

TELESP HOLDING CO  
Form 20-F  
March 26, 2010

As filed with the Securities and Exchange Commission on March 26, 2010

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, 2009

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: \_\_\_\_\_

TELECOMUNICAÇÕES DE SÃO PAULO S.A. – TELESP

(Exact name of Registrant as specified in its charter)

Telecommunications of São Paulo – Telesp

(Translation of Registrant’s name into English)

Federative Republic of Brazil

(Jurisdiction of incorporation or organization)

Rua Martiniano de Carvalho, 851

01321-001 São Paulo, SP, Brasil

(Address of principal executive offices)

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

Title of each class

Preferred Shares, without par value

Name of each exchange on which registered

New York Stock Exchange\*

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American Depositary Shares (as evidenced by American Depositary Receipts), each representing 1 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 as of December 31, 2009 was:

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

Yes  No

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large Accelerated Filer  Accelerated Filer  Non-accelerated Filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

International Financial Reporting Standards as issued by the International Accounting Standards Board  Other

U.S. GAAP

The financial statements included in this filing were prepared in accordance with the accounting practices adopted in Brazil, as prescribed by Brazilian Corporate Law (Brazilian GAAP).

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

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

- “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;

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- “real,” “reais” or “R\$” are to Brazilian reais, the official currency of Brazil;
- “Speedy” are to broadband services provided by Telesp through asymmetric digital subscriber lines, or ADSL;
- “TJLP” are to Taxa de Juros de Longo Prazo, or long term interest rate; and
- “US\$,” “dollars” or “U.S. dollars” are to United States dollars.

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

The “Glossary of Telecommunications Terms” that begins on page 110 provides the definition of certain technical terms used in this annual report.



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FORWARD-LOOKING STATEMENTS

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

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

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

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

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

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PRESENTATION OF FINANCIAL INFORMATION

Our consolidated financial statements as of December 31, 2009 and 2008 and for the years ended December 31, 2009, 2008 and 2007 have been prepared in accordance with the accounting practices adopted in Brazil, as prescribed by Brazilian Corporate Law, or the Brazilian GAAP, which differs in certain significant respects from generally accepted accounting principles in the United States, or U.S. GAAP. Note 34 to our financial statements appearing elsewhere in this annual report describe the principal differences between the Brazilian GAAP and U.S. GAAP as they relate to us, and provide a reconciliation to U.S. GAAP of net income and shareholders' equity. These consolidated financial statements have been audited by Ernst & Young Auditores Independentes S.S. ("E&Y" or "Ernst & Young").

As a result of a change in Brazilian corporate law with respect to financial reporting (Law 11,638), certain changes in accounting criteria became effective for fiscal year 2008. A CVM rule allows companies to adopt these changes for fiscal year 2008 only, without making changes to comparative 2007 financial information, with disclosure in the notes to the financial statements explaining such accounting treatment. Based on this CVM rule, we have elected not to restate our 2007 financial statements. Any changes that would have resulted to our financial statements as of and for the year ended December 31, 2007 as a result of applying the new accounting criteria would not be material, and the application of these changes to our financial statements as of and for the year ended 2008 does not have a material effect on the comparability of our 2008 financial statements with our 2007 financial statements. However, some amounts for 2006 and 2007 presented throughout this Form 20-F have been reclassified to conform with the presentation of the 2009 amounts prepared in accordance with the new accounting criteria. Please see Note 3 and 4 to our 2009 financial statements for a qualitative and quantitative analysis of the changes resulting from this new accounting criteria.

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.

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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

Our consolidated financial statements included in this annual report on Form 20-F and the selected financial data presented for the periods described below have been prepared in accordance with the Corporate Law Method, which is the same basis of accounting used in our annual financial statements published in Brazil, audited by Ernst & Young Auditores Independentes for the fiscal years ended December 31, 2009, 2008, 2007, 2006 and 2005. Although we adopted law 11,638 effective as of January 1, 2008 (see “Presentation of Financial Information”), certain previously reported amounts for 2005, 2006 and 2007 presented below have been reclassified to conform with the presentation of the 2008 and 2009 amounts prepared in accordance with the new accounting criteria. See Notes 3 and 4 to the consolidated financial statements.

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,				
	2009	2008	2007	2006	2005
	(in millions of reais, except for share and per share data)				
<b>Income Statement Data:</b>					
<b>Brazilian Corporate Law</b>					
Net operating revenue	15,796	15,979	14,727	14,643	14,395
Cost of goods and services	(8,956)	(8,726)	(8,029)	(7,781)	(7,717)
Gross profit	6,840	7,253	6,698	6,862	6,678
Operating expenses, net	(3,483)	(3,523)	(3,051)	(2,607)	(2,805)
Operating income before financial expense, net	3,357	3,730	3,647	4,255	3,873
Financial expense, net	(195)	(228)	(307)	(331)	(460)
Income before tax and social contribution	3,162	3,502	3,340	3,924	3,413
Income tax and social contribution	(989)	(1,082)	(977)	(1,108)	(871)
Net Income	2,173	2,420	2,363	2,816	2,542
Earnings per share in reais	4.30	4.78	4.67	5.57	5.17
<b>Cash Dividends per share in reais, net of withholding tax:</b>					
Common Shares	2.56	4.54	5.25	5.58	6.89
Preferred Shares	2.81	4.99	5.77	6.14	7.58

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U.S. GAAP

Net operating revenue	21,624	22,017	20,472	20,293	19,870
Operating income	3,305	3,803	3,635	4,305	4,026
Net income	2,185	2,500	2,370	2,930	2,638
Net income per share:					
Earnings per share—Common shares—basic	4.05	4.63	4.39	5.48	5.02
Weighted average number of common shares outstanding—basic	168,609,291	168,609,291	168,609,292	167,242,724	164,734,052
Weighted average number of common shares outstanding—diluted.....	168,744,596.....	168,638,238	168,609,292	167,242,724	164,734,052
Earnings per share—Preferred shares—basic	4.45	5.10	4.83	6.02	5.52
Weighted average number of preferred shares outstanding—basic	337,232,189	337,232,189	337,232,189	334,342,809	328,130,540
Weighted average number of preferred shares outstanding—diluted	337,469,679	337,276,489	337,232,189	334,342,809	328,130,540

