

BRASIL TELECOM SA  
Form 20-F/A  
May 02, 2011  
Table of Contents

As filed with the Securities and Exchange Commission on May 2, 2011

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 20-F/A  
(Amendment No. 1)**

- .. REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR
- x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
FOR THE FISCAL YEAR ENDED DECEMBER 31, 2010  
OR
- .. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
OR
- .. SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934  
Commission file number: 001-15256

**BRASIL TELECOM S.A.**

(Exact Name of Registrant as Specified in Its Charter)

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N/A  
(Translation of Registrant's Name into English)

The Federative Republic of Brazil  
(Jurisdiction of Incorporation or Organization)

Rua General Polidoro, No. 99, 5th floor/part Botafogo

22280-001 Rio de Janeiro, RJ, Brazil

(Address of Principal Executive Offices)

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Investor Relations Officer

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(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)

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

Title of Each Class	Name of Each Exchange on which Registered
Common Shares, without par value, each represented by American Depositary Shares	New York Stock Exchange
Preferred Shares, without par value, each represented by American Depositary Shares	New York Stock Exchange

**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**

**The total number of issued shares of each class of stock of Brasil Telecom S.A. as of December 31, 2010 was:**

203,423,176 common shares, without par value

399,597,370 preferred shares, without par value

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

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

U.S. GAAP  International Financial Reporting Standards as issued  Other

by the International Accounting Standards Board

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

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

**Table of Contents**

**EXPLANATORY NOTE**

This Amendment No. 1 to our annual report on Form 20-F for the fiscal year ended December 31, 2010, which was originally filed with the U.S. Securities and Exchange Commission on May 2, 2010 (our Original 2010 20-F ), is being filed solely for the purpose of amending our Original 2010 20-F to reflect the correction of contractual obligations under our maintenance contracts contained in the contractual commitments table and related disclosures.

This Amendment No. 1 has not been updated except as required to reflect the revisions stated above. This Amendment No. 1 only amends and restates the Items described below as required to reflect the revisions described above and does not reflect events that have occurred after the May 2, 2011 filing date of our Original Form 20-F, or modify or update other disclosures presented therein.

This Amendment No. 1 amends and restates the following Items:

Part I Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Projected Sources and Uses of Cash.

Part I Item 5. Operating and Financial Review and Prospects Contractual Commitments.

Part III Item 19. Exhibits.

While the above Items have been reproduced in full as required by Rule 12b-15 under the Securities Exchange Act of 1934, as amended, no changes have been made to such Items, except to reflect the corrections stated above, or to any other Items.

In addition, this Amendment No. 1 includes currently dated certifications by the Chief Executive Officer and the Chief Financial Officer pursuant to 17 CFR 240.15D-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, that are attached to this Amendment No. 1 as Exhibits 12.01 and 12.02 and 13.01.

**Table of Contents****TABLE OF CONTENTS**

	<b>Page</b>
<u>PRESENTATION OF FINANCIAL AND OTHER INFORMATION</u>	iii
<u>CAUTIONARY STATEMENT WITH RESPECT TO FORWARD-LOOKING STATEMENTS</u>	iv
PART I	
Item 1. <u>Identity of Directors, Senior Management and Advisers</u>	1
Item 2. <u>Offer Statistics and Expected Timetable</u>	1
Item 3. <u>Key Information</u>	1
Item 4. <u>Information on the Company</u>	20
Item 4A. <u>Unresolved Staff Comments</u>	66
Item 5. <u>Operating and Financial Review and Prospects</u>	67
Item 6. <u>Directors, Senior Management and Employees</u>	98
Item 7. <u>Major Shareholders and Related Party Transactions</u>	108
Item 8. <u>Financial Information</u>	115
Item 9. <u>The Offer and Listing</u>	123
Item 10. <u>Additional Information</u>	130
Item 11. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	151
Item 12. <u>Description of Securities Other Than Equity Securities</u>	153
PART II	
Item 13. <u>Defaults, Dividend Arrearages and Delinquencies</u>	154
Item 14. <u>Material Modifications to the Rights of Security Holders and Use of Proceeds</u>	154
Item 15. <u>Controls and Procedures</u>	154
Item 16A. <u>Audit Committee Financial Expert</u>	156
Item 16B. <u>Code of Ethics</u>	156
Item 16C. <u>Principal Accountant Fees and Services</u>	156
Item 16D. <u>Exemptions from the Listing Standards for Audit Committees</u>	157
Item 16E. <u>Purchases of Equity Securities by the Issuer and Affiliated Purchasers</u>	157
Item 16F. <u>Change in Registrant's Certifying Accountant</u>	157
Item 16G. <u>Corporate Governance</u>	157
PART III	
Item 17. <u>Financial Statements</u>	161
Item 18. <u>Financial Statements</u>	161
Item 19. <u>Exhibits</u>	161
<u>SIGNATURES</u>	164

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**Table of Contents**

**PRESENTATION OF FINANCIAL AND OTHER INFORMATION**

All references herein to *real*, *reais* or R\$ are to the Brazilian *real*, the official currency of Brazil. All references to U.S. dollars, dollars or U are to U.S. dollars.

On April 26, 2011, the exchange rate for *reais* into U.S. dollars was R\$1.565 to US\$1.00, based on the selling rate as reported by the Central Bank of Brazil (*Banco Central do Brasil*), or the Central Bank. The selling rate was R\$1.666 to US\$1.00 at December 31, 2010, R\$1.741 to US\$1.00 at December 31, 2009, and R\$2.337 to US\$1.00 at December 31, 2008, in each case, as reported by the Central Bank. The *real*/U.S. dollar exchange rate fluctuates widely, and the selling rate at April 26, 2011 may not be indicative of future exchange rates. See Item 3. Key Information Exchange Rates for information regarding exchange rates for the *real* since January 1, 2006.

Solely for the convenience of the reader, we have translated some amounts included in Item 3. Key Information Selected Financial Information and in this annual report from *reais* into U.S. dollars using the selling rate as reported by the Central Bank at December 31, 2010 of R\$1.666 to US\$1.00. These translations should not be considered representations that any such amounts have been, could have been or could be converted into U.S. dollars at that or at any other exchange rate.

Unless otherwise indicated or the context otherwise requires:

all references to Brasil Telecom are to Brasil Telecom S.A.;

all references to our company, we, our, ours, us or similar terms are to Brasil Telecom S.A. and its consolidated subsidiaries;

all references to our Common ADSs are to American Depositary Shares, or ADSs, each representing one common share of our company, all references to our Preferred ADSs are to ADSs, each representing three preferred shares of our company, and all references to our ADSs are to our Common ADSs and Preferred ADSs;

all references to Brazil are to the Federative Republic of Brazil; and

all references to the Brazilian government are to the federal government of the Federative Republic of Brazil.

**Financial Statements**

We maintain our books and records in *reais*.

Our consolidated financial statements at December 31, 2010 and 2009 and for the two years ended December 31, 2010 have been audited, as stated in the report appearing herein, and are included in this annual report.

We prepared our consolidated financial statements included in this annual report in accordance with International Financial Reporting Standards, or IFRS, as issued by the International Accounting Standards Board, or the IASB. These consolidated annual financial statements are our first annual consolidated financial statements to be prepared in accordance with IFRS. IFRS 1, First-time Adoption of International Reporting Standards, has been applied in preparing these consolidated financial statements, considering that our previous primary GAAP was Brazilian GAAP and that we have considered January 1, 2009 as the date of transition to IFRS. Reconciliations and descriptions of the effects of the transition from Brazilian GAAP to IFRS are included in note 3 to our consolidated financial statements.

Until December 31, 2009, we prepared our consolidated financial statements in accordance with accounting practices adopted in Brazil in effect on and prior to December 31, 2009, or Prior Brazilian GAAP, which were based on:



## **Table of Contents**

Brazilian Law No. 6,404/76, as amended by Brazilian Law No. 9,457/97, Brazilian Law No. 10,303/01, and Brazilian Law No. 11,638/07, which we refer to collectively as the Brazilian Corporation Law;

the rules and regulations of the Brazilian Securities Commission (*Comissão de Valores Mobiliários*), or the CVM, the accounting standards issued by the Brazilian Institute of Independent Accountants (*Instituto dos Auditores Independentes do Brasil*), or Ibracon, and the Brazilian Federal Accounting Council (*Conselho Federal de Contabilidade*), or CFC; and

the accounting standards issued by the Brazilian Accounting Standards Committee (*Comitê de Pronunciamentos Contábeis*), or the CPC, and applicable on and prior to December 31, 2009.

In preparing our consolidated financial statements as of and for the two years ended December 31, 2010, the comparative figures in respect of 2009 have been restated to reflect the effects of the transition from Prior Brazilian GAAP to IFRS.

We also prepare individual financial statements in accordance with accounting practices adopted in Brazil, or Brazilian GAAP, which include the pronouncements issued by the CPC applicable to dates and periods ended after December 31, 2009, for certain purposes, including for the calculation of dividends.

### **Share Split**

On April 10, 2007, we authorized the reverse split of all of our issued common shares and preferred shares into one share for each 1,000 issued shares. This reverse share split became effective on May 14, 2007. In connection with this reverse share split, we authorized a change in the ratio of our Preferred ADS. Upon the effectiveness of our reverse share split and the ratio change, the ratio of our preferred shares to our Preferred ADSs, changed from 3,000 preferred shares per Preferred ADS to three preferred shares per Preferred ADS. All references to numbers of shares and dividend amounts in this annual report have been adjusted to give effect to the 1,000-for-one reverse share split.

### **Market Share and Other Information**

We make statements in this annual report about our market share and other information relating to the telecommunications industry in Brazil. We have made these statements on the basis of information obtained from third-party sources and publicly available information that we believe are reliable, such as information and reports from the Brazilian federal telecommunications regulator (*Agência Nacional de Telecomunicações*), or ANATEL, among others. Notwithstanding any investigation that we may have conducted with respect to the market share, market size or similar data provided by third parties or derived from industry or general publications, we assume no responsibility for the accuracy or completeness of any such information.

### **Rounding**

We have made rounding adjustments to reach some of the figures included in this annual report. As a result, numerical figures shown as totals in some tables may not be arithmetic aggregations of the figures that precede them.



**Table of Contents**

**CAUTIONARY STATEMENT WITH RESPECT TO FORWARD-LOOKING STATEMENTS**

This annual report contains forward-looking statements. Some of the matters discussed concerning our business operations and financial performance include forward-looking statements within the meaning of the U.S. Securities Act of 1933, as amended, or the Securities Act, or the U.S. Securities Exchange Act of 1934, as amended, or the Exchange Act.

Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as expects, anticipates, intends, plans, believes, estimates and similar expressions are forward-looking statements. Although we believe that these forward-looking statements are based upon reasonable assumptions, these statements are subject to several risks and uncertainties and are made in light of information currently available to us.

Our forward-looking statements may be influenced by factors, including the following:

competition in the Brazilian telecommunications sector;

our management's current expectations and estimates concerning our future financial performance, financing plans and programs;

the Brazilian government's telecommunications policies that affect the telecommunications industry and our business in general, including issues relating to the remuneration for the use of our network, and changes in or developments of ANATEL regulations applicable to us;

the cost and availability of financing;

the general level of demand for, and changes in the market prices of, our services;

our ability to implement our corporate strategies in order to increase our average revenue per user;

political, regulatory and economic conditions in Brazil and the specific Brazilian states in which we operate;

inflation and fluctuations in exchange rates;

legal and administrative proceedings to which we are or become a party; and

other factors identified or discussed under Item 3. Key Information Risk Factors.

Our forward-looking statements are not guarantees of future performance, and our actual results or other developments may differ materially from the expectations expressed in the forward-looking statements. As for forward-looking statements that relate to future financial results and other projections, actual results will be different due to the inherent uncertainty of estimates, forecasts and projections. Because of these uncertainties, potential investors should not rely on these forward-looking statements.

We undertake no obligation to publicly update any forward-looking statement, whether as a result of new information, future events or otherwise.



**Table of Contents****PART I****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****Selected Financial Information**

The following selected financial data should be read in conjunction with our consolidated financial statements (including the notes thereto), Item 5. Operating and Financial Review and Prospects and Presentation of Financial and Other Information

The selected financial data as of and for the years ended December 31, 2010 and 2009 have been derived from our consolidated financial statements, prepared in accordance with IFRS, and included in this annual report. These consolidated annual financial statements are our first annual consolidated financial statements to be prepared in accordance with IFRS. IFRS 1, First-time Adoption of International Reporting Standards, has been applied in preparing these consolidated financial statements, considering that our previous primary GAAP was Brazilian GAAP and that we have considered January 1, 2009 as the date of transition to IFRS. Therefore, we are presenting information related to the years ended December 31, 2010 and 2009.

We have included information with respect to the dividends and/or interest attributable to shareholders equity paid to holders of our common shares and preferred shares since January 1, 2006 in *reais* and in U.S. dollars translated from *reais* at the commercial market selling rate in effect as of the payment date under the caption Item 8. Financial Information Dividends and Dividend Policy Payment of Dividends. We prepare individual financial statements in accordance with Brazilian GAAP for certain purposes, including for the calculation of dividends.

	At and For the Year Ended December 31,		
	2010(1)	2010	2009
	(in millions of US\$, except per share amounts)	(in millions of reais, except per share amounts and as otherwise indicated)	
<b>Income Statement Data:</b>			
Net operating revenue	US\$ 6,160	R\$ 10,263	R\$ 10,919
Cost of sales and services	2,840	(4,732)	(5,764)
Gross profit	3,320	5,531	5,155
Operating expenses	(1,844)	(3,072)	(6,232)
Operating income (loss) before financial income (expenses) and taxes	1,476	2,459	(1,077)
Financial income	588	979	630
Financial expenses	(636)	(1,060)	(912)
Financial expenses, net	(48)	(80)	(281)

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Income (loss) before taxes	1,428	2,379	(1,358)
Income tax and social contribution	(245)	(408)	339
Net income (loss)	US\$ 1,183	R\$ 1,971	R\$ (1,019)

**Table of Contents**

Net income (loss) attributable to controlling shareholders (1)	US\$ 1,183	R\$ 1,971	R\$ (1,021)
Net income (loss) attributable to non-controlling shareholders (1)			2
Net income (loss) applicable to each class of shares:			
Common shares	408	680	(1,021)
Preferred shares	775	1,291	
Net income (loss) per share(2):			
Common shares basic	2.00	3.34	(1.85)
Common shares diluted	2.00	3.34	(1.85)
Preferred shares and ADSs basic	2.00	3.34	
Preferred shares and ADSs diluted	2.00	3.34	
Weighted average shares outstanding (in thousands):			
Common shares basic		203,423	245,749
Common shares diluted		203,423	245,749
Preferred shares basic		386,366	305,439
Preferred shares diluted		386,366	305,439
<b>Balance Sheet Data:</b>			
Cash and cash equivalents	US\$ 1,931	R\$ 3,217	R\$ 1,717
Cash investments	499	832	382
Trade accounts receivable, net	1,242	2,070	1,992
Total current assets	5,094	8,487	6,127
Property, plant and equipment, net	3,191	5,317	5,267
Intangible assets, net	791	1,318	1,572
Total assets	16,138	26,886	24,564
Short-term loans and financing (including current portion of long-term debt)	627	1,044	870
Total current liabilities	4,016	6,691	5,424
Long-term loans and financing	1,993	3,321	3,573
Total equity	6,805	11,337	9,906
Shareholders equity attributable to controlling shareholders	6,805	11,337	9,905
Shareholders equity attributable to non-controlling shareholders			1

(1) Translated for convenience only using the selling rate as reported by the Central Bank at December 31, 2010 for *reais* into U.S. dollars of R\$1.666=US\$1.00.

(2) Under the Brazilian Corporation Law, preferred shareholders are not obligated to absorb losses, and such losses are exclusively attributed to common shareholders.

**Exchange Rates**

The Brazilian foreign exchange system allows the purchase and sale of foreign currency and the international transfer of *reais* by any person or legal entity, regardless of the amount, subject to certain regulatory procedures.

Since 1999, the Central Bank has allowed the U.S. dollar-*real* exchange rate to float freely, and, since then, the U.S. dollar-*real* exchange rate has fluctuated considerably.

In the past, the Central Bank has intervened occasionally to control unstable movements in foreign exchange rates. We cannot predict whether the Central Bank or the Brazilian government will continue to permit the *real* to float freely or will intervene in the exchange rate market through the return of a currency band system or otherwise. The *real* may depreciate or appreciate against the U.S. dollar and/or the euro substantially. Furthermore, Brazilian law provides that, whenever there is a significant imbalance in Brazil's balance of payments or there are serious reasons to foresee a significant imbalance, temporary restrictions may be imposed on remittances of foreign capital abroad. We cannot assure you that such measures will not be taken by the Brazilian government in the future. See Risk Factors Risks Relating to Brazil Restrictions on the movement of capital out of Brazil may impair our ability to service certain debt obligations.



**Table of Contents**

The following table shows the commercial selling rate or selling rate, as applicable, for U.S. dollars for the periods and dates indicated. The information in the Average column represents the average of the exchange rates on the last day of each month during the periods presented.

Year	Reais per U.S. Dollar			Period End
	High	Low	Average	
2006	R\$ 2.371	R\$ 2.059	R\$ 2.168	R\$ 2.138
2007	2.156	1.733	1.930	1.771
2008	2.500	1.559	1.834	2.337
2009	2.422	1.702	1.994	1.741
2010	1.881	1.655	1.759	1.666

Month	Reais per U.S. Dollar	
	High	Low
October 2010	R\$ 1.711	R\$ 1.655
November 2010	1.734	1.680
December 2010	1.712	1.666
January 2011	1.691	1.651
February 2011	1.677	1.660
March 2011	1.676	1.629
April 2011 (through April 26)	1.619	1.565

Source: Central Bank

**Risk Factors**

*You should consider the following risks as well as the other information set forth in this annual report when evaluating an investment in our company. In general, investing in the securities of issuers in emerging market countries, such as Brazil, involves a higher degree of risk than investing in the securities of issuers in the United States. Additional risks and uncertainties not currently known to us, or those that we currently deem to be immaterial, may also materially and adversely affect our business, results of operations, financial condition and prospects. Any of the following risks could materially affect us. In such case, you may lose all or part of your original investment.*

**Risks Relating to the Brazilian Telecommunications Industry and Our Company**

*Our fixed-line telecommunication services face increased competition from mobile services providers, other fixed-line service providers and cable television service providers, which may adversely affect our revenues and margins.*

Our fixed-line telecommunication services in Region II (which consists of the Federal District and nine Brazilian states located in the western, central and southern regions) face increasing competition from mobile services as the prices for mobile services decline and approach those of fixed-line services. Based on information available from ANATEL, from December 2007 to December 2010, the number of fixed lines in service in Brazil increased from 39.4 million to 42.0 million as a result of the increase in the number of fixed lines in service in Region III, while the number of fixed lines in service in Regions I and II decreased. We expect (1) the number of fixed lines in service in Region II to continue to stagnate or decline, as certain customers eliminate their fixed-line services in favor of mobile services, and (2) the use of existing fixed lines to decrease as customers substitute calls on mobile phones in place of fixed-line calls as a result of promotional mobile rates (such as free calls within a mobile provider's network). The rate at which the number of fixed lines in service in Brazil may decline depends on many factors beyond our control, such as economic, social, technological and other developments in Brazil. In addition, new fixed lines that we install are expected to be less profitable than existing ones because new fixed-line customers generally have lower average incomes than our existing customers, subscribe to our lower cost service plans and generate fewer chargeable minutes of usage. Our traditional local fixed-line telecommunication services represented 35.7% of our gross operating revenue for the year ended December 31, 2010. Because we derive a

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**Table of Contents**

significant portion of our net operating revenue from our traditional local fixed-line telecommunication services, a reduction in the number of our fixed-lines in service would negatively affect our net operating revenue and margins.

We also compete in the market for local fixed-line services with other fixed-line service providers, primarily with Empresa Brasileira de Telecomunicações – Embratel, or Embratel, and GVT S.A., or GVT. Embratel competes with us for residential customers with services that it provides using the cable infrastructure of its affiliate, Net Serviços de Comunicação S.A., or Net. Net is a cable television company that is our main competitor in the broadband services market. Embratel and Net are affiliates of Teléfonos de México S.A.B. de C.V., or Telmex, one of the leading telecommunication service providers in Latin America. Under an agreement entered into between Embratel and Net in November 2005, Net offers integrated voice, broadband and pay television services to the Brazilian residential market through a single network infrastructure. In addition, we compete with smaller companies that have been authorized by ANATEL to provide local fixed-line services in Region II. Embratel, GVT and Net are each controlled by multinational companies that may have more significant financial and marketing resources, and greater abilities to access capital on a timely basis and on more favorable terms, than our company.

Our loss of a significant number of fixed-line customers would adversely affect our net operating revenue and may adversely affect our results of operations. In addition, because callers in Brazil placing long-distance calls from their fixed-line telephones generally tend to select the long-distance carrier affiliated with the provider of their fixed-line service, our loss of a significant number of fixed-line customers may adversely affect our revenues from long-distance services and our results of operations. For a detailed description of our competition in the local fixed-line services market, see Item 4. Information on the Company – Competition – Local Fixed-Line Services.

*Our mobile services face strong competition from other mobile services providers, which may adversely affect our revenues.*

The mobile services market in Brazil is extremely competitive. We face competition in Region II from large competitors such as Vivo Participações S.A., or Vivo, Telecom Americas Group, which markets its services under the brand name Claro, and TIM Participações S.A., or TIM. As of December 31, 2010, based on information available from ANATEL, we had an estimated 15.1% share of the mobile services market in Region II as of December 31, 2010, based on the total number of subscribers as of that date, while Vivo, Claro and TIM had estimated market shares of 30.9%, 28.7% and 25.0%, respectively. Vivo, TIM and Telecom Americas Group are each controlled by multinational companies that may have more significant financial and marketing resources, and greater abilities to access capital on a timely basis and on more favorable terms, than our company.

Our ability to generate revenues from our mobile services business depends on our ability to increase and retain our customer base. Each additional customer subscribing to our service entails costs, including sales commissions and marketing costs. Recovering these costs depends on our ability to retain such customers. Therefore, high rates of customer churn could have a material adverse effect on the profitability of our mobile services business. During 2010, our average customer churn rate in the mobile services segment, representing the number of subscribers whose service was disconnected during each month, whether voluntarily or involuntarily, divided by the number of subscribers at the beginning of such month, was 4.6% per month.

We have experienced increased pressure to reduce our rates in response to pricing competition. This pricing competition often takes the form of special promotional packages, which may include, among other things, mobile handset subsidies, traffic usage promotions and incentives for calls made within a mobile services provider's own network. Competing with the service plans and promotions offered by our competitors may cause an increase in our marketing expenses and customer-acquisition costs, which could adversely affect our results of operations. Our inability to compete effectively with these packages could result in our loss of market share and adversely affect our net operating revenue and profitability.

For a detailed description of our competition in the mobile services market, see Item 4. Information on the Company – Competition – Mobile Services.



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**Table of Contents**

*Our long-distance services face significant competition, which may adversely affect our revenues.*

In Brazil, unlike in the United States, a caller chooses its preferred long-distance carrier for each long-distance call, whether originated from a fixed-line telephone or a mobile handset, by dialing such carrier's long-distance carrier selection code (*Código de Seleção de Prestadora*). The long-distance services market in Brazil is highly competitive. Our principal competitor for long-distance services is TIM, which in 2010 began aggressively promoting its long-distance services with significant discounts. Historically, our principal competitor for long-distance services has been Embratel. Generally, callers placing long-distance calls in Brazil from their fixed-line telephones tend to select the long-distance carrier affiliated with the provider of their fixed-line service. Similarly, callers placing long-distance calls in Brazil from their mobile handsets tend to select the long-distance carrier affiliated with the provider of their mobile or fixed-line service. However, increased competition from long-distance service providers has resulted in pressure on our long-distance rates and adversely affected our revenue from these services. In addition, aggressive discounting by TIM during 2010 has substantially reduced the market share of our company and other service providers in the long-distance market. Competition in the long-distance market may require us to increase our marketing expenses or provide services at lower rates than those we currently expect to charge for such services. Competition in the domestic long-distance market has had and could continue to have a material adverse effect on our revenues and margins. See Item 4. Information on the Company Competition Long-Distance Services.

*Data transmission services are not subject to significant regulatory restrictions and, as a result, we face an increasing amount of competition in this business.*

Competition in data transmission services is not subject to significant regulatory restrictions and, therefore, the market is open to a large number of competitors. Some competitors, such as cable operators, offer telephone and broadband services, which do not require them to use our fixed-line network, thereby allowing them to reach our customers without paying interconnection fees to our company. Additionally, although these auctions have not yet been scheduled, we anticipate that ANATEL will auction radio frequency licenses that will be used to establish Worldwide Interoperability for Microwave Access, or WiMax, networks in 2011. The implementation of WiMax networks may allow other internet service providers, or ISPs, to deploy wireless Internet Protocol, or IP, networks over a much greater area, for a much lower cost, than previously possible. This reduced deployment cost may give our competitors, or new entrants into the data transmission market, the ability to provide Voice over Internet Protocol, or VoIP, and other data services over WiMax networks at lower rates than we are able to offer.

