value under IAS 40 should be defined considering that their book value will be recovered through sale. This amendment did not affect the Company’s operations.

**Amendments to IFRS 7, Financial Instruments: Disclosures – Enhanced Derecognition Disclosure Requirements:** This amendment requires additional disclosure on financial assets transferred, yet not derecognized, so as to enable the financial information users to understand the relation with those assets not derecognized and related liabilities. Furthermore, this amendment requires disclosures as to the ongoing involvement in the derecognized financial assets so that the user can evaluate the nature of the entity’s ongoing involvement in these derecognized assets and related risks. This amendment became effective for annual periods beginning on or after July 1, 2011.

Worth noting is that this amendment only affects disclosures – however, it is not currently applicable to the company, and has no impact on the company’s and its subsidiaries’ financial position or performance.

Recently Issued Standards

New IFRS standards and interpretations of the IFRIC (IFRS Interpretations Committee of the IASB) have been issued but their application was not mandatory.

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IAS 1 Presentation of Other Comprehensive Income Account: IAS 1 revisions affected the grouping of items presented in other comprehensive income. Items which might be reclassified (or “recycled”) to P&L at a future time (e.g. net gains on hedged net investments, exchange variation differences from translation of operations abroad, net movements of hedge of cash flows or gains on sale of assets classified as available for sale) should be presented separately from items which will never be reclassified (e.g. actuarial gains or losses on defined benefit plans). The revisions affect only the presentation, with no impacts on the financial position or performance of the company and its subsidiaries. These revisions go into effect for years beginning July 1, 2012 or thereafter and will be applied to the company’s financial statements when effective.

IAS 19 Employee Benefits (Revised): The IASB issued various revisions to IAS 19, which comprises fundamental amendments, such as the removal of the corridor method and the concept of returns expected on the plan assets, and simple clarifications on valuation and devaluation and reformulation. The Company does not expect significant impacts on its consolidated financial statements. This revised IAS will go into effect for annual periods beginning January 1, 2013 or thereafter.

IAS 28 Investments in Associates and Joint Ventures (Revised in 2011): In connection with the issuance of IFRS 11 and IFRS 12 (see below), IAS 28 is now IAS 28 - Investments in Associates and Joint Ventures and describes the application of the equity method of account for investments in joint ventures, besides the investment in associates. The Company does not anticipate any significant impacts on its consolidated financial statements. This revision will go into effect for annual periods beginning January 1, 2013 or thereafter.

IAS 32 Offsetting Financial Assets and Financial Liabilities – Revisions of IAS 32: These revisions shed light on the meaning of the phrase “currently has the legal right to set off”. These revisions also clarify the adoption of offsetting criteria set forth by IAS 32 for the clearing systems (like the clearing house systems), which apply non-simultaneous gross mechanisms for clearing. These revisions are not expected to affect the company’s and its subsidiaries’ financial position, performance or disclosures effective for annual periods beginning January 1, 2014 or thereafter.

IFRS 1 Government Loans – IFRS 1 Revisions: These revisions set the first-time application of the requirements of IAS 20 - Accounting for Government Grants and Disclosure of Government Assistance, prospectively governmental loans existing on the date of transition to IFRS. The entities may opt for applying the IFRS 9 requirements (or IAS 39, as the case may be) and IAS 20 to governmental loans, retrospectively, had the necessary information been obtained upon the initial recording of loans. The exception would give relief to the entities adopting the standard for the first time from retrospectively measuring government loans at an interest rate below market rate. The review will go into effect for annual periods beginning January 1, 2013 or thereafter. The revision will not affect the company and its subsidiaries.

IFRS 7 Disclosures – Offset Between Financial Assets and Financial Liabilities – Revisions of IFRS 7: These revisions require an entity to disclose information about the rights to offset and related agreements (e.g. agreement for guarantee). The disclosures provide users with useful information for them to assess the effect of the offsetting agreements on the financial position of an entity. The new disclosures are necessary for all financial instruments recognized and offset in accordance with IAS 32 Financial Instruments - Presentation. The disclosures also apply to financial instruments recognized which are subject to a master agreement for offsetting or alike, irrespective of being or not offset in accordance with IAS 32. The revision will go into effect for annual periods beginning January 1, 2013 or thereafter.

IFRS 9 Financial Instruments: Classification and Measurement: IFRS 9, as issued, reflects the first phase of IASB work regarding the replacement of IAS 39 and applies to the classification and measurement of financial assets and financial liabilities. The standard initially was effective for annual periods beginning January 1, 2013, however the Amendments to IFRS9 Effective Date of IFRS 9 and Disclosures for Transition, issued in December 2011, changed

the mandatory effective date to January 1, 2015. Later on, the IASB will address the recording of hedging instruments and impairment of financial assets. The adoption of the first phase of IFRS 9 will go into effect for the classification and measurement of the company's and its subsidiaries' financial assets, but will not affect the classification and measurement of financial liabilities. The Company will quantify the effect together with other phases, when the final standard is issued, comprising all the phases.

IFRS 10 Consolidated Financial Statements, IAS 27 Separate Financial Statements: IFRS 10 replaces the portion of IAS 27 – Consolidated and Separate Financial Statements which deals with the recording of consolidated financial

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statements. It also addresses issues raised by SIC-12 Consolidation – Special-purpose Entities. IFRS 10 establishes a single control model applied to all entities, including special-purpose entities. The amendments introduced by IFRS 10 will require management’s significant judgmental analysis to determine which entities are subsidiaries and therefore required to be consolidated by a parent company.

Based on preliminary analyses, IFRS 10 is not expected to have impacts on the investments currently held by the company. This standard will go into effect for annual periods beginning January 1, 2013.

**IFRS 11 Joint Ventures:** IFRS 11 replaces IAS 31 – Interests in Joint Ventures and SIC-13 –Jointly-controlled Entities – Non-monetary Contributions by Venturers. IFRS 11 eliminates the option to record jointly-controlled companies (JCC) based on a proportional consolidation. Instead, the JCC falling into the joint venture definition shall be recorded using the equity method. The application of new standard will affect the company’s financial position, eliminating the proportional consolidation of Aliança, AIX and ACT (Note 12). By applying the new standard, the investments in the aforesaid companies will be recorded using the equity method. This standard will go into effect for annual periods beginning January 1, 2013 and shall be applied retrospectively to joint ventures held on the initial application date. It is estimated that the IFRS 11 impact on the current period (which will correspond to the comparative period of the financial statements at December 31, 2013), considering certain items, consists of a decrease in revenues by R\$28,308 and a decrease in operating income by R\$1,370, since joint venture income will be presented below operating income. Current assets and current liabilities will decrease by R\$64,873 and R\$2,791, respectively, while noncurrent assets will be increased by R\$60,012, and noncurrent liabilities will be decreased by R\$2,896.

**IFRS 12 Disclosure of Interests in Other Entities:** IFRS 12 includes all disclosures previously contained in IAS 27 regarding the consolidated financial statements, as well as all disclosures previously contained in IAS 31 and IAS 28. These disclosures will be regarding interest held by an entity in subsidiaries, joint ventures, associates and structured entities. A number of new disclosures are also necessary, but there will be no impact on the company’s financial position or performance. This standard will go into effect for annual periods beginning January 1, 2013 or thereafter.

**IFRS 13 Fair Value Measurement:** IFRS 13 sets a single source of guideline in IFRS for all fair value measurements. IFRS 13 does not change the time an entity is required to use fair value, but provides guidance on how to measure fair value in accordance with IFRS, whenever fair value is required or allowed. This standard will go into effect for annual periods beginning January 1, 2013 or thereafter. The application of this standard will affect when the Company measures fair value in future financial statements.

## C. Research and Development, Patents and Licenses

### Research and Development

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

Also, to keep pace with constant innovation, Telefônica Brasil 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. In 2012, R\$0.7 million was invested in innovation.

The table below presents the Telefônica Brasil 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, the company partnered with



partners specialized in R&D such as the CPqD and Telefônica Pesquisa e Desenvolvimento (TPD). In 2012, R\$22.7 million was invested in development.

R&D investments	2012	2011	2010
	(in millions of reais)		
Development	22.7	44.6	12.5
Innovation (business incubator and tests)	0.7	1.3	6.8
Total	23.4	45.9	19.3

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The partnership between Telefônica Brasil and CPqD allows Telefônica Brasil to keep informed of technical research services, development of new features in current systems, and services in the areas of consulting and training. Telefônica Brasil 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 Brasil and TPD allows the organization to transfer to an automatic model of management of the planning and operation network focused on performance.

Vivo maintains partnerships with the Universidade Federal do Rio Grande do Sul (UFRGS). Such partnerships permit Vivo to have laboratories at the universities, which conduct research and development of new technologies, and which support and push innovative processes. Vivo also solidified a partnership at the end of 2004 with the Centro de Pesquisas e Desenvolvimento em Campinas—São Paulo (CPqD), to assess and study new technologies. Vivo also relies on the research and development of our third-party suppliers.