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	December 31,				
	2009	2008	2007	2006	2005
	(in millions of reais, except per share data)				
Balance Sheet Data:					
Brazilian Corporate Law					
Property, plant and equipment, net	9,672	9,869	10,260	11,651	12,358
Total assets	20,461	19,992	18,950	18,146	17,760
Loans and financing—current portion	1,768	519	806	1,829	247
Loans and financing—non-current portion	1,752	3,217	2,503	510	2,151
Shareholders' equity	10,057	10,046	9,905	10,610	10,204
Capital stock	6,575	6,575	6,575	6,575	5,978
Number of shares outstanding (in thousands) (1)	505,841	505,841	505,841	505,841	492,030
U.S. GAAP					
Property, plant and equipment, net	9,673	9,909	11,280	12,018	12,726
Total assets	20,965	20,878	20,203	18,825	18,140
Loans and financing—current portion	1,768	519	808	1,828	256
Loans and financing—non-current portion	1,753	3,221	2,503	510	2,151
Shareholders' equity	11,520	10,624	10,478	10,823	10,265

(1) On May 11, 2005, the shareholders approved a reverse stock split in the proportion of 1,000 (one thousand) shares to 1 (one) share of the same class.

	December 31,				
	2009	2008	2007	2006	2005
	(in millions of reais except when indicated)				
Cash Flow Data:					
Brazilian Corporate Law					
Operating activities:					
Cash provided by operations	4,413	5,130	4,778	5,007	5,538
Investing activities:					
Net cash used in investing activities	(2,296)	(2,075)	(2,318)	(1,885)	(1,667)
Financing activities:					
Cash used in financing activities	(1,581)	(2,247)	(1,740)	(3,372)	(3,647)
Increase (decrease) in cash and cash equivalents	536	808	720	(250)	224
Cash and cash equivalents at beginning of year	1,741	933	213	463	239
Cash and cash equivalents at end of year	2,277	1,741	933	213	463

## Exchange Rates

The Brazilian Central Bank allows the real/dollar exchange rate to float freely. The real/dollar exchange rate has been established mainly by the Brazilian interbank market and has fluctuated considerably. The Brazilian Central Bank has intervened occasionally to control unstable movements in the exchange rate. However, the exchange market may continue to be volatile, and the real may depreciate or appreciate substantially in relation to the U.S. dollar in the future. It is not possible to predict whether the Brazilian Central Bank or the Brazilian government will continue to let the real float freely or will intervene in the exchange rate market.

The Brazilian government has been introducing significant changes aimed at simplifying the Brazilian foreign exchange market. Prior to March 4, 2005, there were two principal legal foreign exchange markets in Brazil:

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- the commercial rate exchange market; and
- the floating rate exchange market.

On August 4, 2006, the Brazilian National Monetary Council, through Resolution No. 3,389, relaxed the exchange coverage for exports, allowing Brazilian exporters to keep up to 30% of their income generated from exports of goods and/or services outside of Brazil. The remaining 70% of such income continued to be subject to compulsory repatriation to Brazil.

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

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

Since October 2009, in accordance with Decree No. 6,983/09, the IOF tax is levied at 2% over exchange transactions for the inflow of funds to invest in the financial and capital markets. The IOF rate is zero over exchange transactions for outflow for these funds as well as over proceeds received as a result of initial public offerings. The conversion of Brazilian currency into foreign currency for purposes of paying dividends for ADS programs is currently not taxed.

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
2005	2.163	2.762	2.413	2.341
2006	2.059	2.371	2.168	2.138
2007	1.732	2.156	1.929	1.771
2008	1.559	2.500	1.833	2.337
2009	1.741	2.378	1.990	1.741

Source: Central Bank of Brazil, PTAX.

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

Month Ended	Exchange Rate of R\$ per US\$	
	Low	High
October 31, 2009	1.703	1.784
November 30, 2009	1.702	1.756
December 31, 2009	1.709	1.788
January 31, 2010	1.722	1.874
February 28, 2010	1.804	1.877
March 2010 (through March 24th)	1.764	1.803



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Source:

Central Bank of Brazil, PTAX.

B. Capitalization and Indebtedness

Not applicable.

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C. Reasons for the Offer and Use of Proceeds

Not applicable.

D. Risk Factors

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

Risks Relating to Brazil

The Brazilian government has exercised, and continues to exercise, 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 occasionally 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 (including reforms currently under discussion in the Brazilian Congress); 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. These uncertainties are heightened during presidential elections. 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 global financial system has experienced difficult credit and liquidity conditions and disruptions leading to greater volatility. Since the fall of 2008, global financial markets deteriorated sharply and a number of major foreign financial institutions, including some of the largest global commercial banks, investment banks, mortgage lenders, mortgage guarantors and insurance companies, were experiencing significant difficulties including runs on their deposits and inadequate liquidity.

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In an attempt to increase liquidity in the financial markets and prevent the failure of the financial system, various governments have intervened on an unprecedented scale, but there is no assurance that these measures will successfully alleviate the current financial crisis.

Despite the extent of the above-mentioned intervention, global investor confidence remains low and credit remains relatively lacking. Hence, additional volatility in the global financial markets may occur. Continued or worsening disruption and volatility in the global financial markets could have a material adverse effect on our ability to access capital and liquidity on acceptable financial terms, and consequently on our operations. Furthermore, an economic downturn could negatively affect the financial stability of our customers, which could result in a general reduction in business activity and a consequent loss of income for us.

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

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

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

Brazil has historically experienced high rates of inflation. Inflation and certain of the government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. The Consumer Prices Index (Índice de Preços ao Consumidor), or the IPCA, published by the Instituto Brasileiro de Geografia e Estatística (IBGE), rose 4.3% in 2009, reaching the target fixed by the National Monetary Council. The inflation rate was 5.9 % in 2008, 4.5 % in 2007, 3.1% in 2006 and 5.7% in 2005.