Increasing competition in data transmission services may lead to rate reductions in this segment, adversely affecting the net operating revenue that we generate from this business. Additionally, increased competition for data transmission customers may require us to increase our marketing expenses and our capital expenditures and may lead to the loss of broadband customers, in each case leading to a decrease in our profitability. For a detailed description of our competition in the data transmission services market, see Item 4. Information on the Company Competition Data Transmission Services.

*The telecommunications industry is subject to frequent changes in technology. Our ability to remain competitive depends on our ability to implement new technology, and it is difficult to predict how new technology will affect our business.*

Companies in the telecommunications industry must adapt to rapid and significant technological changes that are usually difficult to anticipate. The mobile telecommunications industry in particular has experienced rapid and significant technological development and frequent improvements in capacity, quality and data-transmission speed. Technological changes may render our equipment, services and technology obsolete or inefficient, which may adversely affect our competitiveness or require us to increase our capital expenditures in order to maintain our competitive position. For example, we made significant investments in the last three years in connection with the implementation of our Universal Mobile Telecommunications System services, which we refer to as 3G services, in Region II. While we have been upgrading our fixed-line networks with technologically advanced fiber optic cable with a microwave overlay for use in our long-distance services, it is possible that alternative technologies may be developed that are more advanced than those we currently provide. If ANATEL auctions radio frequency spectrum for use in the development of WiMax networks, we expect that we may be required to participate in these auctions and deploy a WiMax network to remain competitive in the broadband services market. Even if we adopt new

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**Table of Contents**

technologies in a timely manner as they are developed, the cost of such technology may exceed the benefit to us, and we cannot assure you that we will be able to maintain our level of competitiveness.

*Our industry is highly regulated. Changes in laws and regulations may adversely impact our business.*

Our industry is highly regulated by ANATEL. ANATEL regulates, among other things, rates, quality of service and universal service goals, as well as competition among telecommunication service providers. Changes in laws and regulations, grants of new concessions, authorizations or licenses or the imposition of additional universal service obligations, among other factors, may adversely affect our business, financial condition and results of operations.

In October 2008, ANATEL published items that were on its regulatory agenda, some of which were expected to be adopted during the following two years. In furtherance of ANATEL's regulatory agenda:

ANATEL has proposed amendments to our concession agreements which are expected to become effective during the second quarter of 2011 as described in Item 4. Information on the Company Concessions, Authorizations and Licenses.

ANATEL has proposed new regulations under which the VC-1, VC-2 and VC-3 rates would be reduced from current levels, after giving effect to an inflation adjustment based on the IST, by 10% in 2012 and 10% in 2013. These proposed regulations also provide procedures for determining the reference value for VU-M rates in the event that providers cannot agree upon the VU-M applicable in their interconnection agreements. These regulations were submitted for public consultation in October 2010 and the public consultation period ended on November 12, 2010. ANATEL continues to analyze these proposed regulations. We expect these new regulations, as they may be modified as a result of ANATEL's further analysis, to be adopted in the second quarter of 2011.

ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets (*Plano Geral de Metas de Competição*) in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers.

We cannot predict when regulations regarding these matters will be adopted or whether these regulations will be adopted as proposed. Some of these regulations, if adopted, may have adverse effects on our revenues, costs and expenses, results of operations or financial position.

In May 2010, Executive Decree No. 7,175/10 was adopted which created the National Broadband Plan (*Programa Nacional de Banda Larga*), the goal of which is to make broadband access available at low cost, regardless of technology, throughout Brazil. The Brazilian government is studying options to achieve this goal, including mandating Telecomunicações Brasileiras S.A., or Telebrás, to manage the entire broadband infrastructure owned by the Brazilian government and mandating Telebras to offer the services contemplated by this plan and permitting other telecommunication service providers to offer these services through their existing infrastructure or through complementary infrastructure built or otherwise acquired to offer these services. Executive Decree No. 7,175/10 also instructed ANATEL to adopt new regulations relating to unbundling of telecommunication services and the pricing of backhaul services. We cannot predict when these regulations will be adopted or whether these regulations will be adopted as proposed. Some of these regulations, if adopted, may have adverse effects on our revenues, costs and expenses, results of operations or financial position.

We cannot predict whether ANATEL, the Brazilian Ministry of Communications (*Ministério das Comunicações*) or the Brazilian government will adopt other telecommunications sector policies in the future or the consequences of such policies on our business and the business of our competitors.

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**Table of Contents**

*Proposed laws seeking the termination of monthly subscription fees for local fixed-line services may adversely affect our business and financial condition.*

Certain legislative bills seeking to terminate monthly subscription fees charged by local fixed-line service providers have been submitted to the Brazilian Congress and remain pending. In March 2008, a special committee was formed in the Brazilian House of Representatives to discuss the various proposed bills on this issue. As of the date of this annual report, no action had been taken by the committee.

In 2010, monthly subscription fees represented 23.3% of our gross operating revenue. The enactment of legislation terminating the monthly subscription fees would have a material adverse effect on our results of operations.

*Our local fixed-line and domestic long-distance concession agreements are subject to periodic modifications by ANATEL and expire on December 31, 2025. Our bids for new concessions upon the expiration of our existing concessions may not be successful.*

We provide fixed-line telecommunication services in Region II pursuant to concession agreements with the Brazilian government. Our concession agreements expire on December 31, 2025, and may be amended by the parties every five years prior to the expiration date. ANATEL will engage in public consultation in connection with each five-year amendment to discuss its proposals for new conditions and quality and universal service targets. We are currently discussing modifications to our concession agreements with ANATEL.

On March 30, 2009, ANATEL published a public notice of the proposed modifications to these concession agreements. In this public notice, ANATEL proposed amendments to the General Plan on Universal Service (*Plano Geral de Metas de Universalização*). The public consultation period in connection with the March 30, 2009 public notice ended on June 22, 2009. ANATEL did not adopt the modifications proposed for public consultation.

On September 3, 2010, ANATEL published a public notice of further proposed amendments to the General Plan on Universal Service. The public consultation period in connection with the September 3, 2010 public notice ended on November 1, 2010. We do not expect ANATEL to adopt the modifications proposed for public consultation.

Based on our continuing discussions with ANATEL regarding proposed modifications to our concession agreements and proposed amendments to the General Plan on Universal Service, we believe that the effect of these amendments and modifications will:

increase our obligations to provide universal service in rural areas, including increased obligations to provide individual access to fixed-line voice services;

increase our obligations to provide service to economically disadvantaged segments of the Brazilian population within our service areas, primarily through subsidized service rates for fixed-line voice services; and

reduce the density requirements applicable to our obligations to provide public telephones in urban areas within our service areas.

In the event that the General Plan on Universal Service is amended to require that we provide additional services, the Brazilian Telecommunications Law and our concession agreements require that the costs of implementation of these universalization obligations in excess of the revenues generated by these services must be reimbursed to us from public funds. Although we understand that ANATEL intends to permit us to fund the additional capital and operating expenditures required to meet these expanded service obligations through an offset mechanism against the concession fees that we are obligated to pay under our concession agreements and the application of the savings that we achieve as a result of the reduction of our capital and operating expenditures on public telephone services in urban areas within our service areas, our internal projections indicate that a significant portion of the additional capital and operating expenditures required by these proposals could not be met from these funding sources alone. We understand that ANATEL intends to permit us to fund these shortfalls in future periods

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**Table of Contents**

through payments to us from the Universal Telecommunications Service Fund (*Fundo de Universalização dos Serviços de Telecomunicações*), which we refer to as the FUST, to which we are required to make contributions. As a result of our continuing discussions with ANATEL regarding the additional service obligations that we would be required to undertake and the methodology for the reimbursement of the additional capital expenditures that these proposals would require us to undertake, the finalization of the amendments to our concession agreements and the amendments to the General Plan on Universal Service have been delayed and, although we expect that these amendments will be finalized during the second quarter of 2011, we cannot predict with certainty when these amendments will be adopted and become effective or the effects of these amendments on our financial condition and results of operations.

Our obligations under the concession agreements may be subject to revision in connection with each future amendment. We cannot assure you that the pending amendments or any future amendments will not impose requirements on our company that will require us to undertake significant capital expenditures or will not modify the rate-setting procedures applicable to us in a manner that will significantly reduce the net operating revenue that we generate from our fixed-line businesses. If the amendments to our concession agreements have these effects, our business, financial condition and results of operations could be materially adversely affected.

Our concession agreements will expire on December 31, 2025. We expect the Brazilian government to offer new concessions in competitive auctions prior to the expiration of our existing concession agreements. We may participate in such auctions, but our existing fixed-line and domestic long-distance concession agreements will not entitle us to preferential treatment in these auctions. If we do not secure concessions for our existing service areas in any future auctions, or if such concessions are on less favorable terms than our current concessions, our business, financial condition and results of operations would be materially adversely affected.

*Our local fixed-line and domestic long-distance concession agreements, as well as our authorizations to provide personal mobile services, contain certain obligations, and our failure to comply with these obligations may result in various fines and penalties imposed on us by ANATEL.*

Our local fixed-line and domestic long-distance concession agreements contain terms reflecting the General Plan on Universal Service, the General Plan on Quality Goals (*Plano Geral de Metas de Qualidade*) and other regulations adopted by ANATEL and implemented in 2006, the terms of which could affect our financial condition and results of operations. Our local fixed-line concession agreements also require us to meet certain network expansion, quality of service and modernization obligations in each of the states in Region II. In the event of noncompliance with ANATEL targets in any one of these states, ANATEL can establish a deadline for achieving the targeted level of such service, impose penalties and, in extreme situations, terminate our concession agreements for noncompliance with its quality and universal service obligations. See Item 4. Information on the Company Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services.

On an almost weekly basis, we receive inquiries from ANATEL requiring information from us on our compliance with the various service obligations imposed on us by our concession agreements. If we are unable to respond satisfactorily to those inquiries or comply with our service obligations under our concession agreements, ANATEL may commence administrative proceedings in connection with such noncompliance. We have received numerous notices of the commencement of administrative proceedings from ANATEL, mostly due to our inability to achieve certain targets established in the General Plan on Quality Goals and the General Plan on Universal Service, among others. We have recorded provisions in the amount of R\$240 million as of December 31, 2010 in connection with fines sought to be imposed by ANATEL. Additional fines from ANATEL or fines in excess of the provisioned amount could adversely impact our financial condition and results of operations. See Item 4. Information on the Company Regulation of the Brazilian Telecommunications Industry and Item 8. Financial Information Legal Proceedings Civil Claims Administrative Proceedings.

In addition, our authorizations to provide personal mobile services contain certain obligations requiring us to meet network scope and quality of service targets. If we fail to meet these obligations, we may be fined by ANATEL until we are in full compliance with our obligations and, in extreme circumstances, our authorizations could be revoked by ANATEL. See Item 4. Information on the Company Regulation of the Brazilian Telecommunications Industry Regulation of Mobile Services Obligations of Personal Mobile Services Providers.

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**Table of Contents**

*We may be unable to implement our plans to expand and enhance our existing mobile networks in a timely manner or without unanticipated costs, which could hinder or prevent the successful implementation of our business plan and result in revenues and net income being less than expected.*

Our ability to achieve our strategic objectives relating to our mobile services depends in large part on the successful, timely and cost-effective implementation of our plans to expand and enhance our mobile networks. Factors that could affect this implementation include:

our ability to generate cash flow or to obtain future financing necessary to implement our projects;

delays in the delivery of telecommunications equipment by our vendors;

the failure of the telecommunications equipment supplied by our vendors to comply with the expected capabilities; and

delays resulting from the failure of third-party suppliers or contractors to meet their obligations in a timely and cost-effective manner.

Although we believe that our cost estimates and implementation schedule are reasonable, we cannot assure you that the actual costs or time required to complete the implementation of these projects will not substantially exceed our current estimates. Any significant cost overrun or delay could hinder or prevent the successful implementation of our business plan and result in revenues and net income being less than expected.

*We rely on strategic suppliers of equipment, materials and services necessary for our operations and expansion. If these suppliers fail to provide equipment, materials or services to us on a timely basis, we could experience disruptions, which could have an adverse effect on our revenues and results of operations.*

We rely on few strategic suppliers of equipment, materials and services, including Nokia Siemens Networks Serviços Ltda., or Nokia Siemens Networks, Alcatel-Lucent Brasil S.A., or Alcatel-Lucent, Telemont Engenharia de Telecomunicações S.A., or Telemont, A.R.M. Engenharia Ltda., or A.R.M. Engenharia, and Huawei do Brasil Telecomunicações Ltda., or Huawei, to provide us with equipment, materials and services that we need in order to expand and to operate our business. There are a limited number of suppliers with the capability of providing the mobile network equipment and fixed-line network platforms that our operations and expansion plans require or the services that we require to maintain are extensive and geographically widespread networks. In addition, because the supply of mobile network equipment and fixed-line network platforms requires detailed supply planning and this equipment is technologically complex, it would be difficult for our company to replace the suppliers of this equipment. Suppliers of cables that we need to extend and maintain our networks may suffer capacity constraints or difficulties in obtaining the raw materials required to manufacture these cables. As a result, we are exposed to risks associated with these suppliers, including restrictions of production capacity for equipment and materials, availability of equipment and materials, delays in delivery of equipment, materials or services, and price increases. If these suppliers or vendors fail to provide equipment, materials or service to us on a timely basis or otherwise in compliance with the terms of our contracts with these suppliers, we could experience disruptions or declines in the quality of our services, which could have an adverse effect on our revenues and results of operations, and we might be unable to satisfy the requirements contained in our concession and authorization agreements.

*Our controlling shareholder, TmarPart, has control over us and our controlled companies and TmarPart's interests may not be aligned with your interests.*

We are controlled indirectly by Telemar Participações S.A., or TmarPart, which, as of April 26, 2011 indirectly controlled 79.6% of our outstanding voting shares. TmarPart's shareholders are parties to two shareholders' agreements governing their equity interests in TmarPart. See Item 7. Major Shareholders and Related Party Transactions Major Shareholders TmarPart Shareholders Agreements. Our controlling shareholder and its controlling shareholders are entitled to appoint a majority of the members of our board of directors, and they have the power to determine the decisions to be taken at our shareholders' meetings on matters of our management that require the prior authorization of our shareholders, including in respect of related party transactions, corporate



## Table of Contents

restructurings and the date of payment of dividends and other capital distributions. The decisions of our controlling shareholder and its controlling shareholders on these matters may be contrary to the expectations or preferences of holders of our securities, including holders of our common shares, preferred shares and ADSs.

*We have a substantial amount of existing debt, which could restrict our financing and operating flexibility and have other adverse consequences.*

At December 31, 2010, we had total consolidated debt of R\$4,365 million and a ratio of debt to equity of 0.4:1.

We are subject to certain financial covenants that limit our ability to incur additional debt. Our existing level of indebtedness and the requirements and limitations imposed by our debt instruments could adversely affect our financial condition or results of operations. In particular, the terms of some of these debt instruments restrict our ability, and the ability of our subsidiaries, to:

incur additional debt;

grant liens;

pledge assets;

sell or dispose of assets; and

make certain acquisitions, mergers and consolidations.

Furthermore, some of our debt instruments include financial covenants that require us to maintain certain specified financial ratios. Additionally, the instruments governing a substantial portion of our indebtedness contain cross-default or cross-acceleration clauses and the occurrence of an event of default under one of these instruments could trigger an event of default under other indebtedness or enable the creditors under other indebtedness to accelerate that indebtedness.

If we are unable to incur additional debt, we may be unable to invest in our business and make necessary or advisable capital expenditures, which could reduce future net operating revenue and adversely affect our profitability. In addition, cash required to serve our existing indebtedness reduces the amount available to us to make capital expenditures.

If our growth in net operating revenue slows or declines in a significant manner, for any reason, we may not be able to continue servicing our debt. If we are unable to meet our debt service obligations or comply with our debt covenants, we could be forced to renegotiate or refinance our indebtedness, seek additional equity capital or sell assets. We may be unable to obtain financing or sell assets on satisfactory terms, or at all. For more information regarding our debt instruments and our indebtedness at December 31, 2010, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources.

*We are subject to numerous legal and administrative proceedings, which could adversely affect our business, results of operations and financial condition.*

We are subject to numerous legal and administrative proceedings. It is difficult to quantify the potential impact of these legal and administrative proceedings. We classify our risk of loss from legal and administrative proceedings as probable, possible or remote. We make provisions for probable losses but do not make provisions for possible and remote losses. At December 31, 2010, we had provisioned R\$4,297 million for probable losses relating to various tax, labor and civil legal and administrative proceedings against us, excluding deposits that we have made with various courts relating to these proceedings.

At December 31, 2010, we had claims against us of R\$2,435 million in tax proceedings, R\$2,206 million in labor proceedings and R\$780 million in civil proceedings with a risk of loss classified as possible or remote and for which we had made no provisions.





## **Table of Contents**

If we are subject to unfavorable decisions in any legal or administrative proceedings and the losses in those proceedings significantly exceed the amount for which we have provisioned or involve proceedings for which we have made no provision, our results of operations and financial condition may be materially adversely affected. For a more detailed description of these proceedings, see Item 8. Financial Information Legal Proceedings.

*We are subject to potential liabilities relating to our third-party service providers, which could have a material adverse effect on our business, financial condition and results of operations.*

We are subject to potential liabilities relating to our third-party service providers. Such potential liabilities may involve claims by employees of third-party service providers directly against us as if we were the direct employer of such employees, as well as claims against us for secondary liability for, among other things, occupational hazards, wage parity or overtime pay, in the event that such third-party service providers fail to meet their obligations to their employees. We have not recorded any provisions for such claims, and significant judgments against us could have a material adverse effect on our business, financial condition and results of operations.

*We are subject to delinquencies of our accounts receivables. If we are unable to limit payment delinquencies by our customers, or if delinquent payments by our customers increase, our financial condition and results of operations could be adversely affected.*

Our business significantly depends on our customers' ability to pay their bills and comply with their obligations to us. In 2010, we recorded provisions for doubtful accounts in the amount of R\$352 million, primarily due to subscribers' delinquencies. As a percentage of our gross operating revenue, our provision for doubtful accounts was 2.0% at December 31, 2010.

ANATEL regulations prevent us from implementing certain policies that could have the effect of reducing delinquency, such as service restrictions or limitations on the types of services provided based on a subscriber's credit record. If we are unable to successfully implement policies to limit subscriber delinquencies or otherwise select our customers based on their credit records, persistent subscriber delinquencies and bad debt will continue to adversely affect our operating and financial results.

In addition, if the Brazilian economy declines due to, among other factors, a reduction in the level of economic activity, depreciation of the *real*, an increase in inflation or an increase in domestic interest rates, a greater portion of our customers may not be able to pay their bills on a timely basis, which would increase our provision for doubtful accounts and adversely affect our financial condition and results of operations.

*Our operations depend on our ability to maintain, upgrade and operate efficiently our accounting, billing, customer service, information technology and management information systems and to rely on the systems of other carriers under co-billing agreements.*

Sophisticated information and processing systems are vital to our growth and our ability to monitor costs, render monthly invoices for services, process customer orders, provide customer service and achieve operating efficiencies. We cannot assure you that we will be able to operate successfully and upgrade our accounting, information and processing systems or that these systems will continue to perform as expected. We have entered into co-billing agreements with each long-distance telecommunication service provider that is interconnected to our networks to include in our invoices the long-distance services rendered by these providers, and they have agreed to include charges owed to us in their invoices. Any failure in our accounting, information and processing systems, or any problems with the execution of invoicing and collection services by other carriers with whom we have co-billing agreements, could impair our ability to collect payments from customers and respond satisfactorily to customer needs, which could adversely affect our business, financial condition and results of operations.

*Improper use of our network could adversely affect our costs and results of operations.*

We incur costs associated with the unauthorized and fraudulent use of our networks, including administrative and capital costs associated with detecting, monitoring and reducing the incidence of fraud. Fraud also affects interconnection costs and payments to other carriers for non-billable fraudulent roaming. Improper use of our

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**Table of Contents**

network could also increase our selling expenses if we need to increase our provision for doubtful accounts to reflect amounts we do not believe we can collect for improperly made calls. Any increase in the improper use of our network in the future could materially adversely affect our costs and results of operations.

*Our operations are dependent upon our networks. A system failure could cause delays or interruptions of service, which could cause us to suffer losses.*

Damage to our networks and backup mechanisms may result in service delays or interruptions and limit our ability to provide customers with reliable service over our networks. Some of the risks to our networks and infrastructure include (1) physical damage to access lines; (2) power surges or outages; (3) software defects; (4) disruptions beyond our control; (5) breaches of security; and (6) natural disasters. The occurrence of any such event could cause interruptions in service or reduce capacity for customers, either of which could reduce our gross operating revenue or cause us to incur additional expenses. In addition, the occurrence of any such event may subject us to penalties and other sanctions imposed by ANATEL and may adversely affect our business and results of operations.

*The mobile telecommunications industry and participants in this industry, including us, may be harmed by reports suggesting that radio frequency emissions cause health problems and interfere with medical devices.*

Media and other entities frequently suggest that the electromagnetic emissions from mobile handsets and base stations may cause health problems. If consumers harbor health-related concerns, they may be discouraged from using mobile handsets. These concerns could have an adverse effect on the mobile telecommunications industry and, possibly, expose mobile services providers to litigation. We cannot assure you that further medical research and studies will refute a link between the electromagnetic emissions of mobile handsets and base stations, including on frequency ranges we use to provide mobile services, and these health concerns. Government authorities could increase regulation on electromagnetic emissions of mobile handsets and base stations, which could have an adverse effect on our business, financial condition and results of operations. The expansion of our network may be affected by these perceived risks if we experience problems in finding new sites, which in turn may delay the expansion and may affect the quality of our services. In July 2002, ANATEL enacted regulations that limit emission and exposure for fields with frequencies between 9 kHz and 300 GHz. Although these regulations did not have a material impact on our business, new laws or regulations regarding electromagnetic emissions and exposure may be adopted that could have an adverse effect on our business.

***Risks Relating to Brazil***

*The Brazilian government has exercised, and continues to exercise, significant influence over the Brazilian economy. This involvement, as well as Brazilian political and economic conditions, could adversely impact our business, results of operations and financial condition.*

Substantially all of our operations and customers are located in Brazil, except for minor services provided outside of Brazil. Accordingly, our financial condition and results of operations are substantially dependent on Brazil's economy. The Brazilian government frequently intervenes in the Brazilian economy and occasionally makes significant changes in policy and regulations. The Brazilian government's actions to control inflation and implement macroeconomic policies have often involved increases in interest rates, wage and price controls, currency devaluations, blocking access to bank accounts, imposing capital controls and limits on imports, among other things. We do not have any control over, and are unable to predict, which measures or policies the Brazilian government may adopt in the future. Our business, results of operations and financial condition may be adversely affected by changes in policies or regulations, or by other factors such as:

political instability;

devaluations and other currency fluctuations;

inflation;

**Table of Contents**

price instability;

interest rates;

liquidity of domestic capital and lending markets;

energy shortages;

exchange controls;

changes to the regulatory framework governing our industry;

monetary policy;

tax policy; and

other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over whether possible changes in policies or rules affecting these or other factors may contribute to economic uncertainties in Brazil and to heightened volatility in the Brazilian securities markets and securities issued abroad by Brazilian issuers. The President of Brazil has considerable power to determine governmental policies and actions that relate to the Brazilian economy and, consequently, affect the operations and financial performance of businesses such as our company. In November 2010, Dilma Rousseff was elected President of Brazil to succeed Luiz Inácio Lula da Silva. Ms. Rousseff term began in January 2011. Although we do not believe that Ms. Rousseff will significantly alter the policies followed by her predecessor, we can offer no assurances that the policies that may be implemented by the Brazilian federal or state governments will not adversely affect our business, results of operations and financial condition.

*The global economic downturn may adversely affect economic growth in Brazil or limit our access to the financial markets and, therefore, negatively impact our business and financial condition.*

The global economic downturn and related instability in the international financial system have had, and may continue to have, a negative effect on economic growth in Brazil. The ongoing global economic downturn has reduced the availability of liquidity and credit to fund the continuation and expansion of industrial business operations worldwide. The recent substantial losses in worldwide equity markets, including in Brazil, could lead to an extended worldwide economic recession or depression. A prolonged slowdown in economic activity in Brazil could reduce demand for some of our services, particularly broadband services if the rate of computer sales in Brazil declines, which would adversely affect our results of operations.

As a result of the global economic downturn, our ability to access the capital markets or the commercial bank lending markets may be severely restricted at a time when we would like, or need, to access such markets, which could have an impact on our flexibility to react to changing economic and business conditions. The global economic downturn could have an impact on the lenders under our existing credit facilities, on our customers or on the ability of our suppliers to meet scheduled deliveries, causing them to fail to meet their obligations to us. If the global economic downturn deepens further, it could have an adverse effect on the demand for our services and our ability to fund our planned growth.