## Patents and Licenses

Our principal intellectual property assets include:

- permission to use the trademark name “Telefônica” and all names derived from “Telefônica”;
- our name “Telefônica Brasil S.A.”;
- our commercial brand in Brazil “Vivo” and its sub-brands such as “Vivo Móvel”, “Vivo Fixo”, Vivo TV”, “Vivo Internet”, “Meu Vivo”, “Vivo Empresas,” among others;
- our past commercial brands, “Super 15” for long-distance services and “Speedy” for broadband products, “DUO” for telephone and broadband service and “TRIO” for telephone, broadband and Digital TV service.

## D. Trend Information

For 2013, we expect an improvement in the macroeconomic scenario, leveraged by an uptake in investment levels. Consumption will lead to another year of growth in the telecommunication market revenues, driven by services penetration mainly in data and TV. We expect companies in the industry to maintain the trend of consolidation and to offer integrated (bundled) services, increasing pressure on ARPUs and opening a gap between accesses and revenues growth. Data services (mobile and fixed) will be the most relevant growth driver, leveraged by the adoption of smartphone and services beyond connectivity. In the fixed-line business, we bet on the technological evolution as the way to explore the ultra-broadband and Pay TV markets value. We are well positioned to explore this opportunities, since our organization and resources are focused on developing business in these areas, always sustained by a quality of services differentiated from our competitors.

## E. Off-balance-Sheet Arrangements

None.

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## F. Tabular Disclosure of Contractual Obligations

Our contractual obligations and commercial commitments as of December 31, 2012 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, 2012)				
<b>Contractual obligations</b>					
Long-term debt (1)	7,967,229	1,957,538	2,898,636	2,816,762	294,293
Pension and other post retirement benefits	392,269	6,119	12,046	11,684	362,420
Other long-term obligations including leases	9,906,827	1,230,640	2,380,900	2,835,176	3,460,111
Total contractual cash obligations	18,266,325	3,194,297	5,291,582	5,662,622	4,116,824
<b>Commercial commitments</b>					
Suppliers	5,889,377	5,889,377	–	–	–
Other commercial commitments	–	–	–	–	–
Total commercial commitments	5,889,377	5,889,377	–	–	–

(1) Includes interest payments.

## Long-Term Debt - Principal

Year ending December 31,	Amount (in thousands of reais, as of December 31, 2012)
2014	1,300,124
2015	1,159,235
2016	439,277
2017	2,389,703
2018	427,059
2019 and forward	294,293
Total	6,009,691

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## 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 comprises a minimum of 05 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
Santiago Fernández Valbuena	Vice-Chairman	November 7, 2011(**)
Antonio Gonçalves de Oliveira	Director	November 7, 2011(**)
Eduardo Navarro de Carvalho	Director	November 7, 2011 (**)
Fernando Abril-Martorell Hernández	Director	April 7, 2010
Fernando Xavier Ferreira	Director	April 7, 2010
Francisco Javier de Paz Mancho	Director	April 7, 2010
José Fernando de Almansa Moreno-Barreda	Director	April 7, 2010
José Manuel Fernandez Norniella	Director	May 19, 2010 (*)
Luciano Carvalho Ventura	Director	April 7, 2010
Luis Bastida Ibarguen	Director	April 7, 2010
Luis Fernando Furlan	Director	April 7, 2010
Narcís Serra Serra	Director	April 7, 2010
Paulo Cesar Pereira Teixeira	Director	November 7, 2011 (**)
Roberto Oliveira de Lima	Director	November 7, 2011 (**)

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

(\*) The Board member José Manuel Fernandez Norniella 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 members Santiago Fernández Valbuena, Antonio Gonçalves Oliveira, Eduardo Navarro de Carvalho, Paulo Cesar Pereira Teixeira and Roberto Oliveira de Lima were appointed by the Board of Directors at a meeting dated November 07, 2011, as provided by Article 150 of Law 6,404/76. Their elections were ratified at the General Shareholders' Meeting of April 11, 2012.

Set forth below are brief biographies of our directors:

Antonio Carlos Valente da Silva is 60 years old and acts as Chairman of the Board of Directors of Telefônica Brasil S.A. since December 2006, Chief Executive Officer of Telefônica Brasil S.A. since January 2007 and member of the Committee of Appointments, Compensation and Corporate Governance of Telefônica Brasil S.A. He is the Chief Executive Officer of Vivo S.A., A. Telecom S.A., Telefônica Data S.A., Telefônica Sistemas de Televisão S.A., AJato Telecomunicação Ltda, Lemontree Participações S.A., GTR-T Participações e Empreendimentos S.A., Comercial Cabo TV São Paulo S.A. and TVA Sul Paraná S.A.. He is also the President of the Board of Trustees of Fundação Telefônica, Vice-President Director of SP Telecomunicações Participações Ltda., Chairman of the Board of Directors

of Telefônica Factoring do Brasil Ltda., member of the Control Committees of Media Networks Brasil Soluções Digitais Ltda. and of Telefônica Serviços Empresariais do Brasil Ltda. He was the Chief Executive Officer of Vivo Participações S.A. from May 10, 2011 until October 03, 2011, date on which Vivo Participações S.A. was merged into the Company. He was also a member of the Board of Directors of Telefônica Internacional S.A. He is the President of Telebrasil (Brazilian Association of Telecommunications), President of Sinditelebrasil (National Union of Fixed and Mobile Telephone Service Operators), President of Febratel (Brazilian Federation of Telecommunications), President of Ahciet (Asociación Iberoamericana de Centros de Investigación y Empresas de Telecomunicaciones) in the period from 2007 to 2011, President of the Official Spanish Chamber of Commerce in Brazil and President of the Euro-chambers in Brazil (an association that gathers the main Chambers of

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Commerce in the European Union). He is also a member of the CDES (Economic and Social Development Council of the Presidency of the Republic of Brazil), member of the Advisory Council of CPqD, (Telecommunications Research and Development Center), member of the Executive Committee of ABDIB (Brazilian Infrastructure and Base Industries Association), and member of COINFRA (FIESP's Infrastructure Commission). He was the Chief Executive Officer of Telefônica in Peru until November 2006 and Chairman of the Board of Directors of Telefônica Móviles S.A., Telefónica Móviles Peru Holding S.A.C., Telefônica Peru Holding S.A.C. and Telefónica Multimedia S.A.C. He was also the First Vice-President of the Association for Private and Public Utilities Companies (ADEPSEP) and director of the Official Spanish Chamber of Commerce in Peru (COCEP). Prior to his appointment as Chief Executive Officer of Telefônica in Peru, he was in charge for the regulatory management of Grupo Telefônica in Latin America. He was a Vice-President of the Brazilian National Telecommunications Agency (Anatel), member of the Management Board of Anatel, chief and member of several Brazilian delegations at international conferences and, in the period from 2002 to 2003, he was President of the Latin-American Forum for Telecommunications Regulators (Regulatel), an institution that gathers regulatory agencies of nineteen countries in Latin America. He was the Chairman of the Board of Telest, (Telecommunications of Espírito Santo State), was a member of the board of directors of Perdigão S/A and of Paranapanema. He also occupied several managing positions in the Telebrás System, in the areas of Telecommunication Systems Engineering, Technical Operating Planning and Corporate Planning. He worked for the Communications Ministry, being a member of the team that carried out the restructuring of the Brazilian Telecommunications System. Antonio Carlos Valente has a B.S. degree in Electrical Engineering from PUC/RJ, has large experience in the telecommunications market, in which he has been working since 1975. He has an MBA degree from PUC/RJ, has concluded several specialization courses in telecommunication systems in Brazil and abroad, and several specialization courses in Business Management, including Corporate Strategy at MIT/Sloan.

Santiago Fernández Valbuena is 54 years old and acts as Vice-Chairman of the Board of Directors. President of Telefónica Internacional, S.A. He is Chief Executive Officer of SP Telecomunicações Participações Ltda. Since 2012 he has been a member of the board of directors of Telefonica S.A. In 2010, he acted as Finance, Strategy and Development Officer of the company. From 2005 to 2010, he was Finance and Corporate Development Officer. He was a member of the executive Board of Portugal Telecom and Endemol Holding (Netherlands). Since 2008, he is President of the Control and Audit Committee and Board Member of Ferrovial. From 2006 to 2008, he was a Board Member of Gecina. From 1999 to 2007, he was Vice President of Metrovacesa, S.A.