Since 2006, telephone fees for fixed-line services have been indexed to the Índice de Serviços de Telecomunicações (Telecommunications Service Index or IST), reduced by a productivity factor. The IST is a basket of national indexes that reflect our industry's operating costs. As a result, this index serves to reduce the apparent incongruity between our industry's revenues and costs, and thus reduce the apparent adverse effects of inflation upon our operations. In contrast, Brazilian monetary policy has been using the IPCA as an inflation targeting system. The inflation target for 2010 is 4.5% and if inflation increases beyond this target, basic interest rates may rise, causing direct effects on the cost of debt and indirect effects on the demand for telecommunication goods and services.

Our results of operations have been negatively affected by a decrease in our customer base growth and could also be affected if our rate of customer turnover increases.

Our rate of acquisition of new customers can be negatively affected by market penetration. For example, our fixed-line customer base decreased 1.2% from December 31, 2006 to December 31, 2007, 2.5% from December 31, 2007 to December 31, 2008 and 3.5% from December 31, 2008 to December 31, 2009. The decrease was mostly due to an increase in competition in the fixed telephony industry from cable and fixed-wireless operators, and an increase in substitution of fixed lines with mobiles. This decrease in customer acquisition has negatively affected our results of operations and could continue to do so in the future. In addition, if our rate of customer turnover were to increase significantly, our results of operations and or competitive position could be adversely affected. Several factors could influence our rate of acquisition of new customers and our rate of customer turnover, including competitive pressures from mobile telecommunication service providers and other fixed-line telecommunications providers, and economic conditions in Brazil.

Fluctuations in the real/U.S. dollar exchange rate may adversely affect our ability to pay U.S. dollar-denominated or U.S. dollar-linked obligations and could lower the market value of our preferred shares and ADSs.

The Brazilian currency has experienced devaluations in the past. The real was devalued against the U.S. dollar by 18.7% in 2001 and 52.3% in 2002. Over the next few years, in contrast, the real began appreciating against the U.S. dollar, increasing 18.2%, 8.1%, 11.8%, 8.7% and 17.2%, respectively, in 2003, 2004, 2005, 2006 and 2007.

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However, the real depreciated against the U.S. dollar by 31.9% in 2008. In 2009, the real appreciated against the U.S. Dollar by 25.5%. 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 as compared to the previously applicable index, the IGP-DI. Thus, since 2006, telecommunication revenues, when converted to U.S. dollars, do not adequately reflect the true effect of exchange rate fluctuations, so that our results of operations could be adversely affected. See “—Selected Financial Data—Exchange Rates” for more information on exchange rates.

As of December 31, 2009, 0.7% of our R\$3.52 billion total indebtedness was denominated in foreign currencies, primarily in U.S. dollars. As of December 31, 2008, we had currency hedges in place to cover virtually all of our foreign currency-denominated bank debt. Part of the costs relating to our network infrastructure is payable or linked to payment by us in U.S. dollars. However, other than income derived from hedging transactions and international long distance interconnection, all of our revenues are generated in reais. To the extent that the value of the real decreases relative to the U.S. dollar, our debt becomes more expensive to service and it becomes more costly for us to acquire technology and goods necessary to operate our business that have their prices linked to exchange rate fluctuations. The additional costs from our debt, however, are offset by revenues from corresponding hedging transactions and the exposure of our capital expenditures is constantly monitored so that it does not reach a material amount. Nevertheless, currency fluctuations are expected to continue and they can affect our financial income and expenses.

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

The market for securities issued by Brazilian companies may be influenced, in varying degrees, by economic and international market conditions, especially by those in Latin American and other emerging markets. 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, in particular those of the United States, may reduce investor demand for securities of Brazilian companies, including our preferred shares. Any of the foregoing developments may adversely affect the market value of our preferred shares and hinder our ability to access the capital markets and finance our operations in the future on acceptable terms and costs, or at all.

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

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

Increases in interest rates may have a material adverse effect on our business.

The Central Bank’s Monetary Policy Committee (Comitê de Política Monetária do Banco Central – COPOM), establishes the basic interest rate target for the Brazilian financial system by reference to the level of economic growth of the Brazilian economy, the level of inflation and other economic indicators. As of December 31, 2004, 2005, 2006, 2007 and 2008, the basic interest rate was 17.8%, 18.0%, 13.3%, 11.3% and 13.8%, respectively, and as of December 31, 2009, was 8.75%. Increases in interest rates may have a material adverse effect on us.



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Risks Relating to the Brazilian Telecommunications Industry and Us

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

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

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

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

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

We operate our business under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, expansion of our network to provide public pay-phone service for all areas with populations in excess of 100, expansion of our network to provide private individual telephone service for all areas 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, 2009, the net book value of reversible assets is estimated at R\$7.0 billion, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy



equipment and system and operation support equipment.

The expiration date of the original concession agreements was December 31, 2005, but it has since been renewed as of December 22, 2005 for an additional 20-year term. The current concession agreements contain a provision allowing ANATEL to review the concession terms in 2010, 2015 and 2020. This provision permits ANATEL to update the renewed concession agreements with respect to network expansion, modernization and quality of service targets in response to changes in technology, competition in the marketplace and domestic and international economic conditions. A Public Notice (consulta pública) was published on March 31, 2009 with the

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proposed revisions to the concession agreements and public meetings (audiências públicas) were held in Manaus, Salvador, São Paulo, Brasília, Florianópolis and Rio de Janeiro in May 2009.

ANATEL is currently analyzing the suggestions made to the Public Notice and it may vote on the final version of the concession agreements over 2010. The revised concession agreements will become effective as of January 1, 2011.

We face substantial competition from other fixed-line providers that may reduce our market share.

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

At the end of 2008, ANATEL approved a change to the General Plan of Grants or Plano Geral de Outorgas, allowing fixed-line providers to hold concession licenses within the same business group in more than one region. This change allowed for the merger between Oi and Brasil Telecom, operators in Regions I and II, respectively, thus redefining the competitive landscape in Brazil.

Number Portability was introduced in 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 was introduced for certain of our clients in September of 2008 and as of December 31, 2008, approximately 18% of our clients had Number Portability rights. The year 2009 was the first full fiscal year impacted by the effects of Number Portability. Number Portability rights for all of our clients became effective in March 2009. As a result of Number Portability, we had a small increase in the churn of our fixed-line customers. Mobile operators were more impacted by the effects of Number Portability. However, despite the impact being lower than expected thus far, an attack with an aggressive positioning of GVT can accelerate the demand for portability.