*Depreciation of the real may lead to substantial losses on our liabilities denominated in or indexed to foreign currencies.*

During the four decades prior to 1999, the Central Bank periodically devalued the Brazilian currency. Throughout this period, the Brazilian government implemented various economic plans and used various exchange rate policies, including sudden devaluations (such as daily and monthly adjustments), exchange controls, dual exchange rate markets and a floating exchange rate system. Since 1999, exchange rates have been

set by the market. The exchange rate between the *real* and the U.S. dollar has varied significantly in recent years. For example, the

**Table of Contents**

*real*/U.S. dollar exchange rate increased from R\$1.955 per U.S. dollar on December 31, 2000 to R\$3.533 on December 31, 2002. The *real* appreciated against the U.S. dollar by 11.8% in 2005, 8.7% in 2006 and 17.1% in 2007. In 2008, primarily as a result of the international financial crisis, the *real* depreciated by 31.9% against the U.S. dollar and prompted foreign investors to remove billions of *reais* from the Brazilian Securities, Commodities and Futures Exchange (*BM&FBOVESPA S.A. - Bolsa de Valores Mercadorias e Futuros*), which we refer to as the BM&FBOVESPA. During 2009, the *real* appreciated by 25.5% against the U.S. dollar and during 2010 the *real* appreciated by 4.3% against the U.S. dollar.

A portion of our capital expenditures require us to acquire assets at prices denominated in or linked to foreign currencies, principally the U.S. dollar. We generally do not hedge against risks related to movements of the *real* against foreign currencies. To the extent that the value of the *real* decreases relative to the U.S. dollar, it becomes more costly for us to purchase these assets, which could adversely affect our business and financial performance.

Depreciation of the *real* relative to the U.S. dollar could create additional inflationary pressures in Brazil by increasing the price of imported products and requiring recessionary government policies, including tighter monetary policy. On the other hand, appreciation of the *real* against the U.S. dollar may lead to a deterioration of the country's current account and balance of payments, as well as to a dampening of export-driven growth.

*If Brazil experiences substantial inflation in the future, our margins and our ability to access foreign financial markets may be reduced. Government measures to curb inflation may have adverse effects on the Brazilian economy, the Brazilian securities market and our business and results of operations.*

Brazil has, in the past, experienced extremely high rates of inflation, with annual rates of inflation reaching as high as 2,708% in 1993 and 1,093% in 1994. Inflation and some of the Brazilian government's measures taken in an attempt to curb inflation have had significant negative effects on the Brazilian economy.

Since the introduction of the *real* in 1994, Brazil's inflation rate has been substantially lower than in previous periods. However, actions taken in an effort to control inflation, coupled with speculation about possible future governmental actions, have contributed to economic uncertainty in Brazil and heightened volatility in the Brazilian securities market. More recently, Brazil's rates of inflation, as measured by the General Market Price Index - Internal Availability (*Índice Geral de Preços - Disponibilidade Interna*), or IGP-DI, published by Fundação Getúlio Vargas, or FGV, were 3.8% in 2006, 7.9% in 2007, 9.1% in 2008, (1.4)% in 2009 and 11.3% in 2010. According to the Broad Consumer Price Index (*Índice Nacional de Preços ao Consumidor Ampliado*), or IPCA, published by the Brazilian Institute for Geography and Statistics (*Instituto Brasileiro de Geografia e Estatística*), or IBGE, the Brazilian consumer price inflation rates were 3.1% in 2006, 4.5% in 2007, 5.9% in 2008, 4.3% in 2009 and 5.9% in 2010.

If Brazil experiences substantial inflation in the future, our costs may increase and our operating and net margins may decrease. Although ANATEL regulations provide for annual price increases for most of our services, such increases are linked to inflation indices, discounted by increases in our productivity. During periods of rapid increases in inflation, the price increases for our services may not be sufficient to cover our additional costs and we may be adversely affected by the lag in time between the incurrence of increased costs and the receipt of revenues resulting from the annual price increases. Inflationary pressures may also curtail our ability to access foreign financial markets and may lead to further government intervention in the economy, including the introduction of government policies that may adversely affect the overall performance of the Brazilian economy.

*Fluctuations in interest rates could increase the cost of servicing our debt and negatively affect our overall financial performance.*

Our financial expenses are affected by changes in the interest rates that apply to our floating rate debt. At December 31, 2010, we had, among other debt obligations, R\$2,473 million of loans and financing and debentures that were subject to the *Taxa de Juros de Longo Prazo*, or TJLP, a long-term interest rate, R\$1,093 million of loans and financing and debentures that were subject to the Interbank Certificate of Deposit (*Certificado de Depósito Interbancário*), or CDI, rate, an interbank rate, and R\$45 million of loans and financing that were subject to Japanese Yen LIBOR.

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**Table of Contents**

The TJLP includes an inflation factor and is determined quarterly by the National Monetary Council (*Conselho Monetário Nacional*). In particular, the TJLP and the CDI rate have fluctuated significantly in the past in response to the expansion or contraction of the Brazilian economy, inflation, Brazilian government policies and other factors. For example, the CDI increased from 8.55% per annum as of December 31, 2009 to 10.64% per annum as of December 31, 2010. A significant increase in any of these interest rates, particularly the CDI rate, could adversely affect our financial expenses and negatively affect our overall financial performance.

*The market value of securities issued by Brazilian companies is influenced by the perception of risk in Brazil and other emerging market countries, which may have a negative effect on the trading price of our common shares, preferred shares and ADSs and may restrict our access to international capital markets.*

Economic and market conditions in other emerging market countries, especially those in Latin America, may influence the market for securities issued by Brazilian companies. Investors' reactions to developments in these other countries may have an adverse effect on the market value of securities of Brazilian issuers. Adverse economic conditions in other emerging market countries have at times resulted in significant outflows of funds from Brazil. In 2008, certain Brazilian and Mexican companies announced significant losses in connection with currency derivatives as a result of the depreciation of the Mexican peso and the *real* against the U.S. dollar, respectively. As a result, a number of these companies have suffered financial distress and have sought protection under various bankruptcy regimes. In addition, in October 2008, the Argentine government nationalized the Argentine private pension funds. Crises in other emerging countries or the economic policies of other countries, in particular the United States, may adversely affect investors' demand for securities issued by Brazilian companies, including our common shares, preferred shares and ADSs. Any of these factors could adversely affect the market price of our common shares, preferred shares and ADSs and impede our ability to access the international capital markets and finance our operations in the future on terms acceptable to us or at all.

*Restrictions on the movement of capital out of Brazil may impair our ability to service certain debt obligations.*

Brazilian law provides that whenever there exists, or there is a serious risk of, a material imbalance in Brazil's balance of payments, the Brazilian government may impose restrictions for a limited period of time on the remittance to foreign investors of the proceeds of their investments in Brazil as well as on the conversion of the *real* into foreign currencies. The Brazilian government imposed such a restriction on remittances for approximately six months in 1989 and early 1990. The Brazilian government may in the future restrict companies from paying amounts denominated in foreign currency or require that any such payment be made in *reais*. Many factors could affect the likelihood of the Brazilian government imposing such exchange control restrictions, including the extent of Brazil's foreign currency reserves, the availability of sufficient foreign exchange on the date a payment is due, the size of Brazil's debt service burden relative to the economy as a whole, and political constraints to which Brazil may be subject. There can be no certainty that the Brazilian government will not take such measures in the future.

A more restrictive policy could increase the cost of servicing, and thereby reduce our ability to pay, our foreign currency-denominated debt obligations and other liabilities. Our foreign-currency denominated debt represented 1.3% of our indebtedness on a consolidated basis at December 31, 2010. If we fail to make payments under any of these obligations, we will be in default under those obligations, which could reduce our liquidity as well as the market price of our common shares, preferred shares and ADSs.

In addition, a more restrictive policy could hinder or prevent the Brazilian custodian of the common shares and preferred shares underlying our ADSs or holders who have exchanged our ADSs for the underlying common shares or preferred shares from converting dividends, distributions or the proceeds from any sale of such shares into U.S. dollars and remitting such U.S. dollars abroad. In such an event, the Brazilian custodian for our common shares and preferred shares will hold the *reais* that it cannot convert for the account of holders of our ADSs who have not been paid. Neither the custodian nor The Bank of New York Mellon, as depository of our ADS programs, or the depository, will be required to invest the *reais* or be liable for any interest.

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**Table of Contents**

***Risks Relating to Our Common Shares, Preferred Shares and ADSs***

*Holders of our common shares, preferred shares or ADSs may not receive any dividends or interest on shareholders' equity.*

According to our by-laws, we must generally pay our shareholders at least 25% of our annual net income as dividends or interest on shareholders' equity, as calculated and adjusted under Brazilian GAAP. This adjusted net income may be capitalized, used to absorb losses or otherwise retained as allowed under Brazilian GAAP and may not be available to be paid as dividends or interest on shareholders' equity. Holders of our common shares or Common ADSs, may not receive any dividends or interest on shareholders' equity in any given year due to the dividend preference of our preferred shares. Additionally, the Brazilian Corporation Law allows a publicly traded company like ours to suspend the mandatory distribution of dividends in any particular year if our board of directors informs our shareholders that such distributions would be inadvisable in view of our financial condition or cash availability. Holders of our preferred shares or Preferred ADSs may not receive any dividends or interest on shareholders' equity in any given year if our board of directors makes such a determination or if our operations fail to generate net income.

*Our preferred shares and Preferred ADSs have limited voting rights and are not entitled to vote to approve corporate transactions, including mergers or consolidations of our company with other companies, or the declaration of dividends.*

Under the Brazilian Corporation Law and our by-laws, holders of our preferred shares and, consequently, our Preferred ADSs, are not entitled to vote at meetings of our shareholders, except in very limited circumstances. These limited circumstances directly relate to key rights of the holders of preferred shares, such as modifying basic terms of our preferred shares or creating a new class of preferred shares with superior rights. Holders of preferred shares without voting rights are entitled to elect one member and his or her respective alternate to our board of directors and our fiscal council. Holders of our preferred shares and Preferred ADSs are not entitled to vote to approve corporate transactions, including mergers or consolidations of our company with other companies, or the declaration of dividends. See Item 10. Additional Information Description of Our Company's By-laws Voting Rights.

*Holders of our ADSs may find it difficult to exercise their voting rights at our shareholders' meetings.*

Under Brazilian law, only shareholders registered as such in our corporate books may attend our shareholders' meetings. All common shares and preferred shares underlying our ADSs are registered in the name of the depositary. ADS holders may exercise the voting rights with respect to our common shares and the limited voting rights with respect to our preferred shares represented by our ADSs only in accordance with the deposit agreements relating to our ADSs. There are practical limitations upon the ability of the ADS holders to exercise their voting rights due to the additional steps involved in communicating with ADS holders. For example, we are required to publish a notice of our shareholders' meetings in certain newspapers in Brazil. To the extent that holders of our common shares or preferred shares are entitled to vote at a shareholders' meeting, they will be able to exercise their voting rights by attending the meeting in person or voting by proxy. By contrast, holders of the ADSs will receive notice of a shareholders' meeting by mail from the depositary following our notice to the depositary requesting the depositary to inform ADS holders of the shareholders' meeting. To exercise their voting rights, ADS holders must instruct the depositary on a timely basis. This noticed voting process will take longer for ADS holders than for holders of our common shares or preferred shares. If the depositary fails to receive timely voting instructions for all or part of our ADSs, the depositary will assume that the holders of those ADSs are instructing it to give a discretionary proxy to a person designated by us to vote their ADSs, except in limited circumstances.

In the circumstances in which holders of our ADSs have voting rights, they may not receive the voting materials in time to instruct the depositary to vote our common shares or preferred shares underlying their ADSs. In addition, the depositary and its agents are not responsible for failing to carry out voting instructions of the holders of our ADSs or for the manner of carrying out those voting instructions. Accordingly, holders of our ADSs may not be able to exercise voting rights, and they will have no recourse if the common shares or preferred shares underlying their ADSs are not voted as requested.

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**Table of Contents**

*Holders of our common shares, preferred shares or ADSs in the United States may not be entitled to the same preemptive rights as Brazilian shareholders have, pursuant to Brazilian legislation, in the subscription of shares resulting from capital increases made by us.*

Under Brazilian law, if we issue new shares in exchange for cash or assets as part of a capital increase, subject to certain exceptions, we must grant our shareholders preemptive rights at the time of the subscription of shares, corresponding to their respective interest in our share capital, allowing them to maintain their existing shareholding percentage. We may not legally be permitted to allow holders of our common shares, preferred shares or ADSs in the United States to exercise any preemptive rights in any future capital increase unless (1) we file a registration statement for an offering of shares resulting from the capital increase with the U.S. Securities and Exchange Commission, or SEC, or (2) the offering of shares resulting from the capital increase qualifies for an exemption from the registration requirements of the Securities Act. At the time of any future capital increase, we will evaluate the costs and potential liabilities associated with filing a registration statement for an offering of shares with the SEC and any other factors that we consider important in determining whether to file such a registration statement. We cannot assure the holders of our common shares, preferred shares or ADSs in the United States that we will file a registration statement with the SEC to allow them to participate in any of our capital increases. As a result, the equity interest of such holders in our company may be diluted.

*If holders of our ADSs exchange them for common shares or preferred shares, they may risk temporarily losing, or being limited in, the ability to remit foreign currency abroad and certain Brazilian tax advantages.*

The Brazilian custodian for the common shares and preferred shares underlying our ADSs must obtain an electronic registration number with the Central Bank to allow the depository to remit U.S. dollars abroad. ADS holders benefit from the electronic certificate of foreign capital registration from the Central Bank obtained by the custodian for the depository, which permits it to convert dividends and other distributions with respect to the common shares or preferred shares into U.S. dollars and remit the proceeds of such conversion abroad. If holders of our ADSs decide to exchange them for the underlying common shares or preferred shares, they will only be entitled to rely on the custodian's certificate of registration with the Central Bank for five business days after the date of the exchange. Thereafter, they will be unable to remit U.S. dollars abroad unless they obtain a new electronic certificate of foreign capital registration in connection with the common shares or preferred shares, which may result in expenses and may cause delays in receiving distributions. See Item 10. Additional Information Exchange Controls.

Also, if holders of our ADSs that exchange our ADSs for our common shares or preferred shares do not qualify under the foreign investment regulations, they will generally be subject to less favorable tax treatment of dividends and distribution on, and the proceeds from any sale of, our common shares or preferred shares. See Item 10. Additional information Exchange Controls and Item 10. Additional Information Taxation Brazilian Tax Considerations.

*Holders of our ADSs may face difficulties in protecting their interests because, as a Brazilian company, we are subject to different corporate rules and regulations and our shareholders may have fewer and less well-defined rights.*

Holders of our ADSs are not direct shareholders of our company and are unable to enforce the rights of shareholders under our by-laws and the Brazilian Corporation Law.

Our corporate affairs are governed by our by-laws and the Brazilian Corporation Law, which differ from the legal principles that would apply if we were incorporated in a jurisdiction in the United States, such as the State of Delaware or New York, or elsewhere outside Brazil. Even if a holder of our ADSs surrenders its ADSs and becomes a direct shareholder, its rights as a holder of our common shares or preferred shares under the Brazilian Corporation Law to protect its interests relative to actions by our board of directors may be fewer and less well-defined than under the laws of those other jurisdictions.

Although insider trading and price manipulation are crimes under Brazilian law, the Brazilian securities markets are not as highly regulated and supervised as the U.S. securities markets or the markets in some other jurisdictions. In addition, rules and policies against self-dealing or for preserving shareholder interests may be less well-defined



## **Table of Contents**

and enforced in Brazil than in the United States and certain other countries, which may put holders of our common shares, preferred shares and ADSs at a potential disadvantage. Corporate disclosures also may be less complete or informative than those of a public company in the United States or in certain other countries.

*We are exempt from some of the corporate governance requirements of the New York Stock Exchange.*

We are a foreign private issuer, as defined by the SEC for purposes of the Exchange Act. As a result, for so long as we remain a foreign private issuer, we will be exempt from, and you will not be provided with the benefits of, some of the corporate governance requirements of The New York Stock Exchange, or the NYSE. We are permitted to follow practice in Brazil in lieu of the provisions of the NYSE's corporate governance rules, except that:

we are required to have an audit committee that satisfies the requirements of Rule 10A-3 under the Exchange Act;

we are required to disclose any significant ways in which our corporate governance practices differ from those followed by domestic companies under NYSE listing standards;

our chief executive officer is obligated to promptly notify the NYSE in writing after any of our executive officers becomes aware of any non-compliance with any applicable provisions of the NYSE corporate governance rules; and

we must submit an executed written affirmation annually to the NYSE. In addition, we must submit an interim written affirmation as and when required by the interim written affirmation form specified by the NYSE.

The standards applicable to us are considerably different than the standards applied to U.S. domestic issuers. Although Rule 10A-3 under the Exchange Act generally requires that a listed company have an audit committee of its board of directors composed solely of independent directors, as a foreign private issuer, we are relying on a general exemption from this requirement that is available to us as a result of the features of Brazilian law applicable to our fiscal council. In addition, we are not required to, among other things:

have a majority of the board be independent;

have a compensation committee or a nominating or corporate governance committee of our board of directors;

have regularly scheduled executive sessions with only non-management directors; or

have at least one executive session of solely independent directors each year.

We intend to rely on some or all of these exemptions. As a result, you will not be provided with the benefits of certain corporate governance requirements of the NYSE.

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

We are organized under the laws of Brazil, and all of the members of our board of directors, our executive officers and our independent registered public accountants reside or are based in Brazil. The vast majority of our assets and those of these other persons are located in Brazil. As a result, it may not be possible for holders of our 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. In addition, because substantially all of our assets and all of our directors and officers reside outside the United States, any judgment obtained in the United States against us or any of our directors or officers may not be collectible within the United States. 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

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**Table of Contents**

greater difficulties in protecting their interests in the case of actions by us or our board of directors or executive officers than would shareholders of a U.S. corporation.

*Brazilian tax laws may have an adverse impact on the taxes applicable to the disposition of our common shares, preferred shares and ADSs.*

According to Law No. 10,833, enacted on December 29, 2003, if a nonresident of Brazil disposes of assets located in Brazil, the transaction will be subject to taxation in Brazil, even if such disposition occurs outside Brazil or if such disposition is made to another nonresident. Dispositions of our ADSs between nonresidents, however, are currently not subject to taxation in Brazil. Nevertheless, in the event that the concept of disposition of assets is interpreted to include the disposition between nonresidents of assets located outside Brazil, this tax law could result in the imposition of withholding taxes in the event of a disposition of our ADSs made between nonresidents of Brazil. Due to the fact that as of the date of this annual report Law No. 10,833/2003 has no judicial guidance as to its application, we are unable to predict whether an interpretation applying such tax laws to dispositions of our ADSs between nonresidents could ultimately prevail in Brazilian courts. See Item 10. Additional Information Taxation Brazilian Tax Considerations.

*The relative volatility and illiquidity of the Brazilian securities markets may adversely affect holders of our common shares, preferred shares and ADSs.*

The Brazilian securities markets are substantially smaller, less liquid and more volatile than major securities markets in the United States. The BM&FBOVESPA, which is the principal Brazilian stock exchange, had a market capitalization of R\$2,546 billion (US\$1,528 billion) at December 31, 2010 and an average daily trading volume of R\$5.0 billion (US\$3.0 billion) for 2010. In comparison, aggregate market capitalization of the companies (including U.S. and non-U.S. companies) listed on the NYSE was US\$14.7 trillion at December 31, 2010 and the NYSE recorded an average daily trading volume of US\$70.9 billion for 2010. There is also significantly greater concentration in the Brazilian securities markets. The ten largest companies in terms of market capitalization represented approximately 56% of the aggregate market capitalization of the BM&FBOVESPA at December 31, 2010. The ten most widely traded stocks in terms of trading volume accounted for approximately 53% of all shares traded on the BM&FBOVESPA in 2010. These market characteristics may substantially limit the ability of holders of our ADSs to sell the preferred shares underlying our ADSs at a price and at a time when they wish to do so and, as a result, could negatively impact the market price of our ADSs themselves.

*The imposition of IOF taxes may indirectly influence the price and volatility of our ADSs, common shares and preferred shares.*

Brazilian law imposes the Tax on Foreign Exchange Transactions, or the IOF/Exchange Tax, on the conversion of *reais* into foreign currency and on the conversion of foreign currency into *reais*. Brazilian law also imposes the Tax on Transactions Involving Bonds and Securities, or the IOF/Bonds Tax, due on transactions involving bonds and securities, including those carried out on a Brazilian stock exchange.

In October 2009, the Brazilian government imposed the IOF/Exchange Tax at a rate of 2.0% in connection with inflows of funds related to investments carried out by non-Brazilian investors in the Brazilian financial and capital markets with the objective of slowing the pace of speculative inflows of foreign capital into the Brazilian market and the appreciation of the *real* against the U.S. dollar. In November 2009, the Brazilian government also established that the rate of the IOF/Bonds Tax applicable to the transfer of shares with the specific purpose of enabling the issuance of ADSs would be 1.5% with the objective of correcting an asymmetry created by the imposition of the IOF/Exchange Tax.

The imposition of these taxes may discourage foreign investment in shares of Brazilian companies, including our company, due to higher transaction costs, and may negatively impact the price and volatility of our ADSs, common shares and preferred shares on the NYSE and the BM&FBOVESPA.

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## **Table of Contents**

### **ITEM 4. INFORMATION ON THE COMPANY**

#### **Overview**

We are the largest integrated telecommunication service provider in Region II in Brazil, based on the total number of our fixed lines in service and mobile subscribers as of December 31, 2010, based on information available from ANATEL. We offer a range of integrated telecommunication services that includes fixed-line and mobile telecommunication services, data transmission services (including broadband access services), ISP services and other services, for residential customers, small, medium and large companies, and governmental agencies.

According to the IBGE, Region II (which consists of the Federal District and nine Brazilian states located in the western, central and southern regions) had a population of approximately 44.4 million as of August 1, 2010, representing 23.9% of the total Brazilian population, and represented approximately 27.0% of Brazil's total gross domestic product, or GDP, for 2008 (the most recent period for which such information is currently available).

#### ***Fixed-Line Telecommunications and Data Transmission Services***

Our traditional fixed-line telecommunications business in Region II includes local and long-distance services, network usage services (interconnection) and public telephones, in accordance with the concessions and authorizations granted to us by ANATEL. We are one of the largest fixed-line telecommunications companies in South America in terms of total number of lines in service as of December 31, 2010. We are the principal fixed-line telecommunication service provider in Region II, based on our 7.2 million fixed lines in service as of December 31, 2010, with an estimated market share of 78.0% of the total fixed lines in service in this region as of December 31, 2010, based on information available from ANATEL.

We offer a variety of high-speed data transmission services, including services offered by our subsidiaries BrT Serviços de Internet S.A. and Brasil Telecom Comunicação Multimídia Ltda. We also operate a fiber optic cable system that connects the United States, Bermuda, Brazil, Venezuela and Colombia through our subsidiaries Brasil Telecom Cabos Submarinos Ltda., Brasil Telecom Subsea Cable System (Bermuda) Ltd., Brasil Telecom of America Inc. and Brasil Telecom de Venezuela S.A. Our broadband services, primarily utilizing Asymmetric Digital Subscriber Line, or ADSL, technology, are marketed in Region II under the brand name *Oi Velox*. As of December 31, 2010, we had 1.9 million ADSL subscribers, representing 26.8% of our fixed lines in service at that date. For the year ended December 31, 2010, our fixed-line and data transmission services segment generated R\$8,893 million in net operating revenue and recorded operating income before financial income (expenses) and taxes of R\$2,481 million.

#### ***Mobile Telecommunication services***

We offer mobile telecommunication services in Region II through our subsidiary 14 Brasil Telecom Celular S.A., which we refer to as Brasil Telecom Mobile. Based on our 7.8 million mobile subscribers as of December 31, 2010, we believe that we are one of the principal mobile telecommunication service providers in Region II. Our estimated market share was 15.1% of the total number of mobile subscribers in Region II as of December 31, 2010, based on information available from ANATEL. For the year ended December 31, 2010, our mobile services segment generated R\$1,937 million in net operating revenue and recorded an operating loss before financial income (expenses) and taxes of R\$34 million.

#### ***Other Services***

We operate an internet portal through our subsidiary Internet Group do Brasil S.A. under the brand name *iG* that was one of the largest internet portals in Brazil in terms of the number of unique visitors in 2010, based on information available from Ibope/NetRatings. We also started a call center business for the sole purpose of providing services to our company and our subsidiaries.

Our principal executive office is located at Rua General Polidoro, No. 99, 5th floor/part Botafogo, 22280-001 Rio de Janeiro, RJ, Brazil, and our telephone number at this address is (55-21) 3131-1211.