Antonio Gonçalves de Oliveira is 68 years old and is a member of our Board of Directors and Control and Audit Committee. Mr. Oliveira is also a member of the Board of Directors of Paranapanema S.A. and the fiscal committee of Klabin S.A. He was a member of the Board of Directors of Vivo Participações since March 2001 and Control and Audit Committee since July 2005. Mr. Oliveira was also a member of the Board of Directors of TELESP Celular S.A. and a member of the Board of Directors or Control and Audit Committee of the following businesses: Tele Sudeste Celular Participações S.A., Telemig Celular Participações S.A., Telemig Celular S.A., Tele Leste Celular Participações S.A., Tele Centro Oeste Celular Participações S.A. and Celular CRT Participações S.A., until these companies ceased to exist. Mr. Oliveira was the chairman of the Fiscal Council of Bahia's Electricity Company (Companhia de Eletricidade da Bahia), or COELBA, from April 2006 to April 2008, chairman of the Association of Friends of the Museum of Contemporary Art of USP (Associação de Amigos do Museu de Arte Contemporânea da USP), or AAMAC, from 2006 to 2010, member of the Fiscal Counsel of Iguatemi Shopping Centers, from 2007 to 2008, and Melpaper, from 2009 to 2010, and a member of the Council of Representatives of the Federation of Industries of São Paulo (Federação das Indústrias do Estado de São Paulo), or FIESP. Mr. Gonçalves de Oliveira is a member of the Advisory Board of The Welfare Fund for Employees of Banco do Brasil (Caixa de Previdência dos Funcionários do Banco do Brasil), or PREVI, from 2008 to 2012 and was a member of the Council of Social and Economic Development of the Brazilian government and the Working Group for Small and Medium Enterprises also sponsored by the Brazilian government. He was leader of ADEBIM (Associação de Empresas Brasileiras para a Integração de Mercados), member of the Steering Committee and Management of the Banco do Povo de Estado de São Paulo and Chairman of the Deliberative Board of the Association of Brazilian Companies for Market Integration

(Associação Nacional dos Funcionários do Banco do Brasil), or ANABB, for eight years. In the role of sociologist, was president of the Association of Sociologists of the State of São Paulo, for 6 years, and director, for 4 years, the Latin American Association of Sociology. Mr. Oliveira was the executive coordinator of the National Movement of Micro and Small Enterprise (Movimento Nacional da Micro e Pequena Empresa). Mr. Gonçalves holds a degree in Social Sciences, a master's degree in Communication Sciences and a post-graduate degree in Sociology of Organizations from the University of São Paulo (Universidade de São Paulo) in Brazil. He also holds a specialist title in Human Resources from Fundação Getulio Vargas in São Paulo and extension courses on business

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management topics. Mr. Oliveira is Certified Counselor by the Brazilian Institute of Corporate Governance, IBGC, due to its experience in supervisory boards and management boards.

Eduardo Navarro de Carvalho is 50 years old and is a member of our Board of Directors and President of the Service Quality and Marketing Committee. He is currently Director of Strategy and Alliances at Telefónica SA and member of the Executive Committee of Telefónica SA. Previously, he was responsible for Strategic Planning and Regulatory at Telefónica Internacional. From 1999 and 2005, he served as Vice President of Corporate Strategy and Regulatory Group at Telefonica in Brazil, participating in the Steering Committee of several companies of the Telefónica Group in Brazil. He worked for five years as a consultant at McKinsey & Company (1994-1999), during which he led projects in Brazil, Spain, Portugal and South Africa, focusing on strategies in the areas of Industry, Infrastructure and Telecommunications. He began his professional experience in the steel industry, where he worked from 1986 and 1994 in Group ARBED in Brazil. He graduated in Metallurgical Engineering from the Federal University of Minas Gerais, Brazil.

Fernando Abril-Martorell Hernández is 50 years old and serves on our Board of Directors. He is also CEO of Prisa, 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 64 years old and acts as a member of our Board of Directors. Mr. Ferreira is a member of our Audit and Control Committees. He is Vice President of "COINFRA" (Conselho Superior de Infra-Estrutura da FIESP), an executive officer of "ABDIB" (Associação Brasileira da Infra-Estrutura e Indústrias de Base), member of the Board of Directors of Boa Vista Serviços, Triunfo Participações e Investimentos-TPI, Alupar and Ouro Verde, and served as the chief executive officer of Telecomunicações de São Paulo S.A. (predecessor to Telefônica Brasil S.A.) and SP Telecomunicações Holding Ltda. He was president of the Supervisory Board of Brasilcel N.V., president of the Boards of Directors of Vivo Participações, and Fundação Telefônica. He was 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 Northern Telecom do Brasil S.A., Brazilian General Director of Itaipu Brazilian 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 and Professor in the Department of Microwave in Electrical Engineering from Universidade Federal do Paraná. Participated as a member or chairman of the Board of Directors of several companies. He holds a degree in telecommunications 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 the Management Training Course School of Business Administration University of Western Ontario, Canada, in 1982.

Francisco Javier de Paz Mancho is 54 years old and serves as a member of our Board of Directors. Mr. Mancho is also a member of the Board of Directors of Telefónica S.A. and Telefónica de Argentina S.A. Since July 2006 he has been a member of the Executive Committee of the Superior Board of Councils. From June 2004 until December 2007, he was the President of Mercasa. He was Counselor deputy to the President and Director of the Strategic Corporate area of Panrico Donuts Group (1996–2004), General Director of the Ministry of Commerce and Tourism (1993–1996),



General Secretary of Unión de Consumidores de España (UCE). Delegate Counselor of Ciudadano magazine (1990–1993), General Secretary of Juventudes Socialistas and executive member of PSOE (1984–1993). Also, he has acted in the following capacities: counsel of Túnel del Cadí (2004–2006), President of Patronal Pan and Bollería Marca (COE) (2003–2004), counsel of Mutua de Accidents of Zaragoza (MAZ) (1998–2004), counsel of Panrico Group (1998–2004), President of Observatorio de la Distribucion Comercial del Ministerio de Comercio y Turismo (1994–1996), Member of the Social and Economic Council and Permanent Commission (1991–1993 and 1996–2000) and counsel of Tabacalera, S.A. (1993–1996). Mr. Mancho holds degrees in Information and Publicity and a degree in law studies from the Executive Management Program of IESE (Universidad de Navarra).

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José Fernando de Almansa Moreno-Barreda is 64 years old and is a member of our Board of Directors and President of the Nominations, Compensation and Corporate Governance Committee. 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., Telefónica Latinoamérica S.A., Telefónica Moviles México S.A. de CV, and BBVA Bancomer Mexico. He was a member of the Board of Directors of Telefonica Argentina S.A. 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-Counselor 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 Sofía, Conde de Barcelona, Diputación de San Andrés de los Flamencos - Carlos de Amberes Foundation, Padre Arrupe-Activa, Principe de Asturias and Euroamérica.

José Manuel Fernandez Norriella is 67 years old and he is a member of our Board of Directors and a member of the Nominations, Compensation and Corporate Governance Committee. Mr. Norriella held executive positions from 1972 to 1981 at Electromecanica, Alfa Laval and Blackstone SWG. From 1981 to 1985 he was Risk and Provisions Officer and Asea Brown Boveri S.A., from 1985 to 1993 he was Media and Provisions Officer, Real Estate Officer, Turbochargers Officer and Chief Administrative Officer of Asea Brown Boveri S.A. Mr. Norriella was a Board member at RTVE, Argentaria, Enagas, Endesa, Telvent, Campos Chilenos, Iansa, Vice President of Chilectra (Chile) and member of the Advisory Committee of Abengoa and Accenture. He was elected a Congressman for Madrid in 1993, and was also State Secretary of Commerce, Tourism and Small and Medium Enterprises, and represented Spain as an Adjunct Officer before the World Bank, International Development Bank and European Development Bank. Between 1998 and 2005, he was President of the superior Council of Commerce Chambers of Spain and member of the International Commerce Chamber. From 1998 to 2000, Mr. Norriella was Executive Vice President of Aldeasa and Executive President of Ebro Puleva from 2000 to 2005. He is currently Honorary President of Ebro Puleva, board member of Mapfre America and Telefônica Brasil S.A. He was External Counsel to Iberia since 2003 until its merger with BA, being currently an External Counsel to IAG. Mr. Norriella is also Vice President of the Board of Caja Madrid, of BFA and Executive Board Member of Bankia S.A. Mr. Norriella holds a degree in electrical engineering from Universidad Politécnica de Madrid and has a diploma in Logistics and Risks. He also received the distinction of La Gran Cruz de Isabel la Católica (Spain), Knight of the Bernardo O'Higgins Order (Chile), the Verdienstkreuz mit stern (Germany) and the Order to Civil Merit (Poland).

Luciano Carvalho Ventura is 65 years old and is member of our Board of Directors and a member of the Service Quality and Marketing Committee. He is the officer responsible for LCV Corporate Governance. He serves as a member of the Board of Directors of the Jose Alves Group and of the Grupo Itapemirim. 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 the 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 Ibarguen is 67 years old and is a member of our Board of Directors and President of the Control and Audit Committee. Since 2002, he has acted as an independent consultant. During 2000 and 2001, worked in Banco Bilbao Viscaya Argentaria, where he was a member of the Steering Committee and head of the Global Asset Management Division. Mr. Bastida began working at Banco Bilbao Vizcaya Argentaria in 1988. In the period from 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 to finance. 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

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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 66 years old and is a member of the Boards of Directors of Telefônica Brasil S.A. (Brasil), Telefónica S.A. (Spain), AMIL Participações S.A. (Brasil), BRF–Brasil Foods S.A. (Brasil), AGCO Corporation (USA), as well as a member of the advisory board of Panasonic (Japan) and Wal-Mart (USA). Previously, he was Chairman of the Board of Directors at Sadia S.A., from 1993 to 2002 and from 2008 to 2009, company that he has held numerous executive positions from 1976 to 1993. He was Co-Chairman of the board of BRF Brasil Foods S.A. from 2009 to 2010, as well as a member of the board of Redecard S.A. from 2007 to 2010. He served two terms as Minister of Development, Industry and Foreign Trade of Brazil from 2003 to 2007. 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.