Any loss of market share as a result of competition from fixed-line providers could have an adverse effect on our business, financial condition and results of operations.

We face increasing competition from cellular service providers.

Rapid growth of the cellular telecommunications industry and intense competition among cellular service providers have resulted in lower prices for cellular services. Cellular services are increasingly becoming an alternative to fixed-line services, primarily for residential customers. We expect this to negatively impact the use of fixed telecommunications services and, therefore, mobile services are still the main competitive product to our services. Certain fixed-line services operating on mobile platforms are already common in the market, wherein a user will have two numbers, a mobile number and a fixed number, the latter functioning only in the user's area of residence or "home zone." Additionally, with Oi and AEIOU now operating in the State of São Paulo beginning in the second half of 2008, competition in the mobile telecommunications market has intensified, putting further pressure on the fixed-line telecommunications market. Any loss of market share as a result of competition from cellular service providers could have an adverse effect on our business, financial condition and results of operations.

The industry in which we conduct our business is subject to rapid technological changes that could have a material adverse effect on our ability to provide competitive services.

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. 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.

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As an example of the alternative technology, in December 2007, ANATEL auctioned frequencies for 3G services (third generation cellular telephone services) at premiums of almost 80% over minimum bid prices, for which all current operators as well as other new entrants into the market submitted bids. The 3G networks allow mobile broadband access at speeds and prices competitive with currently offered fixed broadband services, which could have an adverse effect on Speedy's growth and our results. Currently, all current mobile operators in the State of São Paulo (except AEIOU) provide 3G services at prices competitive with those of the fixed technology players in the market.

We seek to invest in new technology to remain competitive in a rapidly changing market. If we do not make sufficient investments in new technology or if our networks and technologies otherwise become outdated or obsolete, we may not be able to compete effectively against new, alternative technologies, which could have an adverse affect on our business, financial condition and results of operations.

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 most of our directors and executive officers and our independent public accountants 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.B—Additional Information—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 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, you may receive only the net proceeds from the sale of your preemptive rights by the depositary, 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 your rights, see "Item 10. Additional Information—B. Memorandum and Articles of Association—Preemptive Rights."

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

The ADSs benefit from the certificate of foreign capital registration, which permits The Bank of New York, as 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 2,689 of the Central Bank of Brazil, dated

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January 26, 2000 and issued by BACEN, which entitles certain investors to buy and sell shares on Brazilian stock exchanges without obtaining separate certificates of registration.

If holders of ADSs do not qualify under Resolution 2,689, they will generally be subject to less favorable tax treatment on distributions 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 non-residents of Brazil, whether to other non-residents or to Brazilian residents, will be subject to Brazilian taxation. The preferred shares are expected to be treated as assets located in Brazil for purposes of the law, and gains on the disposition of preferred shares, even by non-residents of Brazil, are expected to be subject to Brazilian taxation. In addition, the ADSs may be treated as assets located in Brazil for purposes of the law, and therefore gains on the disposition of ADSs by non-residents of Brazil may also be subject to Brazilian taxation. Although the holders of ADSs outside Brazil may have grounds to assert that Law No. 10,833 does not apply to sales or other dispositions of ADSs, it is not possible to predict whether that understanding will ultimately prevail in the courts of Brazil, given the general and unclear scope of Law No. 10,833 and the absence of judicial court rulings in respect thereto. See "Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations."

### Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

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

## ITEM 4. INFORMATION ON THE COMPANY

### A. History and Development of the Company

#### General

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

As of December 31, 2009, we had 168,609,291 outstanding common shares, with no par value per share, and 337,232,189 preferred shares, with no par value per share. Our shareholders' equity was in the amount of R\$10.1 billion as presented under the Brazilian Corporate Law Method.

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

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

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

We also provide multimedia communication services (“serviços de comunicação multimídia” or “SCM”) such as audio, data, voice and other sounds, images, texts and other information. ANATEL granted the SCM license with Act No. 33,791 of February 14, 2003. Telesp possesses one license, for Sectors 31 (our predecessor company’s area prior to the reorganization), 32 (the area corresponding to Ceterp prior to our acquisition) and 34 (CTBC Borda’s area prior to the reorganization).

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

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

In 2008, the Company pioneered the launch of internet access through fiber optic cables (“Fiber to the Home” - FTTH) for non-commercial customers. Aside from the offer of an internet connection with high-speed capacities of 8 Mbps and 30 Mbps, various bundles have also been offered, including Wi-Fi, Digital TV, 2,000 minutes of local and intra-state calls, anti-virus protection, call identification, technical assistance and specific call center assistance.

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

As of December 31, 2009, our telephone network included 11.3 million fixed lines in service, 2.6 million broadband clients and 0.5 million Pay TV clients. Of the access lines in service, approximately 72% were residential, 23% were commercial, 2% were public telephone lines and 3% were for our own use and testing.

## Historical Background

### The Restructuring and Privatization

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

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



In July 1998, the federal government privatized the Telebrás System, selling substantially all its shares in the new holding companies, including 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.

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### The Reorganization of TelespPar

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

### Ceterp's Acquisition

On December 20, 1999, we began the acquisition, through a public auction from the municipal government of the City of Ribeirão Preto, in the State of São Paulo, 51.0% of the voting shares and 36.0% of the total share capital of Centrais Telefônicas de Ribeirão Preto S.A., or Ceterp. Ceterp provided fixed-line and cellular services in the State of São Paulo, outside the Telebrás System, and had been one of our minor competitors.

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

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

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

### Attainment of ANATEL Targets

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

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

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

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

### IP Network Asset Acquisition

On December 10, 2002, after receiving approval from ANATEL, our Board of Directors approved a proposal to acquire certain assets from 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

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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 provides 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 “Companies”), approved the restructuring of the Companies’ serviços de comunicação multimídia (“SCM”), or multimedia communications services, and data transmission activities (the “SCM Restructuring”).