## **Table of Contents**

### **Our History and Development**

Prior to the formation in 1972 of Telebrás, the Brazilian state-owned telecommunications monopoly, there were more than 900 telecommunications companies operating throughout Brazil. Between 1972 and 1975, Telebrás and its operating subsidiaries acquired almost all of the other telecommunications companies in Brazil and thus achieved a monopoly in providing public telecommunication services in almost all areas of the country.

Beginning in 1995, the Brazilian government undertook a comprehensive reform of Brazil's telecommunications regulations. In July 1997, Brazil's Congress adopted the Brazilian General Telecommunications Law (*Lei Geral das Telecomunicações*), which, together with the regulations, decrees, orders and plans on telecommunications issued by Brazil's executive branch, provided for the establishment of a comprehensive regulatory framework introducing competition into the Brazilian telecommunications industry and promoting the privatization of Telebrás and its subsidiaries.

#### ***Privatization of Telebrás***

In January 1998, in preparation for its restructuring and privatization, Telebrás spun-off its previously integrated mobile telecommunications operations from its fixed-line operations into separate companies. In May 1998, Telebrás was restructured to form 12 new holding companies, or the New Holding Companies, by means of a procedure under Brazilian Corporation Law called *cisão*, or spin-off. Virtually all of the assets and liabilities of Telebrás were allocated to the New Holding Companies, including Telebrás's interest in its operating subsidiaries. The New Holding Companies consisted of:

eight holding companies each of which controlled one or more mobile services providers, each operating in one of the ten service regions into which Brazil had been divided for mobile telecommunication services and using the frequency range called Band A (other than one mobile services provider that operated in two regions and one region in which the mobile services provider was not part of the Telebrás system);

three regional holding companies, each of which controlled the fixed-line service providers that provided local and intraregional long-distance service in one of the three service regions into which Brazil has been divided for fixed-line telecommunications; and

a holding company, which controlled Embratel, a provider of domestic (including interstate and interregional) and international long-distance service throughout Brazil.

Brasil Telecom Holding was one of the New Holding Companies in the fixed-line telecommunications business. In the restructuring and privatization of Telebrás, Brasil Telecom Holding was allocated all of the share capital held by Telebrás in the operating subsidiaries that provided fixed-line telecommunication service in Region II, including our company.

In August 1998, the Brazilian government privatized Telebrás by selling all of the voting shares that it held in the New Holding Companies, including Brasil Telecom Holding, to private-sector buyers. The Brazilian government's shares in the corporate capital of Brasil Telecom Holding were purchased by Solpart.

#### ***Expansion of Fixed-Line Network in Rio Grande do Sul***

In July 2000, we acquired the control of Companhia Riograndense de Telecomunicações, or CRT. CRT was the leading fixed-line telecommunication service company in the State of Rio Grande do Sul. In December 2000, CRT was merged with and into us.

#### ***Corporate Reorganization of Brasil Telecom***

Following the formation of Brasil Telecom Holding, it provided fixed-line telecommunication services through nine separate operating subsidiaries, including our company, each of which provided telecommunication services in one of the nine states of Region II or the Federal District of Brazil. In February 2000, Brasil Telecom Holding



## **Table of Contents**

implemented a corporate reorganization, which resulted in each of its other fixed-line operating companies being merged into our company.

### ***Entry into the Internet Service Provider Business***

In October 2001, we formed BrT Serviços de Internet S.A. to provide broadband internet services under the brand name *Turbo*.

### ***Entry into the Personal Mobile Services Business***

In December 2002, we established our wholly-owned subsidiary, Brasil Telecom Mobile, to provide personal mobile services (*Serviço Móvel Pessoal*) in Region II. In December 2002, Brasil Telecom Mobile was granted an authorization by ANATEL to provide personal mobile services in Region II following its successful bid of R\$192 million in an auction held for the authorization and the related radio frequency license. Brasil Telecom Mobile commenced operations in September 2004.

### ***Expansion of Our Internet Service Provider Business***

In June 2003, we acquired all of the share capital of iBest Holding Corporation that we did not own. Prior to this acquisition, we owned 12.8% of the share capital of iBest Holding Corporation. iBest Holding Corporation controlled (1) iBest S.A., or iBest, a free ISP and the then-largest ISP in Region II, (2) Freelance S.A., and (3) Febraio S.A. In May 2004, iBest and Febraio S.A. merged with and into Freelance S.A.

### ***Acquisition of Submarine Fiber-Optic Cable System***

In June 2003, we acquired the submarine fiber-optic cable system of 360 Networks Americas do Brasil Ltda. We refer to this system as GlobeNet. GlobeNet consists of a fiber optic cable system that connects the United States, Bermuda, Brazil, Venezuela and Colombia.

### ***Entry into the Internet Protocol Business***

In May 2004, we acquired substantially all of the share capital of Vant Telecomunicações S.A., or Vant, that we did not own. Prior to this acquisition, we owned 19.9% of the share capital of Vant. Vant offered IP services as well as other services to the corporate market throughout Brazil.

### ***Expansion of Data Transmission Network***

In May 2004, we acquired substantially all of the share capital of MetroRED Telecomunicações Ltda., or MetroRED, that we did not own. Prior to this acquisition, we owned 19.9% of the share capital of MetroRED. We have changed the corporate name of MetroRED to Brasil Telecom Comunicação Multimídia Ltda., or Brasil Telecom Multimedia. Brasil Telecom Multimedia is a leading local fiber optic network provider, with 263 kilometers of local area network in São Paulo, Rio de Janeiro and Belo Horizonte, and a 1,643 kilometer long-distance network linking these three metropolitan areas. Brasil Telecom Multimedia also has an internet solutions data center in São Paulo which provides internet support to our customers.

### ***Acquisition of iG***

In November 2004, we acquired 63.0% of the capital stock of Internet Group (Cayman) Ltd., the parent company of Internet Group do Brasil Ltda., or iG. Prior to this acquisition, Brasil Telecom Holding owned 10.0% of the capital stock of Internet Group (Cayman) Ltd. In July 2005, we acquired an additional 25.6% of the capital stock of Internet Group (Cayman) Ltd. iG is a free internet services provider. iG is the leading dial-up ISP in Brazil and operates in the dial-up and broadband access markets. In addition, iG operates an internet portal under the brand name *iG* and offers value-added internet services to customers in the residential and corporate markets.

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## **Table of Contents**

### ***Consolidation of Call Centers***

In December 2007, our subsidiary Brasil Telecom Call Center S.A. commenced operations, rendering call center services to us and our subsidiaries that demand this type of service. We invested approximately R\$50 million in infrastructure and customer service technologies to create call centers in Goiânia, Campo Grande, Florianópolis, Brasília and Curitiba to replace our 30 pre-existing sites.

### ***Acquisition by Telemar***

On January 8, 2009, Copart 1, a wholly-owned subsidiary of Coari, itself a wholly owned subsidiary of Telemar, acquired indirectly all of the outstanding shares of Invitel, and 12,185,836 common shares of Brasil Telecom Holding owned by the shareholders of Invitel. At that time, Invitel owned 100% of the outstanding shares of Solpart, which owned 52.0% of the outstanding voting share capital, representing 19.0% of the outstanding share capital, of Brasil Telecom Holding, which, in turn, owned 67.2% of the outstanding share capital, including 99.1% of the outstanding voting share capital, of our company.

During 2008, Copart 1 had acquired 76,645,842 preferred shares of Brasil Telecom Holding, representing 33.3% of the outstanding preferred shares of Brasil Telecom Holding, and Copart 2, a wholly owned subsidiary of Coari, had acquired 58,956,565 preferred shares of our company, representing 18.9% of our outstanding preferred shares.

As a result of the acquisition of Invitel, Telemar acquired indirect control of Brasil Telecom Holding and Brasil Telecom.

In connection with the approval of Telemar's acquisition of control of our company by the Administrative Council for Economic Defense (*Conselho Administrativo de Defesa Econômica*), or CADE, the Brazilian antitrust regulator, Telemar entered into a Performance Commitment Term (*Termo de Compromisso de Desempenho*) containing obligations related to the wholesale market, specifically with regard to the provision of interconnection and Industrial Exploitation of Dedicated Lines (*Exploração Industrial de Linha Dedicada*), or EILD. Under this agreement, we must, among other accessory obligations:

maintain a separate business area exclusively responsible for providing interconnection services, EILD and other wholesale services for a minimum of five years;

adopt specific procedures and provide specified assistance for our interconnection services and EILD customers; and

submit reports to CADE periodically and upon CADE's request regarding our activities in these markets.

In addition, in connection with the approval of Telemar's acquisition of control of our company by ANATEL, ANATEL imposed a number of conditions contained in the order granting the approval, some of which have already been fulfilled. The most significant of the remaining conditions applicable to our company require us to:

expand our fiber optic network to 40 new municipalities in each of 2011 through 2015; and

offer broadband services in 50% of the municipalities covered by our obligations to provide transmission lines connecting the fiber-optic internet backbones of our company to municipalities in their concession areas in which they do not provide internet service, which we refer to as backhaul, at rates no greater than Telemar's highest existing rate for broadband services, within five months of completing the backhaul extensions, and 100% of such municipalities within ten months of completing the backhaul extensions.

### ***Mandatory Tender Offers by Copart 1 and Copart 2***

As a result of the acquisition of control of Brasil Telecom and Brasil Telecom Holding by Telemar on January 8, 2009, under Article 254-A of the Brazilian Corporation Law and CVM Instruction No. 361, of March 5,





## **Table of Contents**

2002, as amended, Telemar was required to offer to purchase any and all common shares of Brasil Telecom Holding and Brasil Telecom held by public shareholders.

As a result of these auctions, in June 2009, (1) Copart 1 acquired 40,452,227 common shares of Brasil Telecom Holding, representing 30.5% of the outstanding common shares of Brasil Telecom Holding and 11.2% of the outstanding share capital of Brasil Telecom Holding, and (2) Copart 2 acquired 630,872 common shares of Brasil Telecom, representing 0.3% of the outstanding common shares of Brasil Telecom and 0.1% of the outstanding share capital of Brasil Telecom.

### *Merger of Copart 1 into Brasil Telecom Holding*

On July 31, 2009, (1) Invitel merged with and into Solpart, with Solpart as the surviving company, (2) Solpart merged with and into Copart 1, with Copart 1 as the surviving company, and (3) Copart 1 merged with and into Brasil Telecom Holding, with Brasil Telecom Holding as the surviving company. As a result of these mergers, Coari owned 54.7% of the outstanding share capital, including 91.7% of the outstanding voting share capital, of Brasil Telecom Holding.

### *Merger of Copart 2 into Brasil Telecom*

On July 31, 2009, Copart 2 merged with and into Brasil Telecom, with Brasil Telecom as the surviving company. As a result of this transaction, Coari owned 10.9% of the outstanding share capital, including 0.3% of the outstanding voting share capital, of Brasil Telecom.

### *Merger of Brasil Telecom Holding into Brasil Telecom*

On September 30, 2009, the shareholders of Brasil Telecom and Brasil Telecom Holding approved a merger (*incorporação*) under Brazilian law of Brasil Telecom Holding with and into Brasil Telecom, with Brasil Telecom as the surviving company. In the Brasil Telecom merger:

each issued and then outstanding common share of Brasil Telecom Holding (other than any common shares held by shareholders seeking withdrawal of their common shares) was converted automatically into 1.2190981 common shares of Brasil Telecom;

each issued and then outstanding preferred share of Brasil Telecom Holding (including preferred shares of Brasil Telecom Holding represented by the Brasil Telecom Holding ADSs) was converted automatically into 0.1720066 common shares of Brasil Telecom and 0.9096173 preferred shares of Brasil Telecom;

holders of Brasil Telecom Holding ADSs (each representing five preferred shares of Brasil Telecom), were entitled to receive 0.860033 Common ADSs of Brasil Telecom and 1.516028 Preferred ADSs of Brasil Telecom for each Brasil Telecom Holding ADS they held; and

all issued and then outstanding shares of Brasil Telecom held by Brasil Telecom Holding were cancelled.

As a result of the Brasil Telecom merger, Brasil Telecom Holding ceased to exist and Coari owns 48.2% of the total outstanding share capital of Brasil Telecom, including 79.6% of its outstanding voting share capital. For additional information about our controlling shareholders, see Item 7. Major Shareholders and Related Party Transactions Major Shareholders.

## **Corporate Structure**

The following chart presents our corporate structure and principal subsidiaries as of April 26, 2011. The percentages in bold italics represent the percentage of the voting capital owned directly and indirectly by the parent company of each entity, and the percentages not in bold italics represent the percentage of the total share capital owned directly and indirectly by the parent company of each entity.



**Table of Contents**

- (1) Ownership represents 53.8% of the share capital of Internet Group do Brasil S.A. owned directly by BrT Serviços de Internet S.A. and 13.6% owned by Brasil Telecom S.A.

**Our Service Area**

Our concessions and authorizations from the Brazilian government allow us to provide:

fixed-line telecommunication services in Region II;

long-distance telecommunication services originating from Region II;

mobile telecommunication services in Region II; and

data transmission services throughout Brazil.

Region II covers an area of approximately 2.9 million square kilometers, which represents approximately 33.5% of the country's total land area and accounted for approximately 27.0% of Brazil's GDP in 2008. The population of Region II was 44.4 million as of August 1, 2010, which represented 23.9% of the total population of Brazil as of that date. In 2008, per capita income in Region II was approximately R\$17,874, varying from R\$9,896 in the State of Acre to R\$45,978 in the Federal District.

The following table sets forth key economic data, compiled by IBGE, for the Federal District and each of the Brazilian states in Region II.

State	Population (in millions) (2010)	Population per Square Kilometer (2010)	% of GDP (2008)	GDP per Capita (in reais) (2008)
Rio Grande do Sul	10.6	37.5	6.6	18,378
Paraná	10.3	51.5	5.9	16,928
Santa Catarina	6.2	64.8	4.1	20,369
Goiás	5.8	17.2	2.5	12,879

**Table of Contents**

State	Population (in millions) (2010)	Population per Square Kilometer (2010)	% of GDP (2008)	GDP per Capita (in reais) (2008)
Mato Grosso	3.0	3.3	1.7	17,927
Federal District	2.5	425.6	3.9	45,978
Mato Grosso do Sul	2.4	6.7	1.1	14,188
Rondônia	1.5	6.5	0.6	11,977
Tocantins	1.4	4.9	0.4	10,223
Acre	0.7	4.6	0.2	9,896
Total	44.4		27.0	

Source: IBGE.

Set forth below is a map of Brazil showing the location of Region II.

Our business, financial condition, results of operations and prospects depend in part on the performance of the Brazilian economy and the economy of Region II in particular. See Item 3. Key Information Risk Factors Risks Relating to Brazil.

**Our Services**

Our telecommunication services consist of:

local fixed-line services in Region II, including installation, monthly subscription, metered services, collect calls and supplemental local services;

domestic long-distance services and international long-distance services primarily from Region II, placed through fixed-line and mobile telephones using our long-distance carrier selection code, which is represented by the number 14;

mobile telecommunication services utilizing 2G and 3G technology;

## **Table of Contents**

data transmission services, comprised of (1) ADSL services, (2) the lease of dedicated digital and analog lines to other telecommunication services providers, ISPs and corporate customers, (3) IP solutions, and (4) other data transmission services;

usage of our network (1) to complete calls initiated by customers of other telecommunication services providers (interconnection services) or (2) by service providers that do not have the necessary network;

traffic transportation services;

public telephone services;

value-added services which include voicemail, caller ID, directory assistance and other services;

advanced voice services to corporate customers, such as 0800 (toll free) services; and

the operation of the iG internet portal.

### ***Local Fixed-Line Services***

As of December 31, 2010, we had approximately 7.2 million local fixed-line customers in Region II. Local fixed-line services include installation, monthly subscription, metered services, collect calls and supplemental local services. Metered services include local calls that originate and terminate within a single local area. ANATEL has divided Region II into 1,772 local areas.

Under our concession agreements, we are required to offer two local fixed-line plans to users: the Basic Plan per Minute (*Plano Básico de Minutos*) and the Mandatory Alternative Service Plan (*Plano Alternativo de Serviços de Oferta Obrigatória*), each of which includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2010, 26.7% of our fixed-line customers subscribed to the Basic Plan per Minute or the Mandatory Alternative Service Plan.

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, we offer a variety of alternative fixed-line plans that are designed to meet our customers' usage profiles. As of December 31, 2010, 73.3% of our fixed-line customers subscribed to alternative plans.

We offer (1) integrated, or bundled, plans which permit subscribers to purchase unlimited local calls to other fixed-line customers, a fixed number of minutes per month that may be used for long-distance calls or local calls to mobile subscribers, and broadband services or minutes for use to establish dial-up internet connections, which we market under the brand name *Oi Conta Total*; (2) voice and internet plans which permit subscribers to purchase a fixed number of local minutes per month for calls to fixed-line telephones and for use to establish dial-up internet connections, (3) voice-only plans which permit subscribers to purchase a fixed number of local minutes per month for calls to fixed-line telephones, and (4) budget plans which permit subscribers to purchase a fixed number of local minutes, either on a pre-paid basis or a monthly basis, but restrict local calls after the purchased minutes have been consumed and require the purchase of a pre-paid card to make long-distance calls or calls to mobile handsets, such as our *Oi Fixo Controle* and *Oi Fixo Economia* plans.

Local fixed-line services also include in-dialing services (direct transmission of external calls to extensions) for corporate clients. For corporate clients in need of a large quantity of lines, we offer digital trunk services, which optimize and increase the speed of the customer's telephone system.

### ***Long-Distance Services***

For each long-distance call, whether originated from a fixed-line telephone or a mobile handset, a caller chooses its preferred long-distance carrier by dialing such carrier's long-distance carrier selection code. The caller pays the long-distance service provider for the call and the long-distance service provider pays interconnection fees to the service providers on whose fixed-line or mobile networks the call originated and terminated.



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## **Table of Contents**

Our domestic and international long-distance services consist primarily of calls originated in Region II.

### *Fixed Line-to-Fixed Line*

Calls from one local area to another local area are domestic long-distance calls, other than calls between separate local areas within specified metropolitan regions which, under ANATEL regulations, are charged as local calls. Calls between locations in Brazil and locations outside Brazil are international long-distance calls.

We provide domestic long-distance services for calls originating from Region II through interconnection agreements, mainly with Telemar in Region I (which consists of 16 states of Brazil located in the northeastern and part of the northern and southeastern regions of Brazil) and Telecomunicações de São Paulo S.A., or Telesp, in Region III (which consists of the State of São Paulo), that permit us to interconnect directly with their local fixed-line networks, and through our network facilities in São Paulo, Rio de Janeiro and Belo Horizonte. We provide international long-distance services originating from Region II through agreements to interconnect our network with those of the main telecommunication service providers worldwide.

### *Mobile Long-Distance*

Each mobile subscriber in Brazil is registered in a geographic area (identified by the corresponding area codes, such as 11 (São Paulo) and 61 (Brasília)), which we refer to as the subscriber's home registration area, and Brazil is divided into sectors based on the first digit of the area code of a caller's home registration area. A call originated by a mobile subscriber registered in one home registration area to a mobile subscriber registered in another home registration area sharing the same first digit (for example, Brasília (area code 61) and Goiânia (area code 62)), is referred to as an intrasectorial mobile call. A call originated by a mobile subscriber registered in one home registration area to a mobile subscriber registered in another home registration area that does not share the same first digit (for example, Brasília (area code 61) and São Paulo (area code (11))), is referred to as an intersectorial mobile call. Different rates apply to intrasectorial and intersectorial mobile calls.

We provide mobile long-distance services originating from Region II through interconnection agreements with Telemar in Region I, Telesp in Region III, and each of the principal mobile services providers operating in Brazil that permit us to interconnect directly with their local fixed-line and mobile networks. We provide international long-distance services originating or terminating on our customer's mobile handsets through agreements to interconnect our network with those of the main telecommunication service providers worldwide. We also use our submarine fiber optic network to transport international mobile long-distance calls.

### *Mobile Telecommunication Services*

As of December 31, 2010, we had approximately 7.8 million subscribers located in 1,281 municipalities in Region II. As of December 31, 2010, we had a 15.1% share of the mobile services market in Region II, based on information available from ANATEL. As of December 31, 2010, 87.5% of our customers subscribed to pre-paid plans and 12.5% subscribed to post-paid plans.

### *Pre-Paid Customers*

Pre-paid customers activate their cellular numbers through the purchase and installation of a SIM card in their mobile handsets. Our pre-paid customers are able to add credits to their accounts through the purchase of pre-paid cards at prices that vary based on the number of minutes available, or through the purchase of additional credits over the phone that can be charged to the customer's credit card or included on their bill for fixed-line services. These credits are valid for a fixed period of time following activation.

We market *Oi Ligador* subscriptions to our pre-paid customers, which allow these customers to receive bonus minutes with each purchase of additional credits. We charge a nominal subscription fee to enroll a customer in the *Oi Ligador* program and provide bonus minutes to these customers that may be used for (1) local calls to our fixed-line or mobile subscribers, (2) long-distance calls to our fixed-line subscribers, and (3) sending Short Message Service, or SMS, messages to mobile subscribers of any Brazilian mobile service provider.



## Table of Contents

We sell pre-paid cards in minimum denominations of R\$1.00 and permit our pre-paid customers to add credits to their account in any amount, including *centavos*, in order to facilitate the continued activation of their mobile handsets, allowing them to continue to receive incoming calls. We regularly launch various packages designed to incentivize the purchase and use of credits by our pre-paid customers.

We have launched several programs to stimulate consumption of our prepaid services, such as *Bônus Extra* and *Crédito Especial*. *Bônus Extra* allows a customer to exchange credits that they have in their pre-paid accounts for much larger packages of credits that are available for use on local calls made to any fixed-line or to our mobile customers. *Crédito Especial* allows one of our customers to receive a credit for emergencies for which the customer pays a premium when the customer makes its next purchase of credits.

In connection with our strategy of selling pre-paid service packages, we continue to develop new sales channels in order to increase market penetration and reduce sales costs, including selling SIM cards in small retail shops (newsstands, drugstores and supermarkets, among others).

### *Post-Paid Customers*

Post-paid customers pay a monthly subscription fee and are billed on a monthly basis for services provided during the previous month. Post-paid plans include mailbox, caller ID, conference, call forwarding, calls on hold and special services, including Wireless Application Protocol (a protocol which simplifies standard internet codes for the more limited transmission features of a mobile handset), or WAP, General Packet Radio Service, or GPRS, which allows speeds in the range of 115 kilobytes per second (Kbps), Enhanced Data Rates for Global Evolution, or EDGE, which allows speeds in the range of 230 Kbps, and 3G.

The GPRS, EDGE and 3G services we include in our post-paid plans are available to customers with advanced mobile handset models. These services allow for mobile access to the internet through mobile telephones, laptops or personal digital assistants. They also enable customers simultaneously to use voice and data services, because the connection to the internet remains active even when the customer is speaking on the phone. This means that the customer can remain continuously online and, at the same time, place or receive calls.

The WAP portal is another service and content channel available to our post-paid plan customers. Some of its features include sending and receiving e-mails, forming contact groups, accessing banks and buying tickets. The WAP portal can also be used on the internet, for instance, to schedule personal activities and join or initiate contact groups.

Under our authorizations to provide personal mobile services, we are required to offer a basic post-paid mobile plan that includes activation charges, monthly subscription rates and charges for local calls. As of December 31, 2010, fewer than 1% of our mobile customers subscribed to our basic post-paid plan. In addition to the basic plan, we offer a variety of alternative post-paid plans that are designed to meet our customers usage profiles.

We offer (1) plans which permit a subscriber to purchase a fixed number of minutes per month for local calls to other fixed-line or mobile subscribers; (2) family plans which permit a subscriber to purchase a fixed number of minutes per month for local calls that may be shared by up to four individuals; and (3) data plans providing data transmission at speeds of 1 Mbps.

We also offer plans under the brand name *Oi Controle* that permit a subscriber to purchase a fixed number of local and long-distance minutes per month, but restrict outgoing calls after the purchased minutes have been consumed, other than calls made using a pre-paid card. We account of these hybrid plans as post-paid plans as customers selecting these plans pay monthly subscription fees for their fixed allocations of minutes. In general, these plans are attractive to our other post-paid customers that migrate to these plans to place self-imposed limits on their mobile calling habits and to our pre-paid customers who are able to place calls at lower cost than with our pre-paid services.

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## **Table of Contents**

### *Roaming*

We have roaming agreements with TNL PCS S.A., a wholly-owned subsidiary of Telemar which provides mobile services and which we refer to as Oi, Companhia de Telecomunicações do Brasil Central, or CTBC, and Sercomtel S.A. Telecomunicações, or Sercomtel, providing our customers with automatic access to roaming services when traveling outside of Region II in areas of Brazil where mobile telecommunication services are available on the GSM standard.