Narcís Serra Serra is 69 years old and serves as a member of our Board of Directors and a member of the Nominations, Compensation and Corporate Governance Committee. 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 Barcelona Institute for International Studies (IBEL).

Paulo Cesar Pereira Teixeira is 55 years old and is a member of our Board of Directors. Mr. Teixeira also acts as a General and Executive Officer and as interim Chief Financial Officer, Control and Investor Relations Officer of Telefônica Brasil S.A. He is member of Executive Committee of Vivo, Lemontree Participações S.A., TVA Sul Paraná S.A., GTR-T Participações e Empreendimentos S.A., Comercial Cabo TV São Paulo S.A., A. Telecom S.A., Telefônica Data S.A., Telefônica Sistema de Televisão S.A. and AJato Telecomunicação Ltda. He is also a member of the Board of Trustees of Fundação Telefônica. He was Chief Executive Officer of Vivo Participações from September 13, 2011 to October 3, 2011 (when it was merged into the company). He began his career in the telecommunications industry in 1985, as a member of CRT’s Directive Council. At Vivo, he was responsible for the Individual and Residential Market business unit, involved in customer relations, mobile marketing, fixed marketing, planning and commercial and regional management. From 2003 to 2011, he was the Executive Vice President of Operations at Vivo. From 1997 to 2003, he acted as Vice President of Operations for Telefônica Celular, Vice President and Enterprise Officer of the Telebrás System, board member of Tele Sudeste, Tele Leste and CRT, president of the Brazilian Roaming Association (ABR) and National Association of Cellular Providers (ACEL). Mr. Teixeira holds an electrical engineering degree from Universidade Católica de Pelotas, Brazil. He attended a New Telecommunications Techniques course at École Nationale Supérieure des Télécommunications, France, in 1992.

Roberto Oliveira de Lima is 61 years old and serves as a member of our Board of Directors and a member of the Service Quality and Marketing Committee. Mr. Lima is also a member of the Board of Directors of Edenred SARL, based in Paris/França, MIH Holdings Ltd, based in Johannesburg, Cia Brasileira de Distribuição, based in São Paulo/Brazil, Natura S.A., based in São Paulo, and Rodobens Negocio Imobiliarios, based in São Paulo/Brazil. He was the Chief Executive Officer of Vivo Participações and Vivo and Officer of TBS Celular Participações Ltda., Ptelecom Brasil S.A. and Portelcom Participações S.A. until May, 2011, all subsidiaries of Brasilcel N.V.; he was also Chief Executive Officer of Instituto Vivo. Mr. Lima was Executive Vice President of Marketing and Innovation and Vice President of IT and Products and Services Engineering of the following companies: Vivo Participações and Vivo, Tele Centro Oeste Celular Participações S.A., Telerj, Telest, Telebahia, Telergipe, Celular CRT S.A., TELESP Celular, Global Telecom, Telegoiás, Telemat, Telems, Teleacre, Teleron, NBT and TCO IP S.A. He was also Chief Executive Officer of Tele Sudeste Celular Participações S.A., Tele Leste Celular Participações S.A. and Celular CRT Participações S.A. until 2006 and Telemig Celular Participações S.A. until November, 2009. He was an Officer of Telemig Celular Participações S.A., Avista Participações Ltda., Tagilo Participações Ltda., Sudestecel Participações Ltda. and Vivo Brasil Comunicações Ltda. until November, 2009. He was Chairman of the Board of Directors of

Grupo Credicard from 1999 to 2005 and Chief Executive Officer of Banco Credicard S.A. from 2002 to 2005. Mr. Lima also held executive positions at Accor Brasil S.A., Rhodia Rhone Poulec S.A. and Saint Gobain S.A. He holds a degree in business administration and an MBA from Fundação Getúlio Vargas, Brazil. He holds a master's degree in Finance and Strategic Planning from the Institute Superieur des Affaires, Jouy en Josas, France.

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## Executive Committee

The executive committee consists of at least four 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 who 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
Paulo Cesar Pereira Teixeira	General and Executive Officer and as interim Chief Financial Officer, Control and Investor Relations Officer	September 13, 2011
Breno Rodrigo Pacheco de Oliveira	General Secretary and Legal Officer	June 14, 2011

Set forth below are brief biographies of our executive officers:

Breno Rodrigo Pacheco de Oliveira is 37 years old. Is General Secretary and Legal Officer of Telefônica Brasil S.A., Vivo, A. TELECOM S.A., Telefônica Data S.A., Telefônica Sistema de Televisão S.A. , AJato Telecomunicação Ltda, Lemontree Participações S.A., TVA Sul Paraná S.A., GTR-T Participações e Empreendimentos S.A. and Comercial Cabo TV São Paulo S.A. He is also a member of the Deliberative Council of Visão Prev Sociedade de Previdência Complementar and Officer of SP Telecomunicações Participações Ltda.. Mr. Oliveira is also Corporate Secretary of the Board of Directors of Telefônica Factoring do Brasil Ltda., Corporate Secretary and member of the Board of Directors of Telefônica Corretora de Seguros Ltda., member of the Control Committee of Media Networks Brasil Soluções Digitais Ltda., Telefônica Serviços Empresariais do Brasil Ltda. and Telefônica Engenharia de Segurança do Brasil Ltda. He was General Secretary and Legal Officer from February 3, 2011 to October 3, 2011 of Vivo Participações (when it was merged into the company) and of Vivo from April, 2005 to February, 2011. He holds a law degree from Universidade do Vale do Rio dos Sinos – UNISINOS, Brazil.

For the biographies of Antonio Carlos Valente da Silva and Paulo Cesar Pereira Teixeira, see “—Board of Directors.”

## B. Compensation

For the year ended December 31, 2012, the aggregate amount of compensation paid to all our Directors and Executive Officers was approximately R\$21.6 million, of which R\$16.9 million corresponded to salaries and R\$4.7 million corresponded to bonuses.

For the year ended December 31, 2012, our Directors and Officers did not receive any pension, retirement or similar benefits.

## C. Board Practices

### Board of Directors

Our Board of Directors typically meets 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.

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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;
- 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 nonconvertible 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;

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- 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;
- 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
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Flavio Stamm	Gilberto Lerio	April 11, 2012
Cremênio Medola Neto	Oswaldo Vieira da Luz	April 11, 2012
Stael Prata Silva Filho	Charles Edwards Allen	April 11, 2012

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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.

Control and Audit Committee

Our Control and Audit Committee was created by our Board of Directors in December 2002 and comprises 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.

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
Antonio Gonçalves de Oliveira	November 07, 2011
Fernando Xavier Ferreira	February 15, 2012

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:

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- 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;
- 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
Narcis Serra Serra	November 05, 2012
José Manuel Fernandez Norniella	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
Eduardo Navarro de Carvalho	February 15, 2012
Luciano Carvalho Ventura	May 19, 2010
Roberto Oliveira de Lima	November 07, 2011

D. Employees

As of December 31, 2012, we had 19.614 employees. All of our employees are full-time, and are divided into the following categories: 27% in our network plant operation, maintenance, expansion and modernization; 58% in sales and marketing; and 15% in administration, finance and investor relations, human resources, inventory, technology, legal and strategic planning and management control.

Before December 1999, the SISTEL (Fundação Sistel de Seguridade Social) plan, a multi-employer defined benefit plan that supplements government-provided retirement benefits, covered the employees of the former Telebrás System and we were contingently liable for all of the unfunded obligations of the plan. In January 2000, we and the other companies that formerly belonged to the Telebrás system agreed to divide the existing SISTEL plan into 15 separate

plans, resulting in the creation of private plans covering those employees already enrolled in the SISTEL plan. In that moment, these new private pension plans were still administered by SISTEL and have retained the same terms and conditions of the SISTEL plan. The division was carried out so as to allocate liability among the companies that formerly belonged to the Telebrás system according to each company's contributions with respect to its own employees. Joint liability among the SISTEL plan sponsors will continue with respect to retired employees, who will necessarily remain members of the SISTEL plans, called PBS plan.

At the time of the privatization, employees had the right to maintain their rights and benefits in SISTEL. Under the SISTEL plan, we made monthly contributions to SISTEL equal to a percentage of the salary of each employee who was a SISTEL member. Each employee member also made a monthly contribution to SISTEL on the basis of age and salary. Pension benefits of members of SISTEL vested by the same time their retirement benefits vested

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under the government-provided retirement plan. SISTEL operates independently from us, and its assets and liabilities are fully segregated from us.