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

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

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

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

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

On October 29, 2006, the Company entered into an agreement with Abril Comunicações S.A., TVA Sistema de Televisão S.A., Comercial Cabo TV São Paulo Ltda., TVA Sul Paraná Ltda., and TVA Radioenlaces Ltda. (the “Abril Group”), whereby we combined our telecommunications and broadband services with the broadband and cable services

of Tevecap S.A., or TVA, the second largest Brazilian pay TV provider with operations in the states of Paraná, Rio Grande do Sul, São Paulo and Rio de Janeiro. Through this transaction, we broadened our services to meet our users' increasing demand, combining the Abril Group's expertise in content and media production and placement with the expertise of the Telefónica Group in the telecommunications segment.

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

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

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

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

### Corporate Reorganization involving Ajato

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

### Corporate Reorganization involving DABR and TTP

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

On November 11, 2008, the merger of TTP and DABR was approved by our Extraordinary Shareholders Meeting.

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

As a result of this restructuring: (i) TTP was dissolved; (ii) its shares were cancelled and Telesp’s participation in TTP was exchanged for the respective net assets, without any increase in capital stock or issuance of new shares for Telesp; (iii) Telesp assumed all rights and obligations of TTP, (iv) administrative costs were reduced, the goodwill in connection with the acquisition of TTP was transferred to Telesp, which can be amortized will result in a tax benefit of R\$288 million, based on future yield, and (v) since TTP was a wholly-owned subsidiary of Telesp, the transfer to Telesp of the net equity of TTP 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.

Moreover, following the approval of this restructuring: (i) DABR was dissolved; (ii) Telesp succeeded DABR in all of its rights and obligations; (iii) Telesp's capital stock held by DABR was directly attributed to the controlling shareholder of DABR, SP Telecomunicações Participações Ltda., in exchange for the interests it then held in DABR, and the shares retained the same rights as the shares issued by Telesp; (iv) an increase in Telesp's capital resulted, without the issuance of new shares; (v) DABR's net worth – comprising an amount equivalent to DABR's investment in Telesp and an amount corresponding to goodwill resulting from the shares received by Telesp – was transferred to Telesp, and the amortization of the goodwill resulted in a fiscal benefit to Telesp, which was accounted for in Telesp's Goodwill Special Reserve account in net equity, which shall be capitalized to the

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Company's controlling shareholder, SP Telecomunicações Participações Ltda., at which time the minority shareholders will be assured the right of first refusal to subscribe said capital increase and any amounts paid by them shall be delivered to the controlling shareholder; and (vi) the capitalization of the portion of the Goodwill Special Reserve in share capital, in the amount corresponding to the fiscal benefit, will be realized at the end of each fiscal year to the extent that this benefit represents an effective decrease in the taxes paid by Telesp.

Recent Developments

Corporate Restructuring involving A.TELECOM S.A.

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

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

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

The transaction can be summarized as follows: (1) a partial spin-off of A.TELECOM and the subsequent merger into Telesp of the spun-off part (including the assets, rights and liabilities) was approved pursuant to Article 229 of Brazilian Corporate Law; (2) as a result of the spin-off, the capital of A.TELECOM was reduced in the proportion of the spun-off part valued at R\$99,292,785.24 and the corresponding shares held by Telesp were cancelled; (3) A.TELECOM's spun-off part was merged into Telesp. There was no capital increase for Telesp as a result of the merger because A.TELECOM is a wholly-owned subsidiary of Telesp. Telesp incurred a reduction in its investment accounted in its fixed assets. All assets and liabilities existing on the spin-off special balance sheet were transferred to Telesp, with no changes to its equity; (4) any changes to A.TELECOM's equity between the date of the appraisal report and the shareholders' meeting that approved the merger were absorbed by A.TELECOM; (5) Telesp became liable only for the liabilities that were expressly transferred to it as a result of the merger as memorialized in the Protocol of Merger and the spin-off special balance sheet, with no joint liability with A.TELECOM. There are no material contingencies or off-balance sheet liabilities transferred to Telesp as result of the merger of the spun-off part of A.TELECOM.



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## Corporate Structure and Ownership

Our general corporate and shareholder structure is as follows:

## Capital Expenditures

We are permitted to determine our own capital expenditure budget, subject to compliance with certain obligations to expand service under the concession. With this in mind, we were focused in voice services in order to comply with ANATEL's targets and to provide quality service for clients. Also, in order to achieve a consolidated position in the broadband and Pay TV market, during 2009 the focus of our capital expenditure has been, and continues to be, expanding, modernizing and upgrading our ADSL network, increasing the base of Pay TV and improving our systems and processes of customers relations, marketing and sales.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2009.

	Year ended December 31,		
	2009	2008	2007
	(in millions of reais)		
Switching equipment	73.5	61.1	54.7
Transmission equipment	266.7	226.6	264.5
Infrastructure	121.9	56.0	45.6
External network	463.2	433.4	356.0
Data transmission	426.2	559.8	444.7
Line support equipment	378.3	471.8	380.2
Administration (general)	430.9	459.2	368.5
Other	60.3	74.6	78.3
Total capital expenditures	2,221.0	2,342.5	1,992.5

In addition to the consolidation of our broadband market position, the primary focus of our capital expenditure program has been, and continues to be, the expansion, modernization and digitalization of the network in order to comply with ANATEL's targets and to provide quality service for our clients. See “—B. Business Overview—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies.”

We anticipate that our capital expenditures for 2010 will be approximately R\$2.3 billion. We expect to fund these expenditures with funds internally generated from our operations and through debt.

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### B. Business Overview

#### Our Region

The State of São Paulo covers an area of 248,809 square kilometers, representing approximately 2.9% of Brazil's territory. The population of the State of São Paulo is approximately 40.6 million, representing 21.6% of Brazil's total population. Based on the most recent data available, the gross domestic product, or GDP, of the State of São Paulo in 2007 was an estimated R\$902.8 billion, or approximately US\$509.9 billion, representing approximately 34% of Brazil's GDP for the year. The State of São Paulo's annual per capita income during 2007 was an estimated R\$22.7 thousand, or approximately US\$12.6 thousand.