We generate revenues from roaming when one of our mobile subscribers receives a call while at a location outside the sector that includes their home registration area. In addition, we generate revenues when a subscriber of another mobile services provider places a call from a location that is outside the coverage area of its mobile services provider and the call is originated on our mobile networks. Conversely, when one of our mobile subscribers places a call from outside of Brazil, we pay the applicable roaming rate to the mobile services provider on whose network the call originated.

### *3G Broadband Services*

In 2007, we were granted an authorization and the related frequency licenses by ANATEL to offer 3G mobile services in Region II. The deployment of our 3G network allows us to offer data communication services to our personal mobile services customers at greater speeds than those made available by our previously existing 2G networks. As of December 31, 2010, we had launched 3G services in a total of 84 municipalities, including the nine state capitals in Region II and the Federal District. As of December 31, 2010, we had approximately 175,200 3G mobile broadband customers.

### *Data Transmission Services*

#### *Broadband Services*

We provide high-speed internet access services using ADSL technology, which we refer to as broadband services, to residential customers and businesses in the primary cities in Region II under the brand name *Oi Velox*. As of December 31, 2010, we offered broadband services in 1,810 municipalities in Region II and we had 1.9 million ADSL customers.

ADSL technology allows high-speed transmission of voice and data signals on a single copper wire pair for access to the network. Since voice transmission through telephone lines uses only one of many available frequency bands, the remaining frequency bands are available for data transmission. An ADSL modem is installed using the customer's conventional line, which, in turn, is connected to Digital Subscriber Line Access Multiplexer, or DSLAM, equipment at the switching station. As a result, customers can use the telephone line simultaneously with the internet. Customers pay a fixed monthly subscription fee, irrespective of their actual connection time to the internet.

Our network supports ADSL2+, VDSL2 and FTTx technologies. ADSL2+ is a data communications technology that allows data transmission at speeds of up to 24 Mbps downstream and 1 Mbps upstream, which is much faster than data transmission through conventional ADSL. ADSL2+ permits us to offer a wider range of services than ADSL, including IP TV. As of December 31, 2010, approximately 50% of our fixed-line network had been updated to support ADSL2+. VDSL2, or very-high-bitrate digital subscriber line, is a DSL technology providing faster data transmission, up to 100 Mbps (downstream and upstream), permitting us to support high bandwidth applications such as HDTV, VoIP and broadband internet access, over a single connection. FTTx, or Fiber to the x, is a term for broadband network architecture that uses optical fiber to replace all or part of the usual metal local loop used for last mile telecommunications.

We charge monthly fees to our broadband users that choose iBest or iG as their ISP. We do not charge fees to our fixed-line customers that choose iBest or iG as their ISP for dial-up internet access. As of December 31, 2010, iBest and iG had an aggregate of approximately 0.7 million registered dial-up users.

## **Table of Contents**

### *Commercial Data Transmission Services*

We provide a variety of customized, high-speed data transmission services through various technologies and means of access to other telecommunication services providers, ISPs and corporate customers. Our data transmission services include interconnection between local area networks at data transmission speeds of 34 Mbps, 155 Mbps and 1 Gbps, videoconferencing, video/image transmission and multimedia applications. Our principal commercial data transmission services are:

Industrial Exploitation of Dedicated Lines (*Exploração Industrial de Linha Dedicada*), or EILD, under which we lease trunk lines to other telecommunication services providers, primarily mobile services providers, which use these trunk lines to link their radio base stations to their switching centers;

Dedicated Line Services (*Serviços de Linhas Dedicadas*), or SLD, under which we lease dedicated lines to other telecommunication services providers, ISPs and corporate customers for use in private networks that link different corporate websites;

IP services which consist of dedicated private lines and dial-up internet access which we provide to most of the leading ISPs in Brazil, as well as Virtual Private Network, or VPN, services that enable our customers to operate private intranet and extranet networks; and

frame relay services which we provide to our corporate customers to allow them to transmit data using protocols based on direct use of our transmission lines, enabling the creation of VPNs.

We provide these data transmission services using our service network platform in Region II and our nationwide fiber optic cable network and microwave links.

In order to provide complete solutions to our corporate clients, we have entered into service agreements for the joint supply of international data services with a number of important international data services providers. These commercial relationships with international data services providers are part of our strategy of offering telecommunication services packages to our customers.

In addition, we provide services at our six cyber data centers located in Brasília, São Paulo, Curitiba, Porto Alegre and Fortaleza. We provide hosting, collocation and IT outsourcing at these centers, permitting our customers to outsource their IT structures to us or to use these centers to provide backup for their IT systems.

We also own and operate a submarine fiber optic network, which connects Brazil with the United States, Bermuda, Venezuela and Colombia. Through this network, we offer international data transportation services, primarily leased lines to other telecommunication services providers.

### ***Network Usage Services (Interconnection Service)***

All telecommunication services providers in Brazil are required, if technically feasible, to make their networks available for interconnection on a non-discriminatory basis whenever a request is made by another telecommunication services provider. Interconnection permits a call originated on the network of a requesting local fixed-line, mobile or long-distance service provider's network to be terminated on the local fixed-line or mobile services network of the other provider.

### ***Use of Our Local Fixed-Line Network***

We are authorized to charge for the use of our local fixed-line network on a per-minute basis for (1) all calls terminated on our local fixed-line network in Region II that originate on the networks of other local fixed-line, mobile and long-distance service providers, and (2) all long-distance calls originated on our local fixed-line network in Region II that are carried by other long-distance service providers.



## **Table of Contents**

Conversely, other local fixed-line service providers charge us interconnection fees (1) to terminate calls on their local fixed-line networks that are originated on our local fixed-line, mobile or long-distance networks, and (2) for long-distance calls originated on their local fixed-line networks that are carried by our long-distance network.

In addition, we charge network usage fees to long-distance service providers and operators of trunking services that connect switching stations to our local fixed-line networks.

### *Use of Our Long-Distance Network*

We are authorized to charge for the use of our long-distance network on a per-minute basis for all calls that travel through a portion of our long-distance networks for which the caller has not selected us as the long-distance provider. Conversely, other long-distance service providers charge us interconnection fees on a per-minute basis for all calls that travel through a portion of their long-distance networks for which the caller has selected us as the long-distance provider.

### *Use of Our Mobile Network*

We are authorized to charge for the use of our mobile network on a per-minute basis for all calls terminated on our mobile network that originate on the networks of other local fixed-line, mobile and long-distance service providers. Conversely, other mobile services providers charge us interconnection fees to terminate calls on their mobile networks that are originated on our local fixed-line, mobile or long-distance networks.

### *Traffic Transportation Services*

Long-distance and mobile services providers may avoid paying long-distance network usage charges to us by establishing an interconnection to our local fixed-line networks. In order to retain these customers of our long-distance services, we offer a long-distance usage service, called national transportation, under which we provide discounts to our long-distance network usage fees based on the volume of traffic and geographic distribution of calls generated by a long-distance or mobile services provider.

We also offer international telecommunication service providers the option to terminate their Brazilian inbound traffic through our network, as an alternative to Embratel and Intelig Telecomunicações Ltda., or Intelig. We charge international telecommunication service providers a per-minute rate, based on whether a call terminates on a fixed-line or mobile telephone and the location of the local area in which the call terminates.

### *Public Telephone Services*

We own and operate public telephones throughout Region II. As of December 31, 2010, we had approximately 266,100 public telephones in service, all of which are operated by pre-paid cards. For a discussion of how we account for the sale of the pre-paid cards, see Item 5. Operating and Financial Review and Prospects Financial Presentation and Accounting Policies Critical Accounting Policies and Estimates Revenue Recognition and Trade Receivables.

### *Value-Added Services*

Value-added services include voice, text and data applications, including voicemail, caller ID, and other services, such as personalization (video downloads, games, ring tones and wallpaper), SMS subscription services (horoscope, soccer teams and love match), chat, mobile television, location-based services and applications (mobile banking, mobile search, email and instant messaging).

### *Advanced Voice Services*

We provide advanced voice services to our corporate customers, mainly 0800 (toll free) services, as well as voice portals where customers can participate in real-time chats and other interactive voice services.

**Table of Contents*****iG Internet Portal***

We operate an internet portal under the brand name *iG* that was one of the largest internet portals in Brazil in terms of the number of unique visitors in 2010 according to Ibope/NetRatings. In 2010, *iG* was visited by 26.8 million users on a monthly basis, and as of December 31, 2010, *iG* had approximately 1.6 million registered subscribers and hosted 5.1 million e-mail accounts. *iG* offers high quality content to the internet users that visit *iG*'s website, as well as a large and diversified portfolio of products and services. We are in the process of repositioning the *iG* brand to promote the launch of content channels covering the economy, women's topics, entertainment, education, news, celebrities and sports, among others. We generate revenue through the *iG* portal from (1) monthly subscription fees that we charge to registered users of this portal, (2) fees charged to place advertisements on this portal, and (3) fees that we receive from fixed-line service providers based on the number of minutes that their subscribers are connected to this portal.

**Rates**

Our rates for local fixed-line services, domestic long-distance services, mobile services, interconnection, EILD and SLD services are subject to regulation by ANATEL, subject to certain exceptions relating to the rates we charge under alternative fixed-line and mobile plans that we are authorized to offer to our customers. For information on ANATEL regulation of our rates, see Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services Rate Regulation, Regulation of the Brazilian Telecommunications Industry Regulation of Mobile Services Personal Mobile Services Rate Regulation, Regulation of the Brazilian Telecommunications Industry Interconnection Regulations, and Regulation of the Brazilian Telecommunications Industry Regulation of Data Transmission and Internet Services.

Many of the services we provide charge on a per-minute basis. For these services, we charge for calls based on the period of use. The charge unit is a tenth of a minute (six seconds), and rounding is permitted to the next succeeding tenth of a minute. There is a minimum charge period of 30 seconds for every call.

***Local Fixed-Line Rates******Local Rates***

Our revenues from local fixed-line services consist mainly of monthly subscription charges, charges for local calls and charges for the activation of lines for new subscribers or subscribers that have changed addresses. Monthly subscription charges are based on the plan to which the customer subscribes and whether the customer is a residential, commercial or trunk line customer.

Under our concession agreements, we are required to offer two local fixed-line plans to users: the Basic Plan per Minute and the Mandatory Alternative Service Plan, each of which includes installation charges, monthly subscription charges, and charges for local minutes. As of December 31, 2010, 26.7% of our local fixed-line customers subscribed to the Basic Plan per Minute or the Mandatory Alternative Service Plan.

The monthly subscription fees under the Basic Plan per Minute and the Mandatory Alternative Service Plan vary in accordance with the subscribers' profiles, as defined in the applicable ANATEL regulations. The monthly subscription fee for the Basic Plan per Minute includes the use of 200 local minutes per month by residential customers and 150 local minutes per month by commercial customers and trunk line customers. The monthly subscription fee for the Mandatory Alternative Service Plan includes the use of 400 local minutes per month by residential customers and 360 local minutes per month by commercial customers and trunk line customers. We deduct only two local minutes from a Basic Plan per Minute customer's monthly allotment and four minutes from a Mandatory Alternative Service Plan customer's monthly allotment for each local call made, regardless of the duration of the call, during off-peak hours. If the minute limits are exceeded, customers will incur additional metered-minute charges, the prices of which vary depending on whether the customer is a Basic Plan per Minute subscriber or a Mandatory Alternative Service Plan subscriber. If a customer does not use all of the minutes covered by the monthly subscription fee, the minutes cannot be carried over to the next month.

**Table of Contents**

In addition to the Basic Plan per Minute and the Mandatory Alternative Service Plan, we are permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates and charges for local and long-distance calls) must be submitted for ANATEL approval prior to the offering of those plans to our customers. In general, ANATEL does not raise objections to the terms of these plans. As of December 31, 2010, 73.3% of our fixed-line customers subscribed to alternative plans.

Under our fixed-line rate plans, we charge for calls on a per-minute basis. There is a minimum charge period of 30 seconds for every call. However, calls of three seconds or less are not charged, except in certain specific instances as provided for in ANATEL regulations.

Prior to January 2006, calls were measured and charged in terms of pulses, consisting of a single charge per call and an additional charge for each four-minute interval of usage. In January 2006, our concession agreements established a per-minute billing system for local fixed-line telecommunication services, which we implemented by July 2007. In localities (*localidades*), which are governmental administrative units into which municipalities are divided, where we have not implemented the minute-based rates due to technical or economic infeasibility, we do not charge fees for additional minutes on local calls made to another fixed-line telephone. In these localities we charge only basic monthly subscription fees.

On an annual basis, ANATEL increases or decreases the maximum rates that we are permitted to charge for our basic service plans. ANATEL increased these rates by an average of 3.01% as of July 24, 2008, 0.98% as of September 14, 2009 and 0.66% as of October 23, 2010. In addition, we are authorized to adjust the rates applicable to our alternative plans annually by no more than the rate of inflation, as measured by the IST. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval.

The following table sets forth selected information regarding service rates under our Basic Plan per Minute during the periods indicated.

Monthly subscription rates for Basic Plan per Minute (1)	Year Ended December 31,		
	2010	2009	2008
		(in reais)	
Basic Plan per Minute (residential)	29.22	28.97	28.69
Basic Plan per Minute (commercial)	43.26	42.89	42.48
Basic Plan per Minute (trunk lines)	42.52	42.50	42.09

(1) The amounts represent the weighted average of monthly rates, net of taxes.

*Local Fixed Line-to-Mobile Rates*

When one of our fixed-line customers makes a call to a mobile subscriber of our company or another mobile services provider that terminates in the mobile registration area in which the call was originated, we charge our fixed-line customer per-minute charges for the duration of the call based on rates designated by ANATEL as VC1 rates. In turn, we pay the mobile services provider a per-minute charge based on rates designated by ANATEL as VU-M rates for the use of its mobile network in completing the call. VC1 rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis.

On an annual basis, ANATEL may increase or decrease the maximum VC1 rates that we are permitted to charge. ANATEL authorized us to increase our VC1 rates by an average of 3.03% as of July 24, 2008 and 0.98% as of February 9, 2010. Discounts from the VC1 rates approved by ANATEL may be granted to customers without ANATEL approval.

The following table sets forth the average per-minute VC1 rates that we were permitted to charge for fixed line to mobile calls during the periods indicated.

**Table of Contents**

	Year Ended December 31,		
	2010	2009	2008
	(in reais)		
Per-minute charges for local fixed-line calls made to mobile telephones (1)	0.51	0.51	0.51

(1) The amounts represent the weighted average of monthly rates, net of taxes.

*Domestic Long-Distance Rates**Fixed Line-to-Fixed-Line*

If a caller selects our carrier selection code for a long-distance call that originates and terminates on fixed-line telephones, we receive the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. Rates for these long-distance calls are based on the physical distance separating callers (which are categorized by four distance ranges), time of the day and day of the week, and are applied on a per minute basis for the duration of the call. Rates on these calls are applied on a per-minute basis.

On an annual basis, ANATEL increases or decreases the maximum domestic fixed line-to-fixed line long-distance rates that we are permitted to charge. ANATEL increased these rates by an average of 3.01% as of July 24, 2008, 0.98% as of September 14, 2009 and 0.66% as of October 23, 2010. Discounts from the domestic fixed line-to-fixed line long-distance rates approved by ANATEL may be granted to customers without ANATEL approval.

The following table sets forth selected information on domestic fixed line-to-fixed line long-distance rates that we were permitted to charge per minute during peak hours (i.e., between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. on weekdays) during the periods indicated.

Domestic long-distance rates per minute (1)	Year Ended December 31,		
	2010	2009	2008
	(in reais)		
0 to 50 km	0.20	0.24	0.24
50 to 100 km	0.35	0.35	0.35
100 to 300 km	0.38	0.36	0.36
Over 300 km	0.39	0.37	0.37

(1) The amounts represent the weighted average of monthly rates, net of taxes.

*Mobile Long-Distance*

Rates for long-distance calls that originate or terminate on mobile telephones are based on whether the call is an intrasectorial long-distance call, which is charged at rates designated by ANATEL as VC2 rates, or an intersectorial long-distance call, which is charged at rates designated by ANATEL as VC3 rates. If the caller selects our carrier selection code for the call, we receive the revenues from the call and must pay interconnection fees to the service providers that operate the networks on which the call originates and terminates. The applicable VC2 and VC3 rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis.

On an annual basis, ANATEL may increase or decrease the maximum VC2 and VC3 rates we are authorized to charge. ANATEL authorized us to increase our VC2 and VC3 rates by an average of 3.01% as of July 23, 2008, and 0.98% as of February 9, 2010.

The following table sets forth the average per-minute rates that we were permitted to charge for mobile long-distance calls during peak hours (i.e., between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. on weekdays) during the periods indicated.



**Table of Contents**

Per-minute charges for mobile long-distance calls (1)	Year Ended December 31,		
	2010	2009	2008
	(in reais)		
VC2	1.12	1.11	1.11
VC3	1.28	1.26	1.26

(1) The amounts represent the weighted average of monthly rates, net of taxes.

**Mobile Rates**

Mobile telecommunication service in Brazil, unlike in the United States, is offered on a calling-party-pays basis under which a mobile subscriber pays only for calls that he or she originates (in addition to roaming charges paid on calls made or received outside the subscriber's home registration area). A mobile subscriber receiving a collect call is also required to pay mobile usage charges.

Our revenues from mobile services consist mainly of charges for local and long-distance calls paid by our pre-paid and post-paid mobile subscribers and monthly subscription charges paid by our post-paid plan subscribers. Monthly subscription charges are based on a post-paid subscriber's service plan. If one of our mobile subscribers places or receives a call from a location outside of his or her home registration area, we are permitted to charge that customer the applicable roaming rate.

Under ANATEL regulations, we were required to submit a basic post-paid service plan and a basic pre-paid service plan to ANATEL for its approval. As of December 31, 2010, 0.03% of our mobile customers subscribed to our basic post-paid plan and 1% of our mobile customers subscribed to our basic pre-paid plan.

Under the basic post-paid service plan, customers pay monthly subscription charges (which include a specified number of usage minutes) and pay fees based on usage of excess minutes that were not included in the monthly subscription charge. Under the basic pre-paid service plan, customers pay a one-time activation charge as well as charges for the minutes that they use. The rates for the applicable services under these plans (e.g., activation charges, monthly subscription charges, charges for local and long-distance calls and roaming charges) were approved by ANATEL at the time that the plans were authorized.

We charge for all mobile calls made by our pre-paid customers, and for mobile calls made by our post-paid customers in excess of their allocated monthly number of minutes, on a per-minute basis.

In addition to the basic service plans, we are permitted to offer non-discriminatory alternative plans to the basic service plans. The rates for applicable services under these plans (e.g., monthly subscription rates, charges for local and long-distance calls and roaming charges) must be submitted for ANATEL approval prior to the offering of those plans to our customers. In general, ANATEL does not raise objections to the terms of these plans. As of December 31, 2010, substantially all of our post-paid and pre-paid customers subscribed to these alternative plans.

Although subscribers of a plan cannot be forced to migrate to new plans, existing plans may be discontinued as long as all subscribers of the discontinued plan receive a notice to that effect and are allowed to migrate to new plans within six months of such notice.

Rates under our basic and alternative mobile plans may be adjusted annually by no more than the rate of inflation, as measured by the IST. These rate adjustments occur on the anniversary dates of the approval of the specific plans. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval. The rate of inflation as measured by the IST was 6.56% in 2008, 2.06% in 2009 and 5.65% in 2010.

**Table of Contents****Network Usage (Interconnection) Rates***Fixed-Line Networks*

Our revenues from the use of our local fixed-line networks consist primarily of payments on a per-minute basis, which are charged at rates designated by ANATEL as TU-RL rates, from:

long-distance service providers to complete calls terminating on our local fixed-line network;

long-distance service providers for the transfer to their networks of calls originating on our local fixed-line network;

mobile services providers to complete calls terminating on our local fixed-line network; and

other fixed-line service providers for local fixed-line calls that originate on their local fixed-line networks and terminate on our local fixed-line network.

TU-RL rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis. Charges for the use of our local fixed-line network to terminate local calls originating on the network of another local fixed-line service provider are only billed and due when usage of our network exceeds 55% of the total traffic registered between our network and the network of the other telecommunication service provider.

Since January 1, 2007, our TU-RL rate has been equal to 40% of the rate included in our Basic Plan per Minute for a local fixed-line call, which is adjusted on an annual basis by ANATEL. As of the date of this annual report, our TU-RL rate during peak hours (i.e., between the hours of 9 a.m. and noon and 2 p.m. and 6 p.m. on weekdays) is R\$0.031 per minute. ANATEL announced that beginning in 2008, the method used to determine the TU-RL rates would be based on a cost methodology, known as long-run incremental costs. However, in October 2007, ANATEL published an official letter delaying this change until the end of 2010. In September 2010, ANATEL commenced the bidding process to engage an international consultant to assist with the development of the long-run incremental cost methodology. However, ANATEL has not established a definitive timetable for the completion of the project. Therefore, we cannot predict when this new methodology will be proposed.

Our revenues from the use of our long-distance network consist primarily of payments on a per-minute basis, which are charged at rates designated by ANATEL as TU-RIU rates, from other long-distance carriers that use a portion of our long-distance networks to complete calls initiated by callers that have not selected us as the long-distance provider.

TU-RIU rates vary depending on the time of the day and day of the week, and are applied on a per-minute basis. Since January 1, 2007, our TU-RIU rate has been equal to 30% of our domestic fixed line-to-fixed line long-distance rates for calls of more than 300 km, which are adjusted on an annual basis by ANATEL. See [Local Fixed-Line Rates](#) [Domestic Long-Distance Rates](#) [Fixed Line-to-Fixed Line](#). As of the date of this annual report, our TU-RIU rate during peak hours is R\$0.12 per minute.

The following table sets forth the average per-minute rates we charged for the use of our fixed-line networks during the periods indicated.

Fixed-Line Network Usage Rates (1)	Year Ended December 31,		
	2010	2009	2008
	(in reais)		
TU-RL	0.031	0.031	0.031
TU-RIU	0.094	0.088	0.087

(1) The amounts represent the weighted average of monthly rates, net of taxes.



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## **Table of Contents**

### *Mobile Networks*

Our revenues from the use of our mobile networks consist primarily of payments on a per-minute basis from (1) local fixed-line, long-distance and mobile services providers to complete calls terminating on our mobile network, and (2) long-distance service providers for the transfer to their networks of calls originating on our mobile network.

The terms and conditions of interconnection to our mobile network, including the rates charged to terminate calls on our mobile network (which are designated by ANATEL as VU-M rates), commercial conditions and technical issues, are freely negotiated between us and other mobile and fixed-line telecommunication service providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things. We must offer the same VU-M rates to all requesting service providers on a nondiscriminatory basis. We apply VU-M charges on a per-minute basis.

If we are not able to establish interconnection rates for use of our mobile network with other mobile and fixed-line telecommunication service providers, ANATEL is empowered to arbitrate, at its discretion, the interconnection rates that we may charge. In 2005, mobile service providers and fixed-line service providers in Brazil were unsuccessful in negotiating an agreement for new VU-M rates. All mobile service providers and fixed-line service providers in Brazil commenced arbitration proceedings before ANATEL to establish the applicable VU-M rates. The mobile service providers and fixed-line service providers entered into a provisional agreement establishing provisional rates applicable to each mobile service provider, and after the providers entered into this agreement, ANATEL approved the adjusted VC1 rates that the fixed-line service providers were permitted to charge at that time based on the provisional VU-M rates.

We and the other mobile services providers generally negotiate provisional agreements each year to establish rate increases for the VU-M charged by the mobile services providers.

In March 2006, a provisional agreement among the incumbent fixed-line service providers (i.e., Telemar, Brasil Telecom and Telesp) and the mobile services providers, including Brasil Telecom Mobile, was submitted to ANATEL that increased the VU-M rate for calls terminated on a mobile services provider's network by 4.5% over the previously existing VU-M rate.

In July 2007, a provisional agreement among the incumbent fixed-line service providers, as well as CTBC and Sercomtel, and the mobile services providers, including Brasil Telecom Mobile, was submitted to ANATEL that provided for an annual increase of the VU-M rates of 1.97143% for calls terminated in Region I, and an annual increase of the VU-M rates of 2.25356% for calls terminated in Region II or Region III.

In July 2008, a provisional agreement among the incumbent fixed-line service providers, as well as CTBC and Sercomtel, and the mobile services providers, including Brasil Telecom Mobile, was submitted to ANATEL that established an average increase in the VU-M rates of 2%, and provided that the VU-M rates would be increased by an amount equal to 68.5% multiplied by the percentage increase in VC1 approved by ANATEL in 2008. No provisional agreement with respect to the VU-M rates was entered into in 2009.

Under the rules established for the auctions of 3G spectrum in December 2007, all mobile services providers were required to establish uniform VU-M rate schedules that would apply in all states of each service region no later than October 30, 2009. This requirement did not affect Oi or Brasil Telecom Mobile because these companies had already established uniform VU-M rates in each of their service regions. As of October 30, 2009, none of the other mobile services providers had established uniform VU-M rate schedules and we and Oi commenced arbitration proceedings before ANATEL with respect to the VU-M rates charged by our competitors. In January 2010, ANATEL set provisional reference rates for each mobile services provider for each region based on the mean V-UM previously charged by that mobile services provider in the applicable service region.