From 2000, we decided to establish defined contributions plans, and offered it to participants in our PBS's plan, defined benefit plans, as well as to employees who did not qualify for participation. Unlike the PBS's plan, which is a defined benefits plan, defined contributions plans are 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 these plans, including the risks of death and permanent injury of the participants.

We maintained the following defined benefit plans: PBS Telesp, PBS Telesp Celular, PBS Tele Centro Oeste, PBS Teleleste, PBS Telesudeste and PBS Telemig Celular. Besides these plans were maintained defined contribution plans: Visão Telesp, Visão Telefônica Empresas, Visão Assist, Visão ATelecom, TCPPREV, Visão Celular, CelPrev Telemig Celular, VivoPrev and TCOPREV, the latter being a variable contribution plan.

The plans PBS TELESP, Visão TELESP, Visão Telefônica Empresas, Visão Assist and Visão ATelecom, previously managed by Fundação Sistel de Seguridade Social, or SISTEL, were transferred to another closed social security entity called VISÃO PREV Sociedade de Previdência Complementar on February 18, 2005.

Already in 2007, was the transfer of management of Fundação Sistel para o VISÃO PREV for the following plans: PBS Telesp Celular, TCPPREV, PBS Tele Centro Oeste Celular, TCOPREV, PBS Telesudeste Celular, Visão Celular and PBS Teleleste Celular. These 11 plans were gradually transferred to the VISÃO PREV from 31 July 2007 until 31 December 2007.

On August 21, 2007, after the approval of the board of directors of Vivo, the SPC (Secretariat for Pension Funds) approved the new plan VIVO PREV, a defined contribution plan administered by VISÃO PREV already. From 1 March 2008 to 31 May 2008, from 1 July 2009 to 30 September 2009, and October 1 to December 31, 2011, plan participants PBS Telesp Celular, TCPPREV, PBS Tele Centro Oeste Celular, TCOPREV, PBS Telesudeste Celular, Visão Celular, PBS Teleleste Celular, CelPrev Telemig Celular e PBS Telemig Celular had the opportunity to migrate to the new plan VivoPrev.

Between the events above, on December 15, 2010, filed in PREVIC (National Superintendency of Pension Funds), an agency of the Ministry of Social Security, which replaced the old SPC, the request to transfer the management plans PBS Telemig, CelPrev Telemig Celular from Fundação SISTEL de Seguridade Social to the institution VISÃO PREV Sociedade de Previdência Complementar.

In October 2011, the plans Visão TELESP, Visão Telefônica Empresas, Visão Assist, Visão ATelecom were merged and resulted in the plan VisãoTelefônica.

We also sponsor the plans Planos de Assistência Médica aos Aposentados–PAMA, or the PAMA, and PBS-A–Plano de Benefícios Sistel Assistidos, or the PBS-A, that are still managed by Fundação Sistel de Seguridade Social. 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.

The company currently offers the following plans for employees who do not have any pension plan: Visão Telefônica plan and VIVO PREV plan. Our contributions to the VISÃO PREV plan are equal to those of the individual participants, ranging from 2% to 9% of the participant's salary and to the VIVO PREV plan, ranging from 0% to 8% of the participant's salary, depending on the percentage chosen by the participant. The average contributions of the sponsor under the Visão plan equal approximately to 5.76% and VIVO PREV plan 6.61% of the total amount of



salaries paid to participating employees. Currently, 52.15% of our employees are covered by these plans.

With the acquisition of TVA Group companies we also have the defined contribution for Abrilprev for employees of these companies. In this plan the contributions can be made by participants from 1% to 4.5% of participation salary and the counterpart of the sponsor varies of 30 % to 150% depending on company time. The average contributions within the plan sponsor's Abrilprev are approximately equal to 4.27% of the total amount of wages paid to participating employees. Currently, 57% of our employees are covered by these plans.

Finally, due to the incorporation of companies of the Group in Brazil, the company has decided during the Board Meeting of 26.11.2012 to sponsor the defined contribution plan named Visão Multi. The rules of the plan are under review for approval of a government bureau named PREVIC and the current estimate of its availability for use is the 2nd quarter of 2013.

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Approximately 12% of our employees are union members' representative in the telecommunication industry. These unions have state representation, so we have employees represented by 27 state unions. In turn, 19 of these unions are associated with the National Federation of Telecommunications Workers (Fenattel).

Our Collective Bargaining Agreement for these employees was renewed on September 1, 2012 and will expire on August 31, 2014, and in 2013 the economic clauses of the agreement must be renewed.

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, more than 1% 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 Telefônica Brasil S.A. 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 Telefônica Brasil 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 Telefônica Brasil potentially having the right to 175,534 shares of Telefónica S.A.

The third distribution under the PSP took take place in July 2011, with 51 executives (including two executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 189,763 shares of Telefónica S.A.

The fourth distribution under the PSP did not happen because it was not achieved the minimum established in the program for the indicator valuation Telefonica's share (TSR – Total Shareholder Return).

The fifth provision related to PSP will take place in July 2013, with 38 executives (including 2 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 169.854 shares of Telefónica S.A., for which, on December 31, 2012, we have made a provision of R\$7.4 million.

At the General Shareholders Meeting of Telefónica S.A. (our indirect controlling shareholder), held on May 18, 2011, a new long-term incentive plan—"Performance and Investment Plan" (PIP)—for executives of Telefónica S.A. and of other entities within the Telefónica Group, which includes Telefônica Brasil S.A. was approved. The plan grants a determined number of shares of Telefónica S.A. to selected participants who fulfill the necessary requirements.

The PIP is divided into three 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, 2011 (with distribution of shares of Telefónica S.A. starting on July 1, 2014) and each subsequent cycle commencing on July 1 of each subsequent year, up to and including, the third cycle, which commences on July 1, 2013 (with delivery of shares of Telefónica S.A. starting on July 1, 2016).

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The first provision related to PIP will take place in July 2014, with 109 executives (including 5 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 416,384 shares of Telefônica S.A., for which, on December 31, 2012, we have made a provision of R\$6.3 million.

The second provision related to PIP will take place in July 2015, with 127 executives (including 5 executives appointed pursuant to the bylaws) from Telefônica Brasil potentially having the right to receive 520,325 shares of Telefônica S.A., for which, on December 31, 2012, we have made a provision of R\$2.6 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, 2012, Telefónica Internacional owned 15.43% of our common shares and SP Telecomunicações, owned 50.47% of our common shares. Since Telefónica Internacional owns 55.28% of the equity share capital of SP Telecomunicações, it has effective control over 43.33% 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	192,595,149	50.47	%
Telefónica S.A.	97,976,194	25.68	%
Telefónica Internacional	58,859,918	15.43	%
All directors and executive officers as a group	1,548	–	

Shareholder's Name	Number of preferred shares owned	Percentage of outstanding preferred shares	
SP Telecomunicações	29,042,853	3.90	%
Telefónica S.A.	179,862,845	24.17	%
Telefónica Internacional	271,707,098	36.52	%
All directors and executive officers as a group	1,387	–	

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, New York, Lima and Buenos Aires. 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 32 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.

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\$979.7 million in 2012 (compared to R\$1,041.8 million in 2011).

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In April 2001, we entered into a service agreement for the provision of logistics, administrative, accounting and other services with Telefônica Serviços Empresariais do Brasil Ltda., or TGestiona, an indirect wholly owned subsidiary of Telefónica. Transactions with TGestiona under this service agreement involved approximately R\$97.7 million in 2012 (compared to R\$94.6 million in 2011).

Some international roaming services are provided by companies in the Telefonica Group.

C. Interests of Experts and Counsel

Not applicable.

ITEM 8. FINANCIAL INFORMATION

A. Consolidated Statements and Other Financial Information

See Note 20 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.” The Company and its subsidiaries are parties to labor, tax, civil and regulatory claims and set up a provision for contingencies for which the likelihood of loss was estimated as probable. 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

Federal Taxes

At December 31, 2012, the company was party to administrative and judicial proceedings relating to: (i) additional contributions to the FGTS (Unemployment Compensation Fund) on deposits made by employees ( the issue does not result in the reduction of part of FGTS deposits made by the company on behalf of its employees); (ii) claims resulting from the non-ratification of compensation and refund requests, formulated by the company;(iii) social contributions

relating to a supposed failure to pay 11% on the value of invoices, billing and receipts from service providers hired for the transfer of labor; (iv) CIDE levied on the remittance of funds abroad relating to technical services, administrative assistance and to services of similar nature, as well as royalties; (v) fixed: non-inclusion of interconnection and EILD expenses in the FUST base and Wireless carriers: non-inclusion of revenues from interconnection in the FUST tax base; (vi) contribution to Empresa Brasileira de Comunicação, created by Law No. 11652/08; (vii) TFI/TFF on mobile stations; (viii) IRRF on Interest on shareholder's equity; (ix) Public Price for Numbering Resources Management (PPNUM) by ANATEL instituted by Resolution No. 451/06; (x) IRPJ/PIS/COFINS resulting from the non-ratification of the companies' offset and refund requests; (xi) Social Investment Fund (Finsocial) offset amounts; (xii) failure to pay withholding social contribution levied on services rendered, remuneration, salaries and other salary bases; (xiii) COFINS – Requirement resulting from non-inclusion of financial income into the tax base; (xiv) additional charges to the PIS and COFINS tax base, as well as additional

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charges to COFINS required by Law No. 9718/98; and (xv) Tax on Net Income (ILL). On December 31, 2012, total consolidated provisions amounted to R\$1,860.8 million.