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

Our concession region is Region III, which is comprised of 622 municipalities, including the City of São Paulo, with an aggregate population of approximately 40.6 million. Of the municipalities in Region III, 72 have populations in excess of 100,000. The City of São Paulo has a population of approximately 11 million. According to the plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the State of São Paulo was divided into four sectors, including Sectors 31 (our predecessor company's area prior to the reorganization), 32 (the area corresponding to Ceterp prior to our acquisition), 33 (corresponding to the portion of the State of São Paulo that we do not service) and 34 (CTBC Borda do Campo area prior to the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. According to the Presidential Decree regarding the new General Plan of Grants, published in the Diário Oficial da União on November 21, 2008, we were given a period of 18 months for the unification of the three sectors for which we act as a concessionaire (sectors 31, 32 and 34).

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

#### Services

##### Overview

Our services consist of:

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

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

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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—Public Regime Service Restrictions.”

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

The monthly and usage fees for our services (local and long-distance) were initially determined in our concession agreements. From March 2007 until July 31, 2007, the billing system was converted to a minute basis and the former measurement based on pulses was discontinued for all customers. Our concession agreements also set forth criteria for annual fee adjustments. We derive a substantial portion of our revenues 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.

The following table sets forth our operating revenue for the years indicated. Our fees for each category of service are discussed below under “—Rates and Taxes.” For a discussion of trends and events affecting our operating revenue, see “Item 5—Operating and Financial Review and Prospects.”

	Year ended December 31,		
	2009	2008	2007
	(in millions of reais)		
Local service	8,138	8,609	9,125
Intraregional service	2,672	2,644	2,006
Interregional long-distance service	1,199	1,165	1,215
International long-distance service	113	140	134
Data transmission	4,176	3,760	2,996
Fixed-to-mobile services	4,102	4,372	4,064
Network usage services	488	466	405
Network Access	509	384	319
TV service	600	379	54
Other	1,158	1,102	866
Total	23,155	23,021	21,184
Taxes and discounts	(7,360)	(7,042)	(6,456)
Net operating revenue.	15,795	15,979	14,728

## Local Service

Local service includes activation, monthly subscription, measured service and public telephones. Measured service includes all calls that originate and terminate within the same local area or municipality of our concession region, which we refer to as “local calls.” Excluding the portion of our region that was serviced by Ceterp before our acquisition in December 1999, we were the only supplier of local fixed-line and intraregional long-distance telecommunications

services in our region until July 1999. At that time, licenses were auctioned to permit a competitor to provide local fixed-line and intraregional long-distance telecommunications services in our region, including the area formerly served by Ceterp. Vésper São Paulo S.A. received authorization and began operations in

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December 1999. Embratel, Br Telecom and Telemar also provide local services in our concession region. See “—Competition.”

Telesp became the first telephone service concessionaire in Brazil to offer local services outside its concession region (the State of São Paulo). In May 2003, we achieved the network expansion and universal service targets established by ANATEL, and began providing local services to six other states in Brazil, including Sergipe, Espírito Santo, Rio Grande do Sul, Paraná, Santa Catarina and certain areas in Rio de Janeiro. In May 2004, we began providing local telephone services in seven other states in Brazil, including those in the capitals of Pará, Roraima, Amapá, Rondônia, Maranhão, Tocantins and Acre. In May 2005, we also began to provide local telephone services in the capitals of the following states: Ceará, Amazonas, Pernambuco, Rio de Janeiro, Bahia, Mato Grosso do Sul and Mato Grosso. Since May 2006, we have also been providing local telephone services in Brasília (Distrito Federal) and Goiânia, the capital of the State of Goiás. We have not had any activations since 2007.

### Intraregional Long-Distance Service

Intraregional long-distance service consists of all calls that originate in one local area or municipality and terminate in another local area or municipality of our concession region. We were the sole provider of intraregional long-distance service in our region until July 3, 1999, when the federal government also authorized Embratel and Intelig to provide intraregional long-distance services. Embratel, Br Telecom and Telemar also provide long-distance services in our concession region. See “—Competition.”

### Interregional and International Long-Distance Service

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

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

### Network Services

Brazil is divided into four regions in relation to telecommunication services with the following incumbent service providers: (i) Region I, that encompasses the North and Northeast regions of Brazil and in which concessions are granted to Oi (Telemar) and CTBC Telecom; (ii) Region II, that encompasses the South and Center-West regions of Brazil and in which concessions are granted to Oi (Brasil Telecom), CTBC Telecom, and Sercomtel; (iii) Region III, that encompasses the State of São Paulo and in which concessions are granted to Telefônica 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.

In 2005, after meeting the targets imposed in the concession agreement two years before the target date, Telefônica started to operate in Regions I and II, expanding its long-distance network to the main Brazilian cities, providing services in the main markets with infrastructure based on new generation platforms.

By the end of 2009, 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 and Goiânia.

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

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

In 2007, we developed network solutions and invested significant funds to adapt its network to ANATEL's Number Portability requirements. The implementation of Number Portability in the State of São Paulo was effectively initiated in September 2008 and fully implemented in March 2009. Systems and processes adjustments are still in progress in order to improve support to Number Portability requirements.

Competition for long-distance service has increased and by the end of 2009 there were a total of 34 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora - CSP). A new pre-paid attendant service for long-distance call forwarding has been implemented, as well as satellite services for providing circuits in remote areas for wholesale and large customers.

### Other Services

Currently, we also provide a variety of other telecommunications services that extend beyond basic telephone service, including interactive banking services, electronic mail and other similar services.

As a result of our acquisition of certain assets from Telefónica Data S.A. in 2002, we also started providing 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.

### Interconnection

In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to have 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) an offer of interconnections for Internet Service Providers (ISPs); (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which new interconnection solicitations are answered. These reforms have facilitated market entry for new operators.

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

Telesp has also 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 in their regions.



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

According to the Personal Mobile Service (SMP) regulation, the Mobile Network Interconnection Fee (VUM) price is subject to free negotiation between parties and once an agreement is reached it should be homologated by ANATEL to take effect. The agreement currently in effect was executed in 2008.

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Starting in November 2009, the licenses of each mobile operator were consolidated by region, resulting in the consolidation of tariffs and in the reduction from two to one VUM in the fees owed for on-net network traffic.