In February 2010, ANATEL authorized an increase of 0.67% in our VU-M rates, equivalent to 68.5% of the increase in our VC1 rates granted at that time.

**Table of Contents**

The following table sets forth the average per-minute VU-M rates that we charged during the periods indicated.

	Year Ended December 31,		
	2010	2009	2008
	(in reais)		
Per-minute charges for local fixed-line calls made to mobile telephones (1)	0.42	0.41	0.42

(1) The amounts represent the weighted average of monthly rates, net of taxes.

**Data Transmission Rates**

Broadband services, IP services and frame relay services are deemed to be value-added services under ANATEL regulations and, therefore, the rates and prices for these services are not subject to regulation and are market-driven. We offer broadband services subscriptions at prices that vary depending on the download speeds available under the purchased subscription.

A significant portion of our revenues from commercial data transmission services are generated by monthly charges for EILD and SLD services, which are based on contractual arrangements for the use of part of our network. Under ANATEL regulations, because we are deemed to have significant market power in the fixed-line services business, we are required to make publicly available the forms of agreements that we use for EILD and SLD services, including the applicable rates, and are only permitted to offer these services under these forms of agreements. We are allowed to increase these rates on an annual basis by no more than the rate of inflation, as measured by the IST. ANATEL also publishes reference rates for these services and if one of our customers objects to the rates that we charge for these services, that customer is entitled to seek to reduce the applicable rate through arbitration before ANATEL.

Our revenue from IP services is based on the number of data ports to which the customer is granted access. Our revenue from frame relay services consists mainly of charges for access to the data transmission network and metered service charges based on the amount of data transmitted. Such services are offered as pay-per-use or volume-based packages. Our revenue from cyber data center services is generally based on contractual arrangements that are tailored to the specific services provided.

**Marketing**

In 2010, we incurred R\$152 million in marketing expenses, primarily to:

introduce the *Oi* brand and services in our service area;

launch new services, including (1) *Oi TV* in the Brazilian state of Goiânia and the Federal District; (2) bundled plans which we market under the brand name *Oi Conta Total*; and (3) *Oi Fixo Controle* and *Oi Fixo Economia* for fixed-line services directed towards low-income customers;

promote our mobile telecommunication services through specific marketing campaigns targeting certain market segments, such as post-paid high-value residential customers and corporate customers;

promote our broadband services through specific marketing campaigns targeting geographic regions in which we have expanded our broadband network capabilities; and

maintain a strong base of fixed-lines in service.

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We have promoted the Oi brands through commercial strategies that promote freedom of choice, such as campaigns to unblock mobile phones and financial penalty-free plans.

Throughout 2010, we continued to offer integrated promotions by bundling our various services, such as mobile communications, ADSL services, fixed-line services and public telephone services. We also continued to reinforce

## **Table of Contents**

our strategy of selling SIM cards individually, separate from mobile handsets, to acquire new pre-paid customers and retain existing ones.

We use a broad range of marketing channels, including television, radio, billboards, exterior signage, telemarketing, direct mail and internet advertising to market our fixed-line, mobile, long-distance and broadband services. We also sponsor sporting events and individual athletes, as well as cultural events, such as fashion shows, theatrical performances and popular music concerts. The goal of our marketing initiatives is to increase brand awareness in our targeted customer base and expand the use of our distribution channels.

We target our marketing efforts to three separate segments of the telecommunication services market: (1) retail customers; (2) high-value residential customers and medium and small commercial customers; and (3) large commercial customers.

### *Retail Customers*

We market our local fixed-line services, pre-paid and post-paid mobile services, long-distance services, dial-up internet access to retail customers. The retail marketing segment is our largest marketing channel in terms of net operating revenue. In Region II, our principal distribution channels in the retail segment in 2010 were:

our telemarketing sales channel, which consists of approximately 600 sales representatives that answer more than 500,000 calls per month. This channel provides us with the ability to pro-actively reach new customers, thereby increasing our client base and revenues, and also receive calls prompted by offers in numerous types of media.

exclusive agents with approximately 550 salespeople trained to sell our services door-to-door in Region II in places where customers generally are not reachable by telemarketing.

approximately 2,770 retail stores through which we primarily sell SIM cards and pre-paid mobile cards.

approximately 53,000 drug stores, supermarkets, newsstands and similar outlets through which we primarily sell SIM cards and pre-paid mobile cards.

### *High-Value Residential Customers and Medium and Small Commercial Customers*

We market our local fixed-line services, broadband services, post-paid mobile services and long-distance services to high-value residential customers and medium and small commercial customers. Our principal distribution channels in this marketing segment in 2010 were:

our telemarketing channel described above.

approximately 112 Oi franchised service stores and kiosks located in the largest shopping malls and other high density areas throughout Brazil that are focused on sales of higher value-added services (post-paid mobile plans and broadband services).

approximately 220 stores located throughout our service area that primarily sell telecommunications products and services and have entered into exclusivity agreements with us.

### *Large Commercial Customers*

We market our local fixed-line services, broadband services, post-paid mobile services, long-distance services, commercial data transmission services to large commercial customers. Our principal distribution channel in this marketing segment in 2010 was our own direct sales force.





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**Table of Contents**

**Billing and Collection**

***Fixed-Line Telephone Services***

We send each of our fixed-line customers a monthly bill covering all the services provided during the prior monthly period. Customers are grouped in billing cycles based on the date their bills are issued. Each bill separately itemizes local calls, long-distance calls, calls terminating on a mobile network, toll-free services and other services such as call waiting, voicemail and call forwarding. We have agreements with several banks for the receipt and processing of payments from our customers. A variety of businesses, such as lottery houses, drugstores and grocery stores, accept payments from our customers as agents for these banks.

We are required to include in our monthly bills charges incurred by our customers for long-distance services provided by other long-distance service providers upon the request of these providers. We have billing agreements with each long-distance telecommunication service provider that interconnects with our networks under which we bill our customers for any long-distance calls originated on our network that are carried by another long-distance service provider and transfer the balance to the relevant provider after deducting any access fees due for the use of our network. Payments are due within an average of 15 days after the billing date. We charge late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. At December 31, 2010, 16.7% of all accounts receivable due from our fixed-line customers were outstanding for more than 30 days and 9.0% were outstanding for more than 90 days.

ANATEL regulations permit us to restrict outgoing calls made by a fixed-line customer when the customer's account is more than 31 days past due, restrict incoming calls received by a fixed-line customer when the customer's account is more than 61 days past due, and disconnect a fixed-line customer when the customer's account is more than 91 days past due, provided in each case that 15-days' prior notice has been given to that customer prior to the imposition of each restriction. The disconnection process thus comprises several stages, including customer notification regarding the referral of their delinquency to credit bureaus, before the fixed-line customer may be ultimately disconnected due to non-payment. Notices range from voice messages to active calls for negotiation with the customer. Our collection system enables us to access delinquent subscribers' accounts according to their payment profile. This profile takes into consideration, among other things, the length of subscription, the outstanding balance of the account and the longest payment delays.

***Mobile Telecommunication Services***

We bill our mobile post-paid customers on a monthly basis and itemize charges in the same manner as we bill our fixed-line customers. See Fixed-Line Telephone Services. In addition, the monthly bills also provide details regarding minutes used and roaming charges. Payments are due within an average of 15 days after the billing date. We charge late-payment interest at a rate of 1% per month plus a one-time late charge of 2% of the amount outstanding. At December 31, 2010, 9.2% of all accounts receivable due from our mobile customers were outstanding for more than 30 days and 5.7% were outstanding for more than 90 days.

ANATEL regulations permit us to partially suspend services to a mobile customer when the customer's account is more than 15 days past due, restrict all incoming calls received and outgoing calls made by a mobile customer when the customer's account is more than 45 days past due, and cancel services to a mobile customer when the customer's account is more than 90 days past due, provided in each case that 15-days' prior notice has been given to that customer prior to the imposition of each restriction. The cancellation process thus comprises several stages, including customer notification regarding the referral of their delinquency to credit bureaus, before services to the mobile customer may be ultimately cancelled due to non-payment. Notices range from text messages to active calls for negotiation with the customer. Our collection system enables us to access delinquent subscribers' accounts according to their payment profile. This profile takes into consideration, among other things, the length of subscription, the outstanding balance of the account and the longest payment delays. We have also implemented an information tool to assist with account management that is designed to warn subscribers of high outstanding amounts due and unpaid.

**Table of Contents****Network and Facilities**

Our network is comprised of a physical and logical infrastructure through which we provide fully-integrated services, whether fixed-line or mobile, voice, data or image, thereby optimizing available resources. We monitor our networks remotely from our centralized national network operations center in Rio de Janeiro. Network operating and configuration platforms, located at the network operations center, perform failure monitoring, database and configuration management, security management and performance analysis for each network.

***Fixed-Line Network***

Our fixed-line network includes (1) a network of access lines connecting customers to digital exchanges, DSLAM or next generation network, or NGN, Multi-service Access Nodes, or MSANs, (2) digital exchanges, NGN controllers, NGN trunk gateways and MSANs, (3) trunk lines connecting digital exchanges, and (4) long-distance transmission equipment. As of December 31, 2010, our access network served approximately 7.2 million fixed-line subscribers and approximately 1.9 million ADSL subscribers. As of December 31, 2010, we provided ADSL services in approximately 1,800 municipalities.

In 2010, we provided fixed-line services at 731 new localities, 561 of which were provided with group access (public telephone services) and 170 of which were provided with individual access (residential telephone service), and we visited approximately 1,600 localities to confirm data on our record of localities. As of December 31, 2010, we offered fixed-line services either with individual or group access in approximately 8,300 localities.

The following table sets forth selected information about our fixed-line network as of the dates and for the periods indicated.

	As of and For Year Ended		
	December 31,		
	2010	2009	2008
Installed access lines (in millions)	10.4	10.4	10.4
Access lines in service (in millions)	7.2	7.7	8.1
Public telephones in service (in thousands)	266.1	277.9	277.9
Broadband access lines in service (in millions)	1.9	1.9	1.8

Our fixed-line network is fully digitalized and we have been introducing NGN technology in selected areas. Our long-distance network consists of optical fiber cable networks supporting high capacity Dense Wavelength Division Multiplex systems that can operate with up to 80 channels at 10 and 40 Gbps and microwave links that we use to complement the optical network in Region II. We have a long-distance backbone, consisting of an optical fiber network that connects the state capitals in Region II and the Federal District. Most of the large urban areas in Region II are also connected by optical fiber cable networks. Our transmission infrastructure connects these digital switches to two international gateway switches; one in Curitiba and one in Brasilia. Additionally, our network supports advanced services, including pre-paid and toll-free services, and permits local number portability.

Our long-distance backbone employs the most recent optical technologies available in the telecommunications industry. We employ automatic traffic protection to improve the reliability of our network and increase its traffic capacity. The network is fully supervised and operated by management systems that allow rapid response to customer service requests and reduce the recovery time in case of failures.

***Satellite Network***

We have deployed satellite-based services to comply with our public service obligations to the rural and remote areas of Brazil. These satellite services include internet access and access to corporate data applications. As of December 31, 2010, our satellite network covered approximately 390 localities in eight states and the Federal District and provided voice and data services to approximately 710,000 persons and approximately 110,000 terminals.

## **Table of Contents**

In 2000, we began the implementation of the land-based segment of a satellite network in order to extend transmission to remote areas in the states of Acre, Goiás, Mato Grosso, Mato Grosso do Sul, Paraná, Rondônia, Rio Grande do Sul, Santa Catarina and Tocantins.

The satellite network comprises satellite earth stations located in less-populated rural areas, as well as hub stations in the cities of Brasília, Curitiba, Porto Alegre, Florianópolis, Cuiabá, Porto Velho and Goiânia. This satellite network uses digital technology and began operating in August 2000. The fiber optic and satellite backbones are interconnected in Brasília and Curitiba (located in the Federal District and in the State of Paraná, respectively). The integration of the land-based segment of our satellite network allows us to service our subscribers in any location in Region II.

We lease one transponder from Hispamar with 62.3 Mhz of capacity in the Ku band on the Amazonas 1 satellite.

In 2005, we started to operate a satellite platform operating in the Ku band that is comprised of a satellite transport solution with Digital Video Broadcast Return Channel Satellite, or DVB-RCS, technology.

### ***Mobile Network***

Our mobile networks operate on frequencies of 900 MHz/1800 MHz for GSM and 2100 MHz for UMTS. We offer mobile data applications based on GPRS/EDGE technology for our GSM network and on high speed packet access, or HSPA, technology for our UMTS network. We offer voice applications primarily using our GSM network, although our UMTS network is capable of transmitting voice signals. We are currently upgrading our mobile network to support greater data rates through the HSPA+ standard.

As of December 31, 2010, our 2G mobile network, consisting of 3,704 active radio base stations, covered 1,281 municipalities, or 93.8% of the urban population in Region II. We have GPRS coverage in 100% of the localities covered and EDGE coverage in all state capitals.

As of December 31, 2010, our 3G mobile network, consisting of 1,737 active radio base stations, covered 84 municipalities, or 47.0% of the urban population in Region II. We have 3G coverage in all state capitals.

Our mobile networks have unique data cores that are fully integrated with our fixed-line data networks. Our mobile networks are directly interconnected to the national and international long-distance networks of all long-distance service providers operating in Regions I, II and III and all mobile services providers in Regions I, II and III.

### ***Data Transmission Network***

#### ***Broadband Services***

We use ADSL, ADSL2+ and VDSL2 as a broadband access technology using our existing fixed-line networks which are capable of speeds of up to 100 Mbps (download) and 1 Mbps (upload). We have implemented an address control and name resolution system for our IP networks with the objective of optimizing resources and improving the availability of internet access services.

We have deployed a Metro Ethernet network, which is a network that covers a metropolitan area to connect our subscribers to the internet, in several major metropolitan areas. We are currently expanding our Metro Ethernet network to other cities due to new customer demand. We have also deployed optical fiber networks based on gigabit passive optical network, or GPON, technology together with VDSL2 to provide fiber to the building and GPON providing fiber to the home. As a result of the implementation of this technology we are now able to provide broadband with speeds up to 100 Mbps.

Our dial-up IP platform supports dial-up access from the fixed-line networks. We operate an internet backbone network and a fully IP-routed network, which provides a backbone for all internet dedicated and dial-up services and VPN offerings. Our internet backbone connects to the public internet via international links that we maintain abroad.

## **Table of Contents**

With these international links, we do not need to rely on other companies to connect our outbound internet traffic with the internet backbones of international ISPs.

### *Commercial Data Transmission Services*

Our Asynchronous Transfer Mode, or ATM, network, with its fully-integrated management system, provides:

frame relay data services (a data transmission service using fast protocols based on direct use of transmission lines) from 64 Kbps up to 2 Mbps;

ATM data services supporting access rates from 2 Mbps to 622 Mbps; and

aggregation network services for ADSL2+ platforms.

These features allow our integrated ATM network to service each of the different types of data applications used by our customers. ATM is a technology that converts existing twisted-pair telephone lines into access paths for high-speed communications.

Our Metro Ethernet network is fully-integrated management system and also provides:

Ethernet data services from 4Mbps up to 500Mbps for point-to-point and multipoint dedicated access;

Ethernet access services from 4Mbps up to 500Mbps for IP access and Multiprotocol Label Switching/VPN access;

Aggregation network services for ADSL2+ and VDSL2 platforms; and

Aggregation network services for GPON platforms.

We have a fully integrated and managed network providing access for IP and ATM networks over legacy copper wire through which are able to provide:

symmetric and transparent access to Frame Relay services at speeds from 64 kbps to 1.5 Mbps;

symmetrical access with PPP (Point to Point) for the Internet connection services at speeds from 64 kbps to 1.5 Mbps; and

symmetrical access with PPP (Point to Point) to provide connection services for VPN over Multiprotocol Label Switching at speeds from 64 kbps to 1.5 Mbps.

### ***Network Maintenance***

Most of our maintenance, installation and network servicing are performed by third-party service providers. For example, we have contracts with some well-known providers such as A.R.M. Engenharia for the maintenance of our external plant and equipment, and Alcatel-Lucent and Nokia Siemens Networks for the maintenance of our internal plant and equipment. We also perform some of our ordinary course maintenance with our

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own team of maintenance technicians, which also coordinate the planning and execution of maintenance services performed by third parties.

In November 2009, Telemar and Brasil Telecom entered into a services agreement with Alcatel-Lucent to perform the same services in the States of Rio Grande do Sul, Santa Catarina, Paraná, Mato Grosso do Sul, Mato Grosso, Goiás, Tocantins, Acre, Rondônia and the Federal District, as well as Pegasus data transmission network equipment in the States of Paraná, Santa Catarina, Rio Grande do Sul, Goiás and the Federal District. Brasil Telecom's portion of the total estimated payments under this contract is R\$1.2 billion during the five-year term of this contract.

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## **Table of Contents**

In July 2010, Telemar and Brasil Telecom entered into a services agreement, which was effective as of March 1, 2010, with A.R.M. Engenharia for installation, operation, and corrective and preventive maintenance in connection with their external plant and associated equipment, public telephones, and fiber optic and data communication networks (including broadband access services) in the States of Maranhão, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco, Alagoas, Sergipe, Bahia, Amazonas, Roraima, Pará, Amapá, Paraná, Santa Catarina and Rio Grande do Sul. Brasil Telecom's portion of the total estimated payments under this contract is R\$1.6 billion with BrT during the five-year term of this contract.

Telemar and Brasil Telecom have entered into negotiations regarding a services agreement with Telemont to perform the same services in the States of Minas Gerais, Espírito Santo, a portion of Rio de Janeiro, the Federal District, Mato Grosso, Mato Grosso do Sul, Tocantins, Acre, Rondônia and Goiás. Brasil Telecom's portion of the total estimated payments under this contract is expected to be R\$1.1 billion during the five-year term of this contract.

### ***Call Center***

In 2007, we consolidated our call center structure by merging our 30 pre-existing sites into five sites (Goiânia, Campo Grande, Florianópolis, Brasília and Curitiba). We improved our customer relationship management system which integrates our systems and provides a database of information for each customer in order to provide better service and identify sales opportunities during each contact we have with our customers.

### **Competition**

Our industry is highly competitive. The competitive environment is significantly affected by key trends, including technological and service convergence, market consolidation and combined service offerings by service providers. See Item 5. Operating and Financial Review and Prospects Principal Factors Affecting Our Financial Condition and Results of Operations Effects of Competition on the Rates that We Realize and the Discounts We Record.

### ***Local Fixed-Line Services***

In the local fixed-line telecommunication services market, competition is focused on corporate customers. In addition, competition from other telecommunication services has been increasing, particularly from mobile telecommunication services, which has led to traffic migration from fixed-line traffic to mobile traffic and the substitution of mobile services in place of fixed-line services, encouraged by offers of aggressively-priced packages from some mobile telecommunication service providers. Finally, the decrease in interconnection rates has discouraged the construction of new fixed-line networks and has led to decreases in market prices for telecommunication services by enabling telecommunication service providers that use the local fixed-line networks of incumbent fixed-line providers to offer lower prices to their customers.

We are the leading provider of local fixed-line services in Region II with 7.2 million fixed lines in service as of December 31, 2010 and an estimated market share of 78.0% of the total fixed lines in service in this region as of December 31, 2010, based on information available from ANATEL. Our principal competitors in Region II for fixed-line services are (1) GVT (an affiliate of Vivendi S.A.), which had an estimated market share of 15.3% of the total fixed lines in service in this region as of December 31, 2010, based on information available from ANATEL, and (2) Embratel (an affiliate of Telecom Americas Group, which is a subsidiary of América Móvil S.A.B. de C.V., an affiliate of Telmex), which has an estimated market share of 6.7% of the total fixed lines in service in this region as of December 31, 2010, based on information available from ANATEL.

Embratel provides local fixed-line services to residential customers through the cable network owned by its affiliate Net in the portions of Region II where Net provides cable television service. As a result, Net is able to offer cable television, broadband and telephone services as a bundle at a very competitive price. Net has engaged in efforts to promote Embratel's fixed-line service by offering free local fixed-line service to its customers for a period of one year. We expect competition from Embratel to increase as the cable network of Net expands through internal growth and as a result of acquisitions.

## **Table of Contents**

TIM has entered the local fixed-line services market by offering fixed-line wireless services which, unlike traditional mobile services, only permit a subscriber to place and receive calls when in proximity to a single specified radio base station. These services allow TIM to offer fixed-line service without installing a network of fixed lines directly to the homes or businesses of their fixed-line customers.

We expect to continue to face competition from mobile services providers, which represent the main source of competition in the local fixed-line service market. As of December 31, 2010, there were 51.8 million mobile subscribers (including our mobile customers) in Region II, a 15.9% increase over December 31, 2009, based on information available from ANATEL. The increase in the number of mobile users, in addition to reduced mobile services rates, is expected to continue to adversely affect the number of fixed-line subscribers and the volume of local fixed-line traffic. In addition, because mobile providers offer promotions and service plans that permit subscribers to make calls within the mobile provider's network at rates that are less than those charged for calls from a fixed-line telephone to a mobile telephone, we believe that we may be vulnerable to traffic migration as customers with both fixed-line and mobile telephones use their mobile devices to make calls to other mobile subscribers.

We believe that major technological innovations, such as instant messaging services and VoIP, may impact local fixed-line traffic in the future. In Brazil, those services have been increasing in popularity, which could put further pressure on the local fixed-line telecommunications market.

### ***Long-Distance Services***

The long-distance services market is highly competitive. For the year ended December 31, 2010, based on information available from ANATEL, of the total number of long-distance minutes originated in Region II, we had a market share of 28.1%, ranking behind TIM with 47.1% and ahead of Embratel with 15.9%.

Our principal competitor for long-distance services is TIM, which in 2010 began aggressively promoting its long-distance services with significant discounts. Historically, our principal competitor for long-distance services has been Embratel.

Generally, callers placing fixed-line long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their fixed-line service. Similarly, callers placing mobile long-distance calls in Brazil tend to select the long-distance carrier affiliated with the provider of their mobile or fixed-line service. However, increased competition from long-distance service providers has resulted in pressure on our long-distance rates and adversely affected our revenue from these services.

In addition, the offering of plans by other mobile services providers that include free minutes for calls to other subscribers of those mobile services providers may adversely impact our revenues from mobile long-distance calls if our mobile customers migrate to our competitors to remain within the network of the people to whom they plan to place long-distance calls. However, as a result of the increased use of SIM card only strategies by other mobile service providers, there is a trend among Brazilian pre-paid customers to purchase SIM cards from multiple mobile service providers to maximize the number of calls that they can make which are covered by these promotional offers.

New technologies that serve as an alternative to traditional long-distance telephone calls, such as VoIP, may start to capture part of Brazil's long-distance traffic. However, in contrast to what has occurred in other countries, such as the United States, we do not expect intense competition from VoIP providers in the near term due to (1) the low level of broadband penetration in Brazil due to the population's relatively low per capita income, and (2) the expected adverse effect of the success of this technology on the long-distance call margins of Embratel, which is an affiliate of Net, the main service provider with the ability to offer alternatives through VoIP.

### ***Mobile Services***

The mobile telecommunication services market in Brazil is characterized by intense competition among providers of mobile telecommunication services. We compete primarily with the following mobile services providers, each of which provides services throughout Brazil:

## **Table of Contents**

Vivo, which is controlled by Telefónica S.A, and which markets its services under the brand name Vivo ;

TIM, which is a subsidiary of Telecom Italia S.p.A. and markets its services under the brand name TIM ;

Telecom Americas Group, which markets its services under the brand name Claro.

In December 2010, Nextel Brazil acquired licenses to provide 3G services throughout Brazil. Nextel has announced that it expects to launch commercial services on its 3G network in certain markets between December 2011 and June 2012. We expect that Nextel's entrance in the market will increase competition for mobile services.

Competitive efforts in the Brazilian mobile telecommunication services market generally take the form of handset subsidies in the post-paid market and traffic subsidies in both the pre-paid and post-paid market. The aggressiveness of promotions is generally driven by the desire of the provider offering the promotion to increase market share; however, these promotions generally are for a short duration as the pricing terms offered are not sustainable over the long term.

As of December 31, 2010, based on information available from ANATEL, we had a market share of 15.1% of the total number of subscribers in Region II, ranking behind Vivo with 30.9%, Claro with 28.7% and TIM with 25.0%, and we captured 9.3% of all net additions of mobile subscribers in Region II (calculated based on the number of mobile subscribers at the end of a period less the number of mobile subscribers at the beginning of that period) during 2010.

### ***Data Transmission Services***

Cable television providers that offer broadband services, particularly Net, represent our principal competition in the broadband market. We face competition from these providers that offer integrated packages, consisting of subscription television, broadband and voice telephone services to cable television subscribers who, in general, have more purchasing power than other consumers.