In the opinion of our management and our legal advisors, the chance of loss in these cases is “probable.”

### State Taxes

On December 2012, the company and its subsidiaries were party to administrative and judicial proceedings in progress referring to (i) ICMS tax credits on electric power and tax credits without documentation (ii) ICMS not levied on telecommunication services; (iii) disallowance of ICMS tax incentives for cultural projects; (iv) ICMS on TV subscription; and (v) environmental administrative fine At December 31, 2012, total consolidated provisions amounted to R\$67.4 million.

In the opinion of our management and our legal advisors, the chance of loss in these cases is “probable.”

### Municipal Taxes

On December 31, 2012, the company and its subsidiaries were party to tax claims at a municipal level, both in the administrative and judicial sphere which, based on the opinion of its legal advisors, are classified as a probable loss. At December 31, 2012, total consolidated provisions amounted to R\$16.6 million.

These proceedings relate to: (i) IPTU, (ii) ISS levied on chattel lease services and secondary and complementary activities, and (iii) Surveillance, Control and Inspection Fee (TVCF).

In the opinion of our management and our legal advisors, the chance of loss in these cases is “probable.”

### Other Provisions

At December 31, 2012, the company and its subsidiaries recorded other provisions, relating to legal claims, both in the administrative and in the judicial level, related to ISS on effective provision of services of lease, sublease, right of way or use right, whether shared or not, of railway, highway, telegraph poles, cables, ducts and conducting wires of any kind. At December 31, 2012, the consolidated provisions totaled R\$8.2 million.

In the opinion of our management and our legal advisors, the chance of loss in these cases is “probable.”

### Tax Proceedings

The following tax proceedings were pending as of December 31, 2011, and, in the opinion of our management and our legal advisors, the chance of loss in these cases is “possible.”

### Federal Taxes

At December 31, 2012, the company and its subsidiaries were a party to various administrative and judicial proceedings in the federal sphere, which are waiting to be tried at various court levels. At December 31, 2012, the total consolidated amount was R\$3,146.7 million.

Key proceedings refer to: (i) Non-compliance manifestations due to the ratification of compensation requests made by the company; (ii) fine for distribution of dividends even in view of the alleged existence of outstanding debts payable to the federal government; (iii) social security contribution (INSS) on compensation payment for salary devaluation



arising from losses caused by “Plano Verão” (Summer Plan) and “Plano Bresser” (Bresser Plan), SAT (Work Accident Insurance), Social Security and payables to third parties (INCRA and SEBRAE), supply of meals to employees, 11% retention (labor assignment); (iv) IRRF on the funds remittance abroad related to technical services and to administrative support and similar services, as well as royalties; (v) PIS levied on roaming; (vi) CPMF levied on operations resulting from the technical cooperation agreement with the National Treasury Department (STN) (offsetting through the Integrated System of Federal Government Financial Administration - SIAFI) and on foreign-exchange contracts required by the Brazilian Central Bank; (vii) IRPJ and CSLL related to deductions on revenues from reversal of provisions; (viii) Income tax and social contribution – disallowance of costs and miscellaneous expenses not substantiated; (ix) deductions of COFINS from loss in swap transactions; (x) PIS / COFINS accrual basis versus cash basis; (xi) IRPJ payable in connection with allocation of excess funds to Northeast Investment Fund (FINOR), Amazon Region Investment Fund (FINAM) or Economic Recovery Fund of

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the State of Espírito Santo (FUNRES); (xii) IRPJ on derivative operations; (xiii) IRPJ and CSLL – disallowance of expenses related to the goodwill paid in the acquisition of Celular CRT S.A., goodwill arising from the privatization process and Vivo’s corporate restructuring; and (xiv) contribution to the Brazilian company of communication, created by Law No. 11.652/08.

In the opinion of management and its legal advisors, the chances of loss in these processes are possible.

State Taxes

On December 31, 2012, the company and its subsidiaries were a party to various administrative and judicial proceedings related to ICMS, at the state level, which are ongoing in various court levels. At December 31, 2012, the total consolidated amount was R\$5,870.4 million.

Key proceedings refer to: (i) provision of facility, utility and convenience services and rental of the “Speedy” service modem; (ii) international calls (DDI); (iii) undue credit related to the acquisition of items intended to property, plant and equipment; (iv) lack of proportionate credit reversal referring to the acquisition of property, plant and equipment items; (v) amounts unduly appropriated as ICMS tax credits; (vi) service provided outside São Paulo state with ICMS paid to São Paulo State; (vii) co-billing, (viii) tax substitution with a fictitious tax base (tax guideline); (ix) use of credits related to acquisition of electric power; (x) secondary activities, value added and supplementary services (Agreement 69/98); (xi) tax credits related to opposition/challenges referring to telecommunications services not provided or mistakenly charged (Agreement 39/01); (xii) shipment of goods with prices lower than acquisition prices (unconditional discounts); (xiii) deferred charge of ICMS - Interconnection (DETRAF – Traffic and Service Provision Document); (xiv) credits derived from tax benefits granted by other states; (xv) disallowance of tax incentives related to cultural projects; (xvi) transfers of assets among business units owned by the company; (xvii) communications service tax credits used in provision of services of the same nature; (xviii) card donation for prepaid service activation; (xix) reversal of credit from return and free lease in connection with assignment of networks (used by the company itself and exemption from public bodies); (xx) DETRAF fine, (xxi) ICMS on own consumption; (xxii) ICMS on exemption of public bodies; (xxiii) issue of invoices with negative ICMS amounts; and (xxiv) restructuring of ledger without prior authorization by the Treasury.

In the opinion of management and its legal advisors, the chance of loss is possible in these procedures.

Municipal Taxes

At December 31, 2012, the company and its subsidiaries were party to various administrative and judicial proceedings at the municipal level, which are ongoing various court levels. At December 31, 2012, the total consolidated amount was R\$544.4 million.

Key proceedings refer to: (i) ISS – secondary activities, value added and supplementary services; (ii) withholding ISS; (iii) IPTU; (iv) Land Use Fee; (v) municipal fees; (vi) tariff for Use of Mobile Network (TUM), infrastructure lease; (vii) advertising services; (viii) services provided by third parties; (ix) business management consulting services provided by Telefonica Internacional (TISA); (x) ISS tax levied on caller ID services and on cell phone activation

In the opinion of management and its legal advisors, loss is possible in these proceedings.

ANATEL

FUST – Universalization of Telecommunications Service

Writs of Mandamus filed separately by the fixed and mobile operators to recognize the right to: Fixed: Failure to include interconnection and EILD expenses in the FUST base and Mobile: Failure to include interconnection revenue in the FUST base, pursuant to Abridgement No. 7, of December 15, 2005, since it disagrees with the provisions of the sole paragraph, article 6, of Law No. 9,998/00, which are waiting to be tried in the court of appeals.

A number of delinquency notices referring to debit entry issued by ANATEL in the administrative level to set up the tax credit related to interconnection, EILD and other revenues that are not earned from the provision of telecommunications services.

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At December 31, 2012, the total consolidated amount was R\$1,970.8 million.

In the opinion of management and its legal advisors, there are possible chances of loss in these procedures.

FUNTTEL – Fund for the Technological Development of Telecommunications

At December 31, 2012, the company and its subsidiaries were parties to administrative and judicial proceedings which are waiting to be tried at the lower administrative court and the court of appeals. At December 31, 2012, the total consolidated amount was R\$614.3 million.

Such proceedings concern the collection of contributions to FUNTTEL on other revenues (not related to telecom services), as well as on income and expenses transferred to other operators (interconnection).

In the opinion of management and its legal advisors, the chance of success in these procedures is possible.

FISTEL – Telecommunications Supervision Fund

Due extension of the effective license period to use telephone switches in connection with use of STFC (landline phone carriers) and extension of the right to use radiofrequency in connection with wireless service (wireless carriers), ANATEL charges the Installation Inspection Fee (TFI).

This collection is based on ANATEL's understanding that such extension would represent a taxable event for TFI. The Company and its subsidiaries understand that such collection is unjustified, and separately challenged the aforesaid fee in court. At December 31, 2012, total consolidated amount was R\$1,589.5 million, without the respective deposit in full.

In the opinion of management and its legal advisors, there are possible chances of loss in these procedures.