At the end of 2009, Telefônica was party to 187 local and long-distance interconnection agreements and 91 traffic and transport agreements.

### I-Telefônica

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

### Authorization to Provide Multimedia Services

On January 29, 2003, ANATEL granted our SCM license nationwide, allowing A. Telecom S.A. (formerly Assist Telefônica), 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 paid TV via satellite (Direct to Home – DTH). DTH is one of the special types of subscription TV services that utilize satellites for the direct distribution of television and audio signals for subscribers. The launching of the commercial transaction occurred on August 12, 2007.

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

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

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

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated to the Multichannel Multipoint Distribution Service (MMDS) in São Paulo, Curitiba, Rio de Janeiro and

Porto Alegre. ANATEL is currently analyzing the price to be paid for the spectrum usage.

The STFC Concession Agreement

As mentioned above, we are a concessionaire of STFC to render local and domestic long-distance call services originated in Region III, which comprises the State of São Paulo, in Sectors 31, 32 and 34, established in the General Concession Plan (PGO).

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The current concession agreement, dated December 22, 2005, was renewed on January 1, 2006, and will be valid until December 31, 2025. However, the agreement can be reviewed by ANATEL on December 31, 2010, 2015 and 2020. Based on such review, ANATEL may establish new requirements and targets for universal and high quality telecommunication services, according to the conditions present at the time of review.

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 its prior-year SFTC revenue, net of taxes and social contributions. The first payment of this biennial fee occurred on April 30, 2007, based on the 2006 STFC net revenues, and the second payment occurred on April 30, 2009, based on the 2008 STFC net revenues. The next payment is scheduled for April 30, 2011 based on the 2010 net revenues. See Note 20 to our Consolidated Financial Statements.

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

### Corporate Customer Services

We offer our corporate clients comprehensive telecommunications solutions and IT support designed to address specific needs and requirements of companies operating in a number of different market segments such as manufacturing, services, financial institutions and government.

Our clients are assisted by our highly qualified professionals who offer specialized telecommunication and IT support tailored to meet the specific needs of each company by delivering corporate Internet access, voice and data solutions, and by consistently striving for greater service efficiency to preserve our competitiveness in our market.

### Rates and Taxes

#### Rates

#### Overview

We generate revenues 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 for an additional 20 years until 2025 (all of our relevant concession agreements were renewed), establish a price cap for annual rate adjustments.

As of January 2006, with the renewal of our concession agreements until December 31, 2025, new readjustment rules for fees became effective. The current contract may be reviewed and modified by ANATEL on December 31, 2010, 2015 and 2020 to set forth new terms that account for conditions existing at the time of that future review.

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

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local fee basket has a different weight and, as long as the total local fee price adjustment does not exceed the rate of increase in the Telecommunication General Price Index, or IST, minus a productivity factor as established in the concession agreements, each individual fee within the basket can exceed the IST variation by up to 5%;

- installation of residential and commercial lines and public telephone services, with adjustments limited to the rate of increase in the IST minus a productivity factor as established in the concession agreements; and
- domestic long-distance services, with rate adjustments divided into intraregional and interregional long-distance services, which are calculated based on the weighted average of the traffic, and taking into account time and distance. For these categories, each fee may individually exceed the rate of increase in the IST by up to 5%; however, the total adjustments in the basket of fees cannot exceed the rate of increase in the IST minus a productivity factor as established in the concession agreements. See “—Regulation of the Brazilian Telecommunications Industry.”

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

Local Rates

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

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

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

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

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

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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\$0.15596
Sector 34	-	R\$0.15192
Sector 32	-	R\$0.16365
Local Minutes - charges in excess use of the allotment		
Sector 31	R\$0.10158	R\$0.03899
Sector 34	R\$0.10158	R\$0.03798
Sector 32	R\$0.10158	R\$0.04091
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\$0.20316	R\$0.15596
Sector 34	R\$0.20316	R\$0.15192
Sector 32	R\$0.20316	R\$0.16365

The fees for Local Basic Plan Service were approved by ANATEL's Act No. 5,180 of September 11, 2009. 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.

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

On September 11, 2009, ANATEL's Act No. 5,180 approved new local tariffs for our areas of concession, to take effect as of September 16, 2009. The average readjustment in the local service basket was 0.9767%. The tariffs were applied to customers as demonstrated below:

- Residential customers were charged a monthly subscription fee for the provision of service of R\$40.35;
- Commercial clients and non-residential customers (PBX) were charged a monthly subscription fee for the provision of service of R\$69.22 in Sector 31, R\$67.38 in Sector 34 and R\$64.30 in Sector 32;
  - Local minute tariffs were charged R\$0.10158 per minute to Sectors 31, 32 and 34; and
- Activation fees were charged R\$113.53 in Sector 31, R\$93.44 in Sector 34 and R\$60.63 in Sector 32.



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### Intraregional and Interregional Long-Distance Rates

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

On March 1, 2002, ANATEL acknowledged that we had reached its network expansion and universal service targets two years prior to the scheduled date. As a result, on April 25, 2002, ANATEL published an order that allowed us to be the first concessionaire to provide the full range of STFC services and expanded our license to develop services in the local, intraregional, interregional and international markets throughout Brazil.

On April 29, 2002, certain provisions of ANATEL's order were partially suspended as a result of certain legal proceedings brought by Embratel. The proceedings prevented us, as a concessionaire, from commencing our interregional services that originated in our concession region, Region III, and terminated in other concession areas, namely Region I (Telemar's concession region) and Region II (Brazil Telecom's concession region). However, our authorization to provide local and interregional services in Regions I and II, Sector 33 of Region III, and international services in all three regions was not affected. On June 28, 2002, ANATEL dismissed the proceedings and allowed us to begin offering interregional services originating in our concession region.

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

### International Long-Distance Rates

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

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

### Network Usage Charges

We earn revenues 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."

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

- Fee for the use of our local network—We charge long-distance service providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network. We

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charge local service providers a fee for traffic that exceeds 55% of the total local traffic between the two service providers.

- Fee for the use of our long-distance network—We charge the service providers a network usage charge on a per-minute basis only when the interconnection access to our long-distance network is in use.
- Fee for the rental of certain transmission facilities used by another service provider in order to place a call.