Our principal competitors in the commercial data transmission services market are Embratel, GVT and Intelig. Because the commercial data transmission services market is significantly less regulated than the fixed-line, long-distance and mobile services markets and, therefore, presents fewer barriers to entry, this market is subject to competition from a large number of competitors, including fixed-line telecommunication service providers and specialized services companies competing in this high-growth market and focused on large- and medium-sized business customers. Along with growth in traffic volume and increasing demand for broadband capacity, we expect significant price reductions in data transmission services as competitors expand their networks. We also anticipate a shift in competition towards value-added services provided over IP platforms.

### **Concessions, Authorizations and Licenses**

Under the General Telecommunications Law and ANATEL regulations, the right to provide telecommunication services is granted either through a concession under the public regime or an authorization under the private regime. For additional details regarding the rights and obligations of service providers operating under the public regime and the private regime, see Regulation of the Brazilian Telecommunications Industry Concessions and Authorizations. We operate under:

10 concessions to provide local fixed-line services in Region II (except for excluded areas in the States of Goiás, Mato Grosso do Sul and Paraná);

10 concessions to provide domestic long-distance services in Region II (except for excluded areas in the States of Goiás, Mato Grosso do Sul and Paraná);

authorizations to provide personal mobile services in Region II;



radio frequency licenses to provide 3G mobile services in Region II;

## Table of Contents

authorizations to provide local fixed-line services and domestic long-distance services in the areas in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II;

an authorization to provide international long-distance services originating anywhere in Region II; and

authorizations to provide Multimedia Communication Services (*Serviço de Comunicação Multimídia*) throughout Brazil.

These concessions and authorizations allow us to provide specific services in designated geographic areas and set forth certain obligations with which we must comply.

### ***Fixed-Line Services Concession Agreements***

We have entered into concession agreements with ANATEL that govern our concessions to provide fixed-line services in the Federal District and each of the states of Region II. Each of our concession agreements:

expires on December 31, 2025;

sets forth the parameters that govern adjustments to our rates for fixed-line services;

requires us to comply with the network expansion obligations set forth in the General Plan on Universal Service;

requires us to comply with certain quality of service obligations set forth in these concession agreements as well as the quality of service obligations set forth in the General Plan on Quality Goals; and

requires payment of biannual fees equal to 2.0% of our net operating revenue that is derived from the provision of local fixed-line services (excluding taxes and social contributions) during the immediately preceding year.

For more information regarding the adjustment of our rates for fixed-line services, the General Plan on Universal Service and the General Plan on Quality Goals, see Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services.

These concession agreements required us to render services in public telecommunications offices that serve as business centers for low-income populations. In April 2008, these concession agreements were amended to remove the obligation to construct new public telecommunications offices and replace this obligation with obligations to provide transmission lines connecting our fiber-optic internet backbones to municipalities in our concession areas in which we did not provide internet service, which we refer to as backhaul. Under these amendments, we are obligated to set up backhaul in 452 municipalities in Region II. The facilities that we construct to meet this obligation will be considered to be property that is part of our concessions and will therefore revert to the Brazilian government on January 1, 2026. Under the amendments, we were required to provide backhaul to 40% of these municipalities by December 12, 2008 and 80% of these municipalities by December 31, 2009. These amendments require that we provide backhaul to all of these municipalities by December 31, 2010.

These concession agreements provide that ANATEL may modify their terms in 2010, 2015 and 2020 and may revoke them prior to expiration under the circumstances described under Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services Termination of a Concession. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL is obligated to engage in public consultation in connection with each of these potential modifications.

On March 30, 2009, ANATEL published a public notice of the proposed modifications to these concession agreements. In this public notice, ANATEL proposed amendments to the General Plan on Universal Service. The



## **Table of Contents**

public consultation period in connection with the March 30, 2009 public notice ended on June 22, 2009. ANATEL did not adopt the modifications proposed for public consultation.

On September 3, 2010, ANATEL published a public notice of further proposed amendments to the General Plan on Universal Service. The public consultation period in connection with the September 3, 2010 public notice ended on November 1, 2010. We do not expect ANATEL to adopt the modifications proposed for public consultation.

In November 2010, ANATEL announced the opening of the market for subscription television services. We expect that under pending amendments to our concession agreements the restrictions that currently prohibit us from offering subscription television services over our fixed-line networks will be removed, permitting us to offer IP TV. We expect that ANATEL will no longer limit the number of authorizations that it will grant to provide subscription television services and will permit us to provide subscription television services.

Based on our continuing discussions with ANATEL regarding proposed modifications to our concession agreements and proposed amendments to the General Plan on Universal Service, we believe that the effect of these amendments and modifications will:

increase our obligations to provide universal service in rural areas, including increased obligations to provide individual access to fixed-line voice services;

increase our obligations to provide service to economically disadvantaged segments of the Brazilian population within our service areas, primarily through subsidized service rates for fixed-line voice services; and

reduce the density requirements applicable to our obligations to provide public telephones in urban areas within our service areas.

In the event that the General Plan on Universal Service is amended to require that we provide additional services, the Brazilian Telecommunications Law and our concession agreements require that the costs of implementation of these universalization obligations in excess of the revenues generated by these services must be reimbursed to us from public funds. Although we understand that ANATEL intends to permit us to fund the additional capital and operating expenditures required to meet these expanded service obligations through an offset mechanism against the concession fees that we are obligated to pay under our concession agreements and the application of the savings that we achieve as a result of the reduction of our capital and operating expenditures on public telephone services in urban areas within our service areas, our internal projections indicate that a significant portion of the additional capital and operating expenditures required by these proposals could not be met from these funding sources alone. We understand that ANATEL intends to permit us to fund these shortfalls in future periods through payments to us from the Universal Telecommunications Service Fund (*Fundo de Universalização dos Serviços de Telecomunicações*), which we refer to as the FUST, to which we are required to make contributions. As a result of our continuing discussions with ANATEL regarding the additional service obligations that we would be required to undertake and the methodology for the reimbursement of the additional capital expenditures that these proposals would require us to undertake, the finalization of the amendments to our concession agreements and the amendments to the General Plan on Universal Service have been delayed and, although we expect that these amendments will be finalized during the second quarter of 2011, we cannot predict with certainty when these amendments will be adopted and become effective.

### ***Domestic Long-Distance Services Concession Agreements***

We have entered into concession agreements with ANATEL that govern our concessions to provide domestic long-distance services originating from the Federal District and each of the states of Region II. Each of our concession agreements:

expires on December 31, 2025;

sets forth the parameters that govern adjustments to our rates for domestic long-distance services;

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## **Table of Contents**

requires us to comply with certain quality of service obligations set forth in these concession agreements as well as the quality of service obligations set forth in the General Plan on Quality Goals; and

requires payment of biannual fees equal to 2.0% of our net operating revenue that is derived from the provision of domestic long-distance services (excluding taxes and social contributions) during the immediately preceding year.

For more information regarding the adjustment of our rates for fixed-line services, the General Plan on Universal Service and the General Plan on Quality Goals, see Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services.

These concession agreements provide that ANATEL may modify their terms in 2010, 2015 and 2020 and may revoke them prior to expiration under the circumstances described under Regulation of the Brazilian Telecommunications Industry Regulation of Fixed-Line Services Termination of a Concession. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL is obligated to engage in public consultation in connection with each of these potential modifications.

We are discussing modifications to these concession agreements with ANATEL. We expect that the final modifications to these concession agreements will not impose material obligations on our company and that they will become effective during the second quarter of 2011.

### ***Personal Mobile Services Authorization Agreements and Radio Frequency Spectrum Licenses***

We have entered into authorization agreements with ANATEL that govern our authorizations to provide personal mobile services in Region II. These authorizations permit us to provide personal mobile services for an indeterminate period of time, but do not provide us with the right to use specific radio frequency spectrum.

We hold three licenses to use radio frequency spectrum to provide 2G services in specific geographic regions of Region II. These licenses grant us permission to use the applicable radio spectrum for 15 years from the date of the authorization agreement under which they are granted and are renewable for additional 15-year terms. Upon renewal of any of these licenses and on every second anniversary of such renewal, we will be required to pay an amount equal to 2.0% of our prior year's net operating revenue from personal mobile services. The initial terms of our radio frequency spectrum licenses expire in 2017.

Our authorization agreements are subject to network scope and service performance obligations set forth in these authorization agreements. Under these obligations, as of the date of this annual report, we are required to service all municipalities in Region II with a population in excess of 100,000. A municipality is considered serviced when the covered service area contains at least 80% of the urban area in the municipality. Our failure to meet these targets may result in the imposition of penalties established in ANATEL regulations and, in extreme circumstances, in termination of our personal mobile services authorizations by ANATEL. As of the date of this annual report, we have satisfied the network scope and service performance obligations set forth in these authorization agreements.

In August 2007, ANATEL adopted a revision of the personal mobile services regulations that became effective in February 2008. These revised regulations imposed additional obligations on personal mobile services providers, in particular in connection with customers' rights. For a discussion of these additional obligations, see Regulation of the Brazilian Telecommunications Industry Regulation of Mobile Services Additional Obligations.

### ***3G Radio Frequency Licenses***

We hold three licenses to use radio frequency spectrum to provide 3G services in Region II. Each of these licenses grants us permission to use the applicable radio spectrum for 15 years from the date of grant and is renewable for additional 15-year terms. We will be required to pay an amount equal to 2.0% of our prior year's net

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## **Table of Contents**

operating revenue from personal mobile services upon renewal of the license and on every second anniversary of the renewal. The initial terms of these licenses expire in 2023.

These radio frequency licenses include network scope obligations. Under these obligations, as of the date of this annual report, we are required to (1) service 168 municipalities in Region II that did not have mobile services at the time these licenses were granted with either 2G or 3G mobile telecommunication services, and (2) provide 3G service to all state capitals in Region II, the Federal District and all municipalities with a population in excess of 500,000 inhabitants. In addition, we are required to provide the following services in Region II:

3G service to all of municipalities covered by these licenses with a population in excess of 200,000 by the fourth anniversary of the date of these licenses;

3G service to all of the municipalities covered by these licenses with a population in excess of 100,000 by the fifth anniversary of the date of these licenses;

3G service to 50% of all of the municipalities with a population between 30,000 and 100,000 by the fifth anniversary of the date of these licenses;

3G service to 60% of the municipalities, including 242 specified municipalities, covered by these licenses with a population in excess of 30,000 by the eighth anniversary of the date of these licenses.

A municipality is considered serviced when the covered service area contains at least 80% of the urban area in the municipality. Our failure to meet these targets may result in the imposition of penalties established in ANATEL regulations and, in extreme circumstances, in termination of our 3G frequency licenses by ANATEL. As of the date of this annual report, we have satisfied the network scope and service performance obligations set forth in these licenses.

### ***Fixed-Line Services Authorization Agreements***

We have entered into authorization agreements with ANATEL that govern our authorizations to provide local fixed-line services in the areas in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II. These authorizations do not have termination dates and require us to comply with certain quality of service obligations set forth in the General Plan on Quality Goals.

We have entered into authorization agreements with ANATEL that govern our authorizations to provide domestic long-distance services originating from the areas in the States of Goiás, Mato Grosso do Sul and Paraná that are excluded from the concession area of Region II. These authorizations do not have termination dates and require us to comply with certain quality of service obligations set forth in the General Plan on Quality Goals.

### ***Multimedia Communication Services Authorization Agreement***

We have a Multimedia Communication Services authorization, which superseded our prior Telecommunications Network Transportation Services (*Serviço de Rede de Transporte de Telecomunicações*) authorization, permitting us to provide high speed data service in Region II.

The Multimedia Communication Services authorization became effective in May 2003 and covers the same geographical area as our concession agreements. In April 2008, in connection with the amendments to our fixed-line services concessions, we agreed to provide internet service free of charge until December 31, 2025 to all urban schools in Region II. Under this agreement, we were required to provide internet services to 40% of these schools by December 12, 2008, 80% of these schools by December 31, 2009, and all of these schools by December 31, 2010.

**Table of Contents****Capital Expenditures**

Our capital expenditures on property, plant and equipment and intangible assets were R\$889 million in 2010 and R\$1,090 million in 2009. The following table sets forth our capital expenditures on plant expansion and modernization for the periods indicated.

	Year Ended December 31,	
	2010	2009
	(in millions of reais)	
Mobile network and systems	R\$ 150	R\$ 444
Data transmission equipment	146	170
Voice transmission	260	174
Telecommunication services infrastructure	43	15
Information technology services	55	63
Backbone transmission	21	66
Network management system equipment	45	3
Buildings, improvements and furniture	3	9
Submarine cables	52	69
Internet services equipment	33	17
Other	81	60
Total capital expenditures	889	1,090
(Unpaid) amount and cash outflow to settle previously recorded liabilities	(134)	307
Total capital expenditures according to the cash flow statement	R\$ 755	R\$ 1,397

**Number Portability**

We implemented the systems necessary for us to comply with ANATEL's number portability requirements. This project was commenced in September 2008 and was completed in March 2009. The total cost of this was R\$163 million.

**Upgrade of Our Core Mobile Network**

In February 2010, we completed a project to upgrade our core mobile network, with the primary goal of fully integrating our mobile network into the mobile network of Telemar. We engaged Nokia Siemens Networks to replace our existing core mobile network, which relied on technology from Ericsson, with a new core mobile network that uses the same Nokia Siemens Networks technology employed in Telemar's existing core mobile network to facilitate the integration of our networks. The total cost of this project was R\$131 million.

**Enhancement of Our Mobile Network**

We have undertaken a project to upgrade a portion of our mobile networks to enable us to increase the capacity of our mobile network by approximately 10 million subscribers. We plan to support the growth of our subscriber base by constructing 205 new radio base stations and expanding the capacity at many of our existing radio base stations. In addition, we have undertaken a project to replace approximately 2,265 of our radio base stations, all of which previously employed Alcatel-Lucent technology, with Huawei base stations. We expect to complete the replacement of these radio base stations by December 2012. Our total investment in these projects was R\$498 million in 2009 and R\$151 million in 2010.

**2011 Capital Expenditure Budget**

Our 2011 capital expenditure budget totals approximately R\$1.7 billion. We plan to finance such expenditures through operating cash flows and long-term financings. From this total, we have budgeted 18% of our 2011 capital expenditure budget to the mobile telephone services business, and 74% to the fixed-line business, which includes the capital expenditures that will be necessary in order for us to meet our regulatory targets.





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## **Table of Contents**

### **Research and Development**

We conduct independent innovation, research and development in areas of telecommunication services but historically we have not independently developed new telecommunications technologies. We depend primarily on suppliers of telecommunications equipment for the development of new technology.

As a condition to ANATEL's approval of Telemar's acquisition of control of our company, Telemar agreed to make annual investments in innovation, research and development through 2018 in amounts equal to at least 50% of the amounts of its contributions to the Telecommunications Technology Development Fund (*Fundo para o Desenvolvimento Tecnológico das Telecomunicações*), or the FUNTTEL. To fulfill this obligation, as well as to centralize our innovation, research and development activities and programs, in 2009, Telemar created a division to manage innovation, research and development with the mission of coordinating and promoting efforts and projects that it develops.

As part of the integration of our company's operations with Telemar's, our technology laboratory was integrated with Telemar's. Our technology laboratory performs a variety of functions, such as operation support systems, business support systems and information security. We conduct trials of technologies from different vendors in this laboratory to evaluate these technologies for deployment.

Our investments on innovation, research and development totaled R\$0.4 million in 2009 and R\$2 million in 2010.

### **Property, Plant and Equipment**

Our principal properties, owned and leased, are located in Region II. At December 31, 2010, the net book value of our property, plant and equipment was R\$5,317 million. Our main equipment consists of transmission equipment, trunking and switching stations (including local, tandem and transit telephone exchanges), metallic and fiber-optic cable networks and lines, underground ducts, posts and towers, data communication equipment, network systems and infrastructure (including alternating and direct current supply equipment) and motor-generator groups.

As of December 31, 2010, buildings represented 7.9% of the net book value of our property, plant and equipment infrastructure, primarily underground ducts, post and towers, cables and lines represented 19.4%; plant and equipment related to switching stations represented 6.2%; transmission equipment represented 46.4%; construction in progress represented 13.9%; and other fixed assets represented 6.2%.

All property, plant and equipment that are essential in providing the services described in our concession agreements are considered reversible assets, which means that, should our concession agreements expire or terminate without being renewed, these assets will automatically revert to ANATEL. There are no other encumbrances that may affect the utilization of our property, plant and equipment. For more details, see note 18 to our consolidated financial statements.

### **Intellectual Property**

We believe the trademarks that identify us and our businesses are important for us, and as a result, we have taken steps to protect them. At December 31, 2010, we had 171 trademarks registered with the National Institute of Industrial Property (*Instituto Nacional de Propriedade Industrial*), or INPI, and 273 pending trademark applications. Among the various trademarks we have registered with the INPI, 2 are being contested by third parties. In addition, of the 273 pending trademark applications, 6 have been challenged by third parties.

As of December 31, 2010, we had 837 domain names registered with the Center of Information and Coordination of Dot Br - NIC. Br, an agency responsible for registering domain names in Brazil. The information included on our websites or that might be accessed through our websites is not included in this annual report and is not incorporated into this annual report by reference.

## **Table of Contents**

As of December 31, 2010, we the INPI had granted one patent to our company. We had also filed eight patent applications, which are pending with the INPI. Requests for technical examination have been submitted to the INPI for all of these pending patent applications. Once examination is concluded, a decision accepting or rejecting the application will be issued. If granted, the patent will have a term of 20 years from the date of filing and no less than ten years from the date the application is granted.

We use the *Oi* brand name with the permission of Telemar.

### **Insurance**

Pursuant to requirements in our concession agreements, we maintain the following insurance policies: (1) all risk property insurance covering all insurable assets pertaining to the concessions; (2) loss of profit insurance covering lost profits deriving from property damage and business interruption; and (3) performance bond insurance to assure compliance with our obligations related to quality of service and universal service targets set forth in our concession agreements.

In addition to the above policies, we maintain civil liability insurance. Our assets that are of material value and/or exposed to high degrees of risks are also insured. All of our insurance coverage was purchased from established insurance companies in Brazil, such as Bradesco and Itaú Seguros.

We believe that our current insurance coverage is suitable to our operations.

### **Regulation of the Brazilian Telecommunications Industry**

#### ***Overview***

Our business, including the nature of the services we provide and the rates we charge, is subject to comprehensive regulation under the General Telecommunications Law and a comprehensive regulatory framework for the provision of telecommunication services promulgated by ANATEL. We provide fixed-line, domestic and international long-distance and mobile telecommunication services under concessions, authorizations and licenses that were granted by ANATEL and allow us to provide specified services in designated geographic areas, as well as set forth certain obligations with which we must comply. See Concessions, Authorizations and Licenses.

ANATEL is a regulatory agency that was established in July 1997 pursuant to the General Telecommunications Law and the *Regulamento da Agência Nacional de Telecomunicações*. ANATEL oversees our activities and enforces the General Telecommunications Law and the regulations promulgated thereunder. ANATEL is administratively independent and is financially autonomous. ANATEL is required to report on its activities to the Brazilian Ministry of Communications. ANATEL has authority to propose and to issue regulations that are legally binding on telecommunication service providers. ANATEL also has the authority to grant concessions and licenses for all telecommunication services, other than broadcasting services. Any regulation or action proposed by ANATEL is subject to a period of public comment, which may include public hearings, and ANATEL's decisions may be challenged administratively before the agency itself or through the Brazilian judicial system.

#### ***Concessions and Authorizations***

Under the General Telecommunications Law and ANATEL regulations, the right to provide telecommunication services is granted either through a concession under the public regime (as discussed below) or an authorization under the private regime (as discussed below). A concession is granted for a fixed period of time following a public auction, and is generally renewable only once. An authorization is granted for an indeterminate period of time and public auctions are held for some authorizations. These concessions and authorizations allow service providers to provide specific services in designated geographic areas, set forth certain obligations with which the service providers must comply and require equal treatment of customers by the service providers.

The four principal providers of fixed-line telecommunication services in Brazil, Telemar, Brasil Telecom, Telesp and Embratel, provide these services under the public regime. In addition, CTBC and Sercomtel, which are

## **Table of Contents**

secondary local fixed-line telecommunication service providers, operate under the public regime. All of the other providers of fixed-line telecommunication services and all providers of personal mobile services and data transmission services in Brazil operate under the private regime.

Providers of public regime services are subject to more obligations and restrictions than providers of private regime services. Under Brazilian law, providers of public regime services are subject to certain requirements with respect to services such as quality of service, continuity and universality of service, network expansion and network modernization. Additionally, the rates that public regime service providers may charge customers are subject to ANATEL supervision.

Providers of private regime services, although not generally subject to the requirements concerning continuity and universality of service and network modernization, are subject to certain network expansion and quality of service obligations set forth in their respective authorizations.

### ***Regulation of Fixed-Line Services***

#### *General Policies for the Regulation of the Fixed-Line Telecommunications Sector*

In June 2003, Brazil's president issued Decree No. 4,733, outlining a number of new rules and guidelines which were intended to consolidate several changes in the regulation of Brazil's fixed-line telecommunications sector. This decree sets forth general declarations of policy regarding, among other things:

universal access to telecommunication services;

stimulation of employment and development of the Brazilian telecommunications sector;

promotion of competition and adoption of rate readjustment policies that take into account Brazilian socioeconomic considerations; and

the financial equilibrium of existing concession agreements.

This decree also defined certain changes that are reflected in the concession agreements entered into by providers of public regime services that became effective on January 1, 2006.

A number of bills affecting telecommunications policy have been submitted to the Brazilian Congress with an aim to make telecommunication services more accessible to Brazil's low-income population. These bills have proposed to (1) eliminate the monthly subscription fee (*assinatura mensal*) that compensates telecommunication companies for extending and maintaining fixed-line telecommunication services for their customers, and (2) impose inexpensive fixed-line telephone plans (*telefone social*) that telecommunication companies would be required to provide to certain eligible low-income residential customers. If approved, we expect that these types of proposals will adversely affect the overall margin of telecommunications providers, including us. For a discussion of the legal and regulatory risks associated with our business, see Item 3. Key Information Risk Factors Risks Relating to Our Company and the Brazilian Telecommunications Industry Our industry is highly regulated. Changes in laws and regulations may adversely impact our business.

#### *Private Regime Authorizations*

With the goal of introducing competition in fixed-line telephone services in Brazil, the federal government granted four private-regime authorizations in 1999 to permit fixed-line service providers to compete with the incumbent fixed-line concessionaires. Since 2002, the number of authorizations to provide fixed-line services that the federal government may issue is unlimited.

## **Table of Contents**

### *Public Regime Concessions*

Each of the public regime service providers operated under a concession agreement that expired at the end of 2005. Each of these providers entered into new concession agreements in December 2005 that extended its concessions for an additional 20-year period expiring in December 2025. Under these new concession agreements, each of the public regime service providers is required to comply with the provisions of (1) the General Plan on Universal Service that was adopted by ANATEL in June 2003, (2) the General Plan on Quality Goals that was adopted by ANATEL in June 2003, and (3) the General Plan on Competition Targets, which, as of the date of this annual report, has not yet been adopted by ANATEL. ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers.

The concession agreements provide that ANATEL may modify their terms in 2010, 2015 and 2020 and may revoke them prior to expiration under the circumstances described below under Termination of a Concession. The modification right permits ANATEL to impose new terms and conditions in response to changes in technology, competition in the marketplace and domestic and international economic conditions. ANATEL is obligated to engage in public consultation in connection with each of these potential modifications. As described under Concessions, Authorizations and Licenses Fixed-Line Services Concession Agreements, the amendments of our concession agreement that were expected to become effective at the end of 2010 have been delayed.

### *Rate Regulation*

Public regime service providers must offer a basic service plan comprised of the following basic services: (1) installation; (2) monthly subscription; and (3) switched local minutes. Modifications of the rates charged for these basic services are determined by reference to a local rate basket that represents the weighted average of the rates for monthly subscriptions and switched local minutes. Rates for long-distance services originated and terminated on fixed lines vary in accordance with three basic criteria: (1) physical distance separating callers; (2) time of the day; and (3) day of the week on which the call is placed. Modifications of the rates charged for these long-distance services are determined by reference to a long-distance rate basket that represents the weighted average of the rates for long-distance calls. The rates for the provision of services through payphones and installation rates are treated separately. The rates for international long-distance services provided by Embratel, the incumbent international long-distance concessionaire, are regulated by ANATEL. However, the rates for international long-distance services charged by other long-distance service providers, all of whom provide these services under authorizations rather than concessions, are not subject to ANATEL regulation.

The concession agreements establish a price-cap mechanism for annual rate adjustments for basic service plans and domestic long-distance rates based on formulas set forth in each provider's concession agreement. The formula provides for two adjustments to the price cap based on the local rate basket, the long-distance rate basket and the use of a price index. The price cap is first revised upward to reflect increases in inflation, as measured by an index, then ANATEL applies a productivity discount factor, or Factor X, which reduces the impact of the rate readjustment provided by the index.