PPNUM – Price Relative to the Public Administration of Numbering Resources

Our subsidiary Vivo, along with other wireless carriers in Brazil, are challenging in court the tariff charged by ANATEL for use by such carriers of the numbering resources managed by the agency. When charged by ANATEL, Vivo made a judicial deposit referring to the amounts payable. On April 23, 2009, the carriers received a favorable sentence and the lawsuit is currently waiting to be tried at the court of appeals. At December 31, 2012, total amount was R\$2.1 million.

In the opinion of management and its legal advisors, there are possible chances of loss in these procedures.

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 Company; and proceedings regarding our outsourcing practices.

In addition, we are also a 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 unable to calculate the total

amount we will owe 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\$795.3 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:

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

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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\$31.3 million.

- **Service Complaints.** We and our subsidiaries are defendants in certain civil actions, in various court levels, regarding claims related to our services and our ordinary course of business initiated by individual customers, civil associations on behalf of customers or by the PROCON foundation, as well as by the Federal and State Public Prosecutor’s Offices. We recorded a provision of R\$377.6 million for these claims. We are also defendants to civil actions in which the risk of loss is classified as “possible” in the amount of R\$1,236.3 million.
- **Consumer Relations Claims.** We are defendants in several civil actions initiated by individual customers in which the claims are the same or very similar from to other and, when considered individually, are not material, to which we recorded a provision of R\$78.7 million, calculated on the basis of 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) ) and National Federation of Associations of Retirees and Pensioners and Participants in Pension Funds in Telecom (FENAPAS), they filed with two distinct - same object though - 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 in both of them is possible based on the opinion of our legal advisors. The amount involved in both cases cannot yet be determined until an expert appraisal report is conducted 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 have not received shares for their financial investment in the municipality of Mogi das Cruzes, involving a total amount of approximately R\$236.2 million. Based on the opinion of our legal advisors, the chance of loss is possible. The appellate court has ruled in our favor and changed the lower court decision. The plaintiff filed an appeal to the Supreme Court which is awaiting resolution.
- **Services Quality Class Action.** The Public Prosecutor Office of the State of São Paulo commenced a class action suit claiming moral and property damages suffered by all consumers of telecommunication services from 2004 to 2009 due to the bad quality of service and failures of the communications system. The Public Prosecutors Office suggested a total award against the company of R\$1 billion. A judgment was rendered on April 20, 2010 imposing the payment of damages 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 and the effects of the sentence were suspended. Despite the possible degree of risk, no value amount was attributed to this action because currently we are unable 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.
- **Ownership of Caller ID.** Lune Projetos Especiais Telecomunicação Comércio e Ind. Ltda., a Brazilian company, filed on November 20, 2001 lawsuits against 23 wireless telecommunications operators, including TELESP Celular

Participações and its subsidiaries. The lawsuits allege that those operators violated patent No. 9202624-9, related to Equipamento Controlador de Chamadas Entrantes e do Terminal do Usuário, or Caller ID, granted to Lune by the Brazilian Intellectual Property Agency–INPI, on September 30, 1997. Lune called on the operators to cease to provide Caller ID services and sought payment from them for the unauthorized use of the Caller ID system in an amount equivalent to the payment of fees received by such operators for use of the Caller ID system. On October 5, 2011, the law suit was judged groundless against the

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Phone Companies. Vivo will file an appeal due to this decision. This decision is not final, and will be tried before the Court and Superior Court of Justice. However, Lune's right to use patent No. 9202624-9 was suspended by a federal judge in response to a lawsuit filed against Lune and INPI by Ericsson Telecomunicações S.A., TC and Telerj Celular (formerly Vivo subsidiaries before our corporate restructuring) filed identical lawsuits against Lune and INPI and those lawsuits are still pending before the courts. In connection with this proceeding, a third company, Sonintel, and its two partners also brought an Ação de Oposição, whereby they reinvoked their rights to a previous patent related to Caller ID, and to which the above mentioned patent (No. 9202624-9) was linked. We believe, based on the opinion of outside counsel that the likelihood of an unfavorable outcome with respect to Lune's claim against us is possible. We are unable to determine at this time the extent of any potential liabilities with respect to this claim.

- Validity of Prepaid Plan Minutes. We and our subsidiaries, together with other Brazilian wireless telecommunications operators, are defendants in various lawsuits brought by the public prosecutor's office and consumer protection associations challenging the imposition of a deadline for the use of purchased prepaid minutes. The plaintiffs allege that purchased prepaid minutes should not expire after any specified deadline. Conflicting decisions have been issued by the courts reviewing this matter. Although we believe that our criteria for imposing the deadline is in compliance with ANATEL's rules, we believe, based on the opinion of outside counsel, that the likelihood of an unfavorable outcome with respect to this claim is possible.

Regulatory and Antitrust Litigation

ANATEL

Administrative Proceedings for Noncompliance with Regulatory Obligations Brought by ANATEL – PADOs. As of December 31, 2012, the fixed service division 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, 2012, R\$265.0 million. We are also defendants to such administrative proceedings in which the risk of loss classified as possible is in the amount of R\$1,081.6 million.

Our subsidiary Vivo is also part of several administrative and legal actions brought by ANATEL that allege non compliance with regulatory requirements related to SMP service, in the total amount of approximately R\$42.6 million. Based on the opinion of our counsel, we believe that the likelihood of unfavorable outcomes with respect to these claims is probable. We are also defendants to such administrative proceedings in which the risk of loss classified as possible in the amount of R\$39.4 million.

On August 6, 2007, Global Village Telecom Ltda (GVT), Intelig Telecomunicações Ltda (Intelig), Transit of Brazil Ltda. and Easytone Telecomunicações Ltda., brought an administrative action under the Brazilian System of Competition Defense (Sistema Brasileiro de Defesa da Concorrência), or SBDC, against Claro SA (Claro), Tim Brazil Services and Telecommunications SA (TIM), TNL SCS SA (Hi) and Vivo, for alleged anticompetitive practices and price fixing, alleging price fixing related to the VUM rate charged to competitors. On August 21, 2008, the Secretariat of Economic Law (Secretaria de Direito Econômico), or SDE, initiated administrative



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proceedings in order to assess whether the practices alleged were in breach of Law No. 8.884/94, the applicable Brazilian antitrust and price fixing legislation.

The SDE and federal prosecutors have issued advice recommending: (i) removal of the antitrust charge against all represented parties, (ii) the exclusion of Hi as defendants in the price fixing investigation, (iii) the conviction of Vivo, TIM and Claro for price fixing. The process is the Administrative Council for Economic Defense (Conselho Administrativo de Defesa Econômica), or CADE, awaiting trial.

Based on the opinion of our counsel, we believe the risk of an adverse judgment in the aforementioned administrative proceedings related to price fixing to be possible, and we estimate that the penalty for this conduct may range from 0.1% to 0.5% of the gross revenues of Vivo for 2006. However, in the unlikely event CADE were to find that Vivo engaged in anticompetitive practices, a position already rejected by SDE and MPF, it is estimated that the fine could range from 10% to 15% of the gross revenues of Vivo in 2006.

Notably, a new law governing antitrust, Law No. 12,529/12, recently came into force on May 29, 2012, and as there have been few cases decided by CADE applying the new criteria, the estimates above are based on previous case law and our analysis of the new law.

### 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 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:
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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.

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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 if 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 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 before 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 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, Citibank N.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

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be delivered to the depositary for distribution to holders of ADSs. If 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 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.

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 2008 in reais.

Year	Description (Dividends or Interest on Shareholders' Equity)(1)	Common Shares (per share/in R\$)	Preferred Shares
2012	Div/Int	2.567510	2.824261
2011	Div/Int	4.783035	5.261339
2010	Div/Int	3.616248	3.977873
2009	Div/Int	2.556431	2.812074
2008	Div/Int	4.539838	4.993823

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(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 actual payment was made as follows:

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- an initial installment of R\$800 million, with payment due June 30, 2010. The actual payment occurred on April 26, 2010; and
- the remaining portion of R\$451.6 million, with payment due 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.

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 actual payment occurred on May 20, 2011.

On March 18, 2011, at the General Shareholders Meeting, the shareholders approved the distribution of dividends to the common and preferred shares in the total amount of R\$1,694 million declared on the basis of the closing balance sheet on December 31, 2010. The actual payment was made as follows:

- an initial installment of R\$1,429 million which the payment occurred on May 20, 2011; and
- the remaining portion of R\$264.7 million which payment occurred on November 3, 2011.

On September 13, 2011, the Board of Directors approved the distribution of interim dividends of R\$382.4 million based on earnings accumulated in our existing balance sheet as of June 30, 2011. The actual payment occurred on November 3, 2011.

On September 13, 2011, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$1,250 million. The actual payment occurred on November 3, 2011.

On December 12, 2011, the Board of Directors approved, subject to shareholder approval, a payment of interest on shareholders equity for the common and preferred shares totaling R\$617.0 million. The actual payment occurred on May 1, 2012.

On April 11, 2012, at the General Shareholders Meeting, the shareholders approved the distribution of dividends to the common and preferred shares in the total amount of R\$1,953 million declared on the basis of the closing balance sheet on December 31, 2011. The actual payment was made as follows:

- an initial installment of R\$1,075.6 million which the payment occurred on May 01, 2012; and
- the remaining portion of R\$877.4 million which payment occurred on December 12, 2012.