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

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

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

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

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

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

## Data Transmission Rates

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

Operations” and “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

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## Taxes

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

Other taxes on gross operating revenues include two federal taxes, the Contribuição para o Programa de Integração Social or “PIS,” and Contribuição para o Financiamento da Seguridade Social or “COFINS,” imposed on gross operating revenues at a combined rate of 3.65% for telecommunications services and 9.25% for other services. 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 revenues. COFINS is a tax designed to finance special social programs created and administered by the Brazilian government. On February 2, 2004, the combined rate of PIS and COFINS imposed on gross operating revenues generated by services other than telecommunications services increased from 3.65% to 9.25% (on a non-cumulative basis). However, revenues related to, among other things, equity, dividends and fixed asset sales, are not subject to PIS and COFINS, except for revenues relating to hedging transactions and interest on shareholders’ equity (juros sobre o capital próprio).

In addition, the following contributions are imposed on certain telecommunications services revenues:

- Contribution for the Fund for Universal Access to Telecommunications Services—“FUST”. FUST was established in 2000 to provide resources to cover the cost exclusively attributed to fulfilling obligations (including free access to telecommunications services by governmental institutions) of universal access to telecommunications services that cannot be recovered with efficient service exploration or that is not the responsibility of the concessionaire. Contributions to FUST by all telecommunications services companies began in January 2001, at the rate of 1% of net operating telecommunications services revenue (except for interconnection revenues), and it may not be passed on to customers.
- Contribution for the Fund of Telecommunications Technological Development—“FUNTTEL.” FUNTTEL was established in 2000, in order to stimulate technological innovation, enhance human resources development, create employment opportunities and promote access by small and medium-sized companies to capital resources, so as to increase the competitiveness of the Brazilian telecommunications industry. Contributions to FUNTTEL by all telecommunications services companies began in March 2001, at the rate of 0.5% of net operating telecommunications services revenue (except interconnection revenues), and it may not be passed on to customers.

We must also pay a contribution to the Fund for Telecommunications Regulation—“FISTEL.” FISTEL is a fund supported by a tax applicable to telecommunications operators (the “FISTEL Tax”) and was established in 1966 to provide financial resources to the Brazilian government for the regulation and inspection of the telecommunications sector. The FISTEL Tax consists of two types of fees: (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. The amount of the installation inspection fee is a fixed charge, depending upon the kind of equipment installed in the authorized telecommunications station. The operations inspection fee equals 50% of the total amount of the installation inspection fee that would have been paid with respect to existing equipment.

## Billing and Collection

We send each customer a monthly bill covering all of the services provided during the prior period. Telephone service providers are required under Brazilian law to offer their customers the choice of at least six different payment dates within the monthly billing cycle. In our case, customers are divided into 16 different groups, and each group receives a bill according to a specific billing date within the monthly billing cycle.

We have a billing and collection system with respect to fixed-line-to-fixed-line and fixed-line-to-mobile for local, long-distance, subscription and receivables services. Payments of the bills are effected under agreements with

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various banks and other collection agencies (including lottery-playing facilities, drugstores and supermarkets) either by debiting the customer's checking account, by direct payment to a bank or through the Internet.

In accordance with the Brazilian telecommunications regulations, we use a billing method called "co-billing." This method allows billing from other phone service providers to be included within our own invoice. Our customers can receive and subsequently pay all of their bills (including the fees for the use of services of another telephone service provider) by using one invoice. To allow for this method of billing, we provide billing and collection services to other telephone service companies and have developed a special system for such bills. We have co-billing agreements ("co-billing in") with Intelig, Embratel, Telemar/TNL, GVT, CTBC Telecom, IP Corp, Brasil Telecom and Convergia, each of which provides fixed-line services, and with TIM, which provides mobile services. Similarly, we use the same method of co-billing to bill charges for our services on the invoices of other telephone service providers. We have co-billing agreements of this nature ("co-billing out") with Telemar, CTBC Telecom, Brasil Telecom, Sercomtel, GVT and Embratel, each of which provides fixed-line services, and with Oi, Tim, Sercomtel Celular, CTBC Celular, Brasil Telecom Celular, VIVO and Claro, each of which provides mobile services.

ANATEL regulations allow us to prevent a customer from making outgoing calls after a receivable has been outstanding for 30 days—a partial block—or prevent a customer from making outgoing or receiving incoming calls—a total block—after 60 days, and to disconnect a customer upon failure to pay after 90 days. During 2009, the monthly average of partial blocks was 884,750 telephone lines and the monthly average of total blocks was 156,009 telephone lines. On December 31, 2009, 10.2% of all receivables had been outstanding between 30 and 90 days, and 40.3% of all receivables had been outstanding for more than 90 days. For a discussion of provisions for past due accounts, see "Item 5—Operating and Financial Review and Prospects."

We continue working on improving the system to control the revenue chain. This control is important for continual improvements in our billing and collections processes, as well as for the assurance of the non occurrence of losses in the implementation of new systems and in roll-outs. The actions are followed closely by our Revenue Assurance Team, which measures every risk of loss of revenue detected along the billing and collection chain. These risks are managed to minimize revenue losses.

### Network and Facilities

Our network consists of an access layer, that connects our clients to our central switching voice and data hubs, and a network transport layer for managing client concentration, which also connects our clients to our central hubs. These central hubs are interconnected locally or remotely through transmission equipment, which forms a layer of network services that interconnect with other operators. Local transmission is provided through fiber-optic and metallic trunk lines. Intraregional long-distance transmission is provided by fiber-optic cable or by a microwave network. Our network strategy is to develop a broadband integrated network that is compatible with several types of telecommunications services 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 mount our networks and facilities through which we supply our services. The following table sets forth selected information about our network in aggregate, at the dates and for the years indicated:

	At and for Year ended December 31,				
	2009	2008	2007	2006	2005
Installed access lines (millions)	14.5	14.7	14.6	14.4	14.3
Access lines in service (millions) (1)	11.3	11.7	12.0	12.1	12.3
Average access lines in service (millions)	11.5	11.8	12.0		