Under the concession agreements entered into in 2005, a new calculation method for Factor X was adopted. In 2006 and 2007, Factor X, which was discounted from the IST, was equal to 50% of the increase in a public regime provider's productivity. Beginning in 2008, ANATEL has calculated the sector's weighted average productivity rate. As of the date of this annual report, Factor X is equal to (1) 50% of the increase in the weighted average productivity rate of public regime providers, plus (2) a factor calculated by ANATEL that is designed to reflect cost optimization targets for the telecommunications industry as a whole. If the weighted average productivity rate is negative, ANATEL will not allow an annual adjustment in excess of the IST.

A provider may increase rates for individual services within the local rate basket or the long-distance rate basket by up to 5% more than the IST so long as the rates for other services in that rate basket are reduced to the extent

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## Table of Contents

necessary to ensure that the weighted average increase for the entire rate basket does not exceed the permitted annual rate adjustment.

A provider may also offer alternative plans in addition to the basic service plan. Alternative plans must be submitted for ANATEL's approval. The rates offered under the alternative plans may be adjusted annually based on the IST.

Prior to January 2006, calls were measured and charged in terms of pulses, consisting of a single charge per call and an additional charge for each four-minute interval of usage. The concession agreements entered into in 2005 established a per-minute billing system for local fixed-line telecommunication services to meet ANATEL's objective to establish a more objective and transparent billing criteria for customers.

ANATEL is analyzing the adoption of a new Factor X regulation under which a new model of rate adjustments that is based on projected improvements in service costs may be adopted in 2011. If ANATEL were to pursue the adoption of this new model, we expect that public consultations regarding the new Factor X regulation would begin in 2011.

For information on our rates and service plans, see Rates.

### *General Plan on Universal Service*

The General Plan on Universal Service was approved by ANATEL in June 2003 and became effective in January 2006. The General Plan on Universal Service sets forth the principal network expansion and modernization obligations of the public regime providers, such as providing public telephones in localities with a population in excess of 100, and installing residential fixed lines within seven days of a request in localities with a population in excess of 300. In addition, public regime providers must comply with the Special Individual Access Class (*Acesso Individual Classe Especial*) rules, which are designed to require service for economically disadvantaged people. Under the Special Individual Access Class rules, a qualifying customer may subscribe to a service plan, limited to one fixed-line per household, and pay a lower monthly fee for service than under the basic service plans.

Public regime providers are also subject to network expansion requirements under the General Plan on Universal Service, which are revised by ANATEL from time to time. No subsidies or other supplemental financings are anticipated to finance our network expansion obligations. Our failure to meet the network expansion and modernization obligations established by the General Plan on Universal Service or in our concession agreements may result in fines and penalties of up to R\$50 million, as well as potential revocation of our concessions.

### *Unbundling of Local Fixed-Line Networks*

On May 2004, ANATEL issued an order establishing rules for partial unbundling of the local fixed-line networks of the public regime service providers, which we refer to as line sharing, and requiring the eventual full unbundling of local fixed-line networks, which will entail these providers making their entire networks available to other telecommunication service providers. This order (1) establishes a time by which service providers must comply with the order to provide such access, (2) limits the rates service providers can charge for line sharing, and (3) addresses related matters such as co-location space requirements. Co-location means that a service provider requesting unbundling may place its switching equipment in or near the local exchange of the service provider whose network the requesting service provider wishes to use and may connect to the network at this local exchange.

This regulation was designed to increase competition in the local fixed-line and broadband internet access markets by making it easier for new telecommunication service providers operating under either the public or private regime to enter these markets and for existing service providers to provide new services or enter new regions.

As of the date of this annual report, ANATEL has not yet adopted final unbundling rules or rates for full unbundling, although we expect that the rates that we would receive from other telecommunication services providers accessing our fixed-line networks will be lower than the rates we currently charge our customers for

## **Table of Contents**

providing fixed-line and broadband internet services. As of the date of this annual report, no unbundled lines had been used by competitors in our region.

ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers.

### *Service Restrictions*

Pursuant to regulations in effect as of the date of this annual report, public regime providers are subject to certain restrictions on alliances, joint ventures and mergers and acquisitions with other public regime providers, including:

a prohibition on holding more than 20% of the voting shares of more than one other provider of public regime services;

a restriction on mergers between regional fixed-line service providers and mobile services providers (a prohibition that also applies to private regime companies); and

a restriction on offering cable television services, unless the company offering public regime services has won a public auction to provide cable television services in the relevant region and no other bidders participated.

In November 2010, ANATEL announced the opening of the market for subscription television services. The pending amendments to our concession agreements are expected to remove the restrictions that currently prohibit us from offering subscription television services over our networks, permitting us to offer IP TV. Under the new regulations, ANATEL will no longer limit the number of authorizations that it will grant to provide subscription television services and will permit companies that control public regime providers to also provide subscription television services.

### *Termination of a Concession*

ANATEL may terminate the concession of any public regime telecommunication service provider upon the occurrence of any of the following:

an extraordinary situation jeopardizing the public interest, in which case the Brazilian government is authorized to start rendering the services set forth under the concession in lieu of the concessionaire, subject to congressional authorization and payment of adequate indemnification to the owner of the terminated concession;

termination by the provider (through an agreement with ANATEL or pursuant to legal proceedings) as a consequence of an act or omission of the Brazilian government that makes the rendering of the services excessively burdensome to the provider;

annulment of the concession due to a contractual term, which is deemed by subsequent law to be illegal;

material failure to comply with the provider's universalization targets;

failure to meet insurance requirements set forth in the concession agreement;

a split-up, spin-off, amalgamation, merger, capital reduction or transfer of the provider's control without ANATEL's authorization;

**Table of Contents**

the transfer of the concession without ANATEL's authorization;

the dissolution or bankruptcy of the provider; or

an extraordinary situation in which Brazilian government intervention, although legally permissible, is not undertaken, as such intervention would prove to be inconvenient, unnecessary or would result in an unfair benefit to the provider.

In the event a concession is terminated, ANATEL is authorized to administer the provider's properties and its employees in order to continue rendering services.

*General Plan on Quality Goals*

The General Plan on Quality Goals was approved by ANATEL in June 2003 and became effective in January 2006. Each fixed-line service provider operating under the public regime or the private regime must comply with the provisions of the General Plan on Quality Goals. All costs related to compliance with the quality goals established by the General Plan on Quality Goals must be borne exclusively by the service provider. The General Plan on Quality Goals establishes minimum quality standards with regard to:

modernization of the network;

responses to repair requests;

responses to change of address requests;

rate of call completion;

operator availability;

availability of services to customers;

personal services to customers;

issuance of bills;

responses to mail received from customers; and

quality of public telephones.

These quality standards are measured according to the definitions and quality indicators established by ANATEL. Every month, fixed-line service providers are required to report their compliance with quality goals to ANATEL. Additionally, they are obligated to provide ANATEL with an in-depth report and analysis on each quality goal that is not satisfied. ANATEL may also collect such data from fixed-line service providers at any time without prior notice. Fixed-line service providers that fail to meet quality goals established by ANATEL may be subject to



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warnings, fines, intervention by ANATEL, temporary suspensions of service or cancellation of their concessions and authorizations.

ANATEL measures the performance of fixed-line service providers in each individual state in which they operate. As a result, the performance of fixed-line service providers in any particular state may not meet one or more quality performance targets even if such service provider's overall performance is satisfactory. Therefore, fixed-line service providers, including us, could be subject to fines or penalties as a result of the failure to meet the quality performance targets in one or more particular states.

## **Table of Contents**

Our failure to meet the quality of service obligations established by the General Plan on Quality Goals or in our concession agreements may result in fines and penalties of up to R\$40 million.

### ***Regulation of Mobile Services***

In September 2000, ANATEL adopted regulations that established operating rules for providers under the personal mobile service (*Serviço Móvel Pessoal*) regime. The regulations permitted ANATEL to grant authorizations to provide mobile telecommunication services under the personal mobile service regime. For purposes of the personal mobile service regulations, Brazil is divided into three service regions covering the same geographic areas as the concessions for fixed-line telecommunication services.

Under the personal mobile service regulations:

Band A and Band B service providers can apply for an additional frequency range;

each service provider may apply to provide domestic and international long-distance services originating from its service region;

existing service providers, as well as new entrants into the Brazilian telecommunications market, may bid for new licenses in all frequency bands, other than Band A and Band B;

personal mobile services providers are required to offer a basic service plan to their customers containing certain prescribed features;

personal mobile services providers are required to establish interconnection rates for the use of one provider's network by another provider;

the number of regions in which a personal mobile services provider may offer services is not limited; and

a personal mobile services provider, or its controlling shareholders, may not hold more than one personal mobile services authorization covering any specific region.

### ***Auction of Personal Mobile Services Spectrum***

Prior to the establishment of the personal mobile services regime, ANATEL had granted licenses to mobile services providers to operate in each region of Brazil using Bands A and B. In 2001 and 2002, ANATEL successfully auctioned authorizations and licenses to operators in Band D and Band E in each region. Brasil Telecom Mobile was granted its initial authorization to provide personal mobile services in Region II and a license to operate in Band E in December 2002.

ANATEL conducted additional auctions of radio frequency licenses in 2004 and 2006. In April 2004, Brasil Telecom Mobile acquired an additional license to operate in Region II.

### ***Auction of 3G Spectrum***

In preparation for auctions of spectrum in Bands F, G, I and J (2.1 GHz), the use of which allows personal mobile services providers to offer 3G services to their customers, ANATEL issued regulations that divide the Brazilian territory into nine regions for purposes of operations using these frequency bands. In December 2007, ANATEL auctioned radio frequency licenses to operate on each of these frequency bands in each of the nine regions and the related licenses to use these frequency bands. In this auction, we acquired the radio frequency licenses necessary to offer 3G services in two of the nine regions delineated by ANATEL for 3G services (corresponding to Region II under the personal mobile services regime).



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## **Table of Contents**

### *Personal Mobile Services Rate Regulation*

Rates for personal mobile services are regulated by ANATEL. Personal mobile services providers are required to offer a basic service plan that consists of a monthly subscription, local calls and roaming. Basic service plans were approved by ANATEL for each of the personal mobile services providers following the grant of personal mobile services authorizations to each of these providers.

Following the effectiveness of the basic service plans, annual adjustments of the rates under these plans have been subject to a price cap mechanism. Through 2005, rates were adjusted annually by no more than the rate of inflation, as measured by the IGP-DI. In 2006, ANATEL replaced the IGP-DI with the IST to calculate annual rate adjustments.

Personal mobile services providers are permitted to offer non-discriminatory alternative plans to the basic service plan. The rates charged under these plans (e.g., monthly subscription rates, charges for local calls and roaming charges) are subject to ANATEL approval prior to the time that these plans are first offered to mobile customers. Following the approval of these plans, the rates under these plans may be increased up to an annual adjustment that is approved by ANATEL and is no more than the rate of inflation, as measured by the IST.

Although subscribers of a plan cannot be forced to migrate to new plans, existing plans may be discontinued as long as all subscribers receive a notice to that effect and are allowed to migrate to new plans within six months of such notice. Discounts from the rates set in basic service plans and alternative service plans may be granted to customers without ANATEL approval.

### *Obligations of Personal Mobile Services Providers*

As a telecommunication service provider, we are subject to requirements concerning network expansion and quality of service, as established in applicable regulations and in our personal mobile services authorizations. If we fail to meet these obligations, we may be fined, subject to a maximum penalty of R\$50 million, until we are in full compliance with our obligations. While it is possible for an authorization to be revoked for non-compliance with these obligations, there are no precedents for such a revocation.

### *Network Expansion Obligations*

The personal mobile services authorizations set forth certain obligations and targets that must be met by a personal mobile services provider. For a description of the obligations and targets that must be met by our company, see [Concessions, Authorizations and Licenses Personal Mobile Services Authorization Agreements and Radio Frequency Spectrum Licenses](#) and [Concessions, Authorizations and Licenses 3G Radio Frequency Licenses](#).

### *Quality of Service Obligations*

Our personal mobile services authorizations impose obligations on us to meet quality of service standards relating to our network's ability to make and receive calls, call failure rates, capacity to handle peak periods, failed interconnection of calls and customer complaints. ANATEL defines these quality of service standards, and we must report information in connection with such standards to ANATEL.

### *Additional Obligations*

In August 2007, ANATEL adopted revisions to the personal mobile services regulations that became effective in February 2008. These revised regulations imposed additional obligations on personal mobile services providers, particularly in connection with customers' rights. These obligations require personal mobile services providers to:

establish at least one customer service center in each registration area served that has more than 100,000 inhabitants;

upgrade customer service centers to improve access by people with hearing disabilities;

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**Table of Contents**

increase the term applicable to pre-paid cards from 90 days to 180 days or more;

deliver to pre-paid customers a detailed report of service use upon request;

reimburse unused pre-paid credits;

limit the duration of contracts with pre-paid customers to 12 months;

permit customers to change service plans without penalties; and

unblock mobile handsets, allowing a customer who purchased a mobile handset from any personal mobile services provider to use it on the network of another personal mobile services provider.

***Interconnection Regulations***

Under the General Telecommunications Law, all telecommunication service providers are required, if technically feasible, to make their networks available for interconnection on a non-discriminatory basis whenever a request is made by another telecommunication service provider. Interconnection permits a call originated on the network of a requesting fixed-line or personal mobile services provider's network to be terminated on the fixed-line or personal mobile services network of the other provider. ANATEL initially adopted General Rules on Interconnection (*Regulamento Geral de Interconexão*) in 1998, which were amended and restated in July 2005.

***Interconnection Regulations Applicable to Fixed-Line Providers***

Interconnection fees are charged at a flat rate per minute of use of a fixed-line provider's network. Interconnection rates charged by a fixed-line provider to terminate a call on its local network (the TU-RL rate) or intercity network (the TU-RIU rate) are subject to a price cap established by ANATEL. The price cap for interconnection rates varies from service provider to service provider based on the underlying cost characteristics of such service provider's network and whether such service provider has significant market power.

Fixed-line service providers must offer the same TU-RL and TU-RIU rates to all requesting providers on a nondiscriminatory basis. The price caps on interconnection rates are adjusted annually by ANATEL at the same time that rates for local and long-distance rates are adjusted.

Fixed-line service providers are only required to pay interconnection fees to another fixed-line service provider for traffic in the same local area in the event that the ratio of the outbound traffic generated by that provider (measured in minutes) to the inbound traffic terminated by that provider (measured in minutes) exceeds 55% or was less than 45%. This system is designated the "bill-and-keep" system.

In 2006, the TU-RL rates that fixed-line service providers could charge each other to terminate a call on their respective networks were reduced to 50% of the rate included in their Basic Plan per Minute for a local fixed-line call. In 2007, the TU-RL rates of the fixed-line service providers were reduced to 40% of the rate included in their Basic Plan per Minute for a local fixed-line call. ANATEL announced that beginning in 2008, the method used to determine the TU-RL rates would be based on a cost methodology, known as long-run incremental costs. However, in October 2007, ANATEL published an official letter delaying this change until the end of 2010. In September 2010, ANATEL commenced the bidding process to engage an international consultant to assist with the development of the long-run incremental cost methodology. However, ANATEL has not established a definitive timetable for the completion of the project. Therefore, we cannot predict when this new methodology will be proposed.

In 2006, the TU-RIU rates that fixed-line service providers could charge each other to use a portion of their long-distance networks to complete long-distance calls were reduced to 30% of the applicable domestic fixed line-to-fixed line long-distance rates for calls of more than 300 km.

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**Table of Contents**

*Interconnection Regulations Applicable to Personal Mobile Services Providers*

Interconnection fees are charged at a flat rate per minute of use of a personal mobile services provider's network. The terms and conditions of interconnection agreements of all personal mobile services providers, including the rates charged by the operator of the network to terminate a call on its mobile network (the VU-M rate), commercial conditions and technical issues, are freely negotiated between mobile and fixed-line telecommunication service providers, subject to compliance with regulations established by ANATEL relating to traffic capacity and interconnection infrastructure that must be made available to requesting providers, among other things.

Personal mobile services providers must offer the same VU-M rate to all requesting providers on a nondiscriminatory basis. Interconnection agreements must be approved by ANATEL before they become effective and they may be rejected if they are contrary to the principles of free competition and the applicable regulations. If the providers cannot agree upon the terms and conditions of interconnection agreements, ANATEL may determine terms and conditions by arbitration. Since no agreement with fixed-line service providers could be reached regarding VU-M rates when Brasil Telecom Mobile began offering personal mobile services, ANATEL set the initial VU-M rates for Brasil Telecom Mobile.

Personal mobile services providers negotiate annual rate increases for their VU-M charges with the fixed-line telecommunications providers. If the providers cannot agree upon the terms and conditions of annual rate increases, ANATEL may determine the annual rate increases by arbitration.

ANATEL has proposed new regulations under which the VC-1, VC-2 and VC-3 rates would be reduced from current levels, after giving effect to an inflation adjustment based on the IST, by 10% in 2012 and 10% in 2013. These proposed regulations also provide procedures for determining the reference value for VU-M rates in the event that providers cannot agree upon the VU-M applicable in their interconnection agreements. These regulations were submitted for public consultation in October 2010 and the public consultation period ended on November 12, 2010. ANATEL continues to analyze these proposed regulations. We expect these new regulations, as they may be modified as a result of ANATEL's further analysis, to be adopted in the second quarter of 2011.

*Transition from Bill-and-Keep System to Full Billing System*

Prior to July 2006, a personal mobile services provider was only required to pay interconnection fees to another personal mobile services provider for traffic in the same registration area in the event that the ratio of the outbound traffic generated by that provider (measured in minutes) to the inbound traffic terminated by that provider (measured in minutes) exceeded 55% or was less than 45%.

In July 2006, ANATEL adopted new regulations under which personal mobile services providers recognize interconnection revenues (and costs) for traffic in the same registration area on a gross basis based on the total traffic between personal mobile services providers' networks. This system is designated the "full billing" system. These regulations also:

require that personal mobile services providers adopt discounts to the VU-M rates for off-peak calls that correspond to the discounts required to be offered by fixed-line service providers; and

provide that more stringent regulations applicable to interconnection between personal mobile services providers that are members of economic groups with significant market power will be adopted in order to ensure market competition.

*Regulation of Interconnection Rates Charged by Providers with Significant Market Power*

In 2005, ANATEL issued regulations defining a series of cost-based methods, including the fully allocated cost methodology, for determining interconnection fees charged by telecommunication service providers belonging to economic groups with significant market power based on their fixed-line or personal mobile services interconnection networks. All incumbent fixed-line service providers and all personal mobile services providers are deemed by ANATEL to belong to economic groups with significant market power in their respective service areas

## **Table of Contents**

until ANATEL finalizes its evaluation of each provider under published criteria to determine significant market power.

In July 2006, ANATEL issued regulations regarding the fees that may be charged for the use of mobile networks by personal mobile services providers with significant market power in the mobile interconnection market. The date on which these regulations will become effective has not yet been established by ANATEL. Under these regulations, ANATEL will determine, based on a fully allocated cost model, a reference value for VU-M rates of providers that are deemed to hold significant market power. This reference value will be reassessed every three years. In order to determine whether a provider has significant market power, ANATEL will establish criteria that consider:

that provider's market share in the mobile interconnection market and in the personal mobile services market;

the economies of scope and scale available to that provider;

that provider's dominance over infrastructure that is not economically viable to duplicate;

the existence of that provider's power to negotiate the acquisition of equipment and services;

the existence of vertical integration in that provider's operations;

the existence of barriers to entry in the mobile interconnection market and the personal mobile services market served by that provider; and

that provider's access to financing sources.

ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers.

### ***Number Portability Regulations***

Number portability is the ability of a customer to move to a new home or office or switch service providers while retaining the same fixed-line or mobile telephone number. In March 2007, ANATEL adopted the General Regulation of Portability (*Regulamento Geral de Portabilidade*), establishing the deadlines and general rules regarding portability of fixed-line and mobile telephone numbers. These regulations permit fixed-line customers to retain their telephone numbers if they become customers of a different fixed-line service provider in the same municipality or if they move to a new home or office in the same municipality. Personal mobile services customers are permitted to retain their telephone numbers if they change their service plan or if they become customers of a different personal mobile services provider within the same registration area. Implementation of number portability commenced in August 2008 and was completed in March 2009.

Each telecommunications provider has been required to contract a third-party management entity to manage all procedures relating to number portability. Service providers are permitted to charge a migrating customer that elects to retain its telephone number a one-time fee of no more than R\$4.00. This amount is intended to compensate the customer's current provider for the costs associated with managing the portability process. The new provider may elect to absorb this fee on behalf of the customer.

## **Table of Contents**

### ***Regulation of Data Transmission and Internet Services***

Under Brazilian regulation, ISPs are deemed to be suppliers of value-added services and not telecommunication service providers. Value-added services are considered an activity that adds features to a telecommunication service supported by such value-added services.

Telecommunication service providers are permitted to render value-added services through their own networks. In addition, ANATEL regulations require all telecommunication service providers and cable television operators to grant network access to any party interested in providing value-added services, including internet access, on a non-discriminatory basis, unless not technically feasible.

ANATEL has adopted regulations applicable to fixed-line service providers with significant market power. Under these regulations, these providers are required to make the forms of agreements that they use for EILD and SLD services publicly available, including the applicable rates, and are only permitted to offer these services under these forms of agreement. Following publication of these forms of agreement, the rates under these agreements may be increased on an annual basis by no more than the rate of inflation, as measured by the IST. ANATEL also publishes reference rates for these services, and if a customer of one of these providers objects to the rates which that provider charges for these services, the customer is entitled to seek to reduce the applicable rate through arbitration before ANATEL.

ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers.

### **Environmental and Other Regulatory Matters**

As part of our day-to-day operations, we regularly install ducts for wires and cables and erect towers for transmission antennae. We may be subject to federal, state and/or municipal environmental licensing requirements due to the installation of cables along highways and railroads, over bridges, rivers and marshes and through farms, conservation units and environmental preservation areas, among other places. As of the date of this annual report, we have been required to obtain environmental licenses for the installation of transmission towers and antennae in several municipalities with no material impact on our operations. However, there can be no assurances that other state and municipal environmental agencies will not require us to obtain environmental licenses for the installation of transmission towers and antennae in the future and that such a requirement would not have a material adverse effect on the installation costs of our network or on the speed with which we can expand and modernize our network.

We must also comply with environmental legislation regarding the management of solid waste. According to resolutions adopted by the National Environmental Council (*Conselho Nacional do Meio Ambiente*), companies responsible for the treatment and final disposal of solid industrial waste, special waste and solid urban waste are subject to environmental licensing. Should the waste not be disposed of in accordance with standards established by environmental legislation, the company generating such waste may be held jointly and severally liable with the company responsible for waste treatment for any damage caused. Also, in all states where we operate, we have implemented management procedures promoting the recycling of batteries, transformers and fluorescent lamps.

In addition, we are subject to ANATEL regulations that impose limits on the levels and frequency of the electromagnetic fields originating from our telecommunications transmissions stations.

We believe that we are in compliance with ANATEL standards as well as with all applicable environmental legislation and regulations. We are currently not involved in any administrative or judicial proceeding involving material liability for environmental damage.



**Table of Contents**

**ITEM 4A. UNRESOLVED STAFF COMMENTS**

Not applicable.

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**Table of Contents**

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements as of and for the years ended December 31, 2010 and 2009, which are included in this annual report, as well as with the information presented under the sections entitled "Presentation of Financial and Other Information" and "Item 3. Key Information - Selected Financial Information."*

*The following discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in the forward-looking statements as a result of various factors, including those set forth in "Forward-Looking Statements" and "Item 3. Key Information - Risk Factors."*

The following discussion and analysis of our financial condition and results of operations presents the following:

a brief overview of our company and the principal factors that influence our results of operations, financial condition and liquidity;

a review of our financial presentation and accounting policies, including our critical accounting policies;

a discussion of the principal factors that influence our results of operations;

a discussion of our results of operations for the years ended December 31, 2010 and 2009;

a discussion of our liquidity and capital resources, including our working capital at December 31, 2010, our cash flows for the years ended December 31, 2010 and 2009, and our material short-term and long-term indebtedness at December 31, 2010; and

a discussion of our contractual commitments.

**Overview**

We are the largest telecommunications service provider in Region II in Brazil, based on our aggregate number of fixed-lines in service and mobile subscribers as of December 31, 2010 and information available from ANATEL. We offer a range of integrated telecommunication services that includes fixed-line and mobile telecommunications services, data transmission services (including broadband access services), ISP services and other services, for residential customers, small, medium and large companies, and governmental agencies. We operate under the brand name Oi. In 2010, we recorded net operating revenue of R\$10,263 million and net income of R\$1,971 million.

Our results of operations for the years ended December 31, 2010 and 2009 have been influenced, and our future results of operations will continue to be influenced, by a variety of factors, including:

the acquisition of our company and Brasil Telecom Holding by Telemar and the subsequent