On November 05, 2012, the Board of Directors approved the distribution of interim dividends of R\$1,122.5 million based on earnings accumulated in our existing balance sheet as of June 30, 2012. The actual payment occurred on December 12, 2012.

On January 10, 2013, the Board of Directors approved the distribution of interim dividends of R\$1,650 million based on earnings accumulated in our existing balance sheet as of September 30, 2012. This amount was paid on February 18, 2013.

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## 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 “VIVT4” (formerly TLPP4).” Our common shares trade under the symbol “VIVT3” (formerly TLPP3). At December 31, 2012, we had approximately 1,125.6 million common and preferred shares held by approximately 2.3 million common and preferred shareholders.

In the United States, the preferred shares trade in the form of ADRs, each representing one preferred share, issued by Citibank N.A, 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 and are traded on NYSE under the symbol “VIV” (formerly TSP). The following table sets forth the reported high and low closing sales prices for ADRs on the NYSE for the periods indicated.

Year ended	NYSE		BM&FBOVESPA		BM&FBOVESPA	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
	(in US\$ per ADS)		(in reais per preferred share)		(in reais per common share)	
December 31, 2008	21.72	18.62	52.12	44.94	39.95	33.84
December 31, 2009	25.53	23.74	43.54	42.12	39.29	36.00
December 31, 2010	24.53	22.70	42.03	38.60	39.30	36.22
December 31, 2011	28.33	25.74	52.97	47.47	48.00	43.50
December 31, 2012	31.22	21.17	56.92	43.45	51.69	37.53
Year ended December 31, 2011						
First quarter	25.34	23.07	42.60	37.80	42.30	36.24
Second quarter	30.40	25.00	46.99	39.48	43.90	37.02
Third quarter	31.77	25.84	52.50	43.06	46.88	37.30
Fourth quarter	29.34	25.39	52.97	46.55	48.00	40.50

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Year ended December 31, 2012						
First quarter	31.02	27.02	56.59	47.50	50.98	42.77
Second quarter	31.22	23.31	56.92	47.30	51.69	43.20
Third quarter	25.66	21.35	51.60	43.45	47.88	39.40
Fourth quarter	24.08	21.17	49.28	43.54	43.65	37.53

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Month ended	NYSE		BM&FBOVESPA		BM&FBOVESPA	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
	(in US\$ per ADS)		(in reais per preferred share)		(in reais per common share)	
September 30, 2012	23.07	21.37	46.63	43.45	41.30	39.40
October 31, 2012	22.40	21.45	45.70	43.54	40.94	37.53
November 30, 2012	23.35	21.80	48.95	44.79	42.76	39.33
December 31, 2012	24.08	21.17	49.28	45.20	43.65	39.35
January 31, 2013	25.79	24.32	52.55	49.62	47.47	43.00
February 29, 2013	26.59	24.43	52.57	48.14	46.10	43.00
March 2013 (through March 19)	27.66	26.41	54.12	52.04	48.24	45.41

## 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 5:30 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 6:15 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.

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, 2012, the aggregate market capitalization of the 364 companies listed on BM&FBOVESPA was approximately US\$1,235 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 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.

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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 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 (Política de Divulgação de Ato e Fato Relevante);
- created a policy for internal controls related to financial information (Normativa sobre Registro, Comunicação e Controle de Informação Financeiro-Contábil);
  - created Service Quality and Marketing Committee;
  - created Control and Audit Committee;
  - created Nominations, Compensation and Corporate Governance Committee;
  - created a policy to denounce fraud within the company (Canal de Denúncias);

- created a policy for prior approval of contracting audit services (Normativa sobre Aprovação Prévia de Serviços a serem Prestados pelo Auditor Externo);
  - created an internal rule of conduct relating to the securities market (Regulamento Interno de Conduta);
- created an Ethics Code in respect of handling financial information (Normas de Conduta para Financeiros); and
- created a policy regarding communication of information to the securities market (Normativa sobre Comunicação de Informação aos Mercados).

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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 rules. In addition to the prohibition on trading of our shares by such individuals when in possession of insider information, the rules 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 nonpublic information and data 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.

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;



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- 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 no longer 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), however our bylaws require that our directors own shares of the company.

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 comprises preferred shares and common shares, all without par value. At December 31, 2012, there were 261,308,985 outstanding preferred shares and 31,208,300 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 capital must be approved by a general shareholders meeting.

The preferred shares are nonvoting, 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;
- 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

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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 nonvoting 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 nonvoting 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 before 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 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:

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- (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.

C. Material Contracts

On June 30, 2011, we have renewed our concession agreement with ANATEL and consolidated our existing material contracts related to the concession of public telecommunications service granted by ANATEL into two new contracts (each filed as an Exhibit to this Annual Report). One of these contracts authorizes the company to provide commuted fixed telephone service (Sectors 31) and the other contract authorizes the company to provide long-distance telephone services (Sector 31). These contracts will expire on December 31, 2025.

Telefônica Brasil had also authorization to provide local and long-distance telephone services under the private system (all sectors, except Sector 31), which was granted in 2002, for an unlimited period of time. On September 5, 2011, these Authorization Terms were transferred to Vivo. Telefônica Brasil and VIVO have Multimedia Communication Service Authorization Terms, which are also material contracts. Based on this Authorization Terms, the companies are allowed to provide broadband services in the State of São Paulo (Telefônica) and all over Brazilian territory (Vivo\*).

The Term was signed on April 17, 2003 and March 19, 2004 for an undetermined period of time and is still currently in effect.

\*The Authorization Term was granted to Global Telecom, an incorporated company.

In line with the General Plan of Authorization, which had split the country into three regions, Vivo holds three Authorization Terms for the provision of Personal Mobile Services, SMP, with national coverage. The regions were split as follows: Region I: states of Rio de Janeiro, Espírito Santo, Minas Gerais, Amazonas, Roraima, Amapá, Pará, Maranhão, Bahia, Sergipe, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco and Alagoas, Region II: states

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of Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondônia, Acre and Federal District and Region III: State of São Paulo.

In Region I, Vivo holds the Terms of Service Authorization n ° 078/2012 of 07/02/2012, in Region II, VIVO SA holds the Terms of Service Authorization n ° 005/2010 of 29/01/2010, and in Region III, VIVO SA holds the Terms of Service Authorization n ° 006/2010 of 29/01/2010.

The authorization is a legal requirement for the provision of telecommunications services in the region covered thereby. Licenses for personal mobile services (SMP) carry the right to provide mobile services for an unlimited period of time. However, the use of spectrum is restricted in accordance with the specific license conditions. All Telefónica's Brazilian mobile authorizations were granted to Vivo as follows:

- Vivo-Rio Grande do Sul except Pelotas, Capão do Leão, Morro Redondo e Turuçu ("A" band) until 2022 (renewed in 2007);
  - Vivo-Rio de Janeiro ("A" band) until 2020 (renewed in 2005);
  - Vivo-Espírito Santo ("A" band) until 2023 (renewed in 2008);
  - Vivo-Bahia ("A" band) and Vivo-Sergipe ("A" band) until 2023 (renewed in 2008);
- Vivo-São Paulo ("A" band) until 2023 (renewed in 2008); or 2024, for the cities of Ribeirão Preto and Guatapar (renewed in 2009);
  - Vivo-Paraná/Santa Catarina ("B" band) until 2013;
  - Vivo-Distrito Federal ("A" band) until 2021 (renewed in 2006);
- Vivo-Acre ("A" band), Vivo-Rondnia ("A" band), Vivo-Mato Grosso ("A" band) and Vivo-Mato Grosso do Sul ("A" band) until 2024 (renewed in 2009);
  - Vivo-Gois/Tocantins ("A" band) until 2023 (renewed in 2008);
  - Vivo-Amazonas/Roraima/Amap/Par/Maranho ("B" band) until 2013;
  - Vivo Minas Gerais\* ("A" band) until 2023 (renewed in 2008);
- Vivo for the cities in which CTBC Telecom operates in the state of Minas Gerais\* ("E" band) until 2020;

\* On October 1, 2011, assets, rights and obligations of Vivo Participaes relating to mobile operations in Minas Gerais were awarded to Vivo, a subsidiary of Vivo Participaes.

License renewals for "A" and "B" bands must be requested 30 months in advance of the expiry date. Spectrum rights may be renewed only once, for a 15-year period. After this period, the license must be renegotiated.

License renewals for the "E" band must be requested between 36 and 48 months in advance of the expiry date. Spectrum rights may be renewed only once, for a 15-year period. After this period, the license must be renegotiated.

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In December 2007, ANATEL auctioned off nationally 15 blocks in the 1900 MHz band (“L” band). Vivo won 13 through Brasil, except in the northern region and the towns of Londrina and Tamarana in the state of Paraná. The spectrum licenses, along with the related renewal dates, are as follows:

- Vivo-Rio Grande do Sul (“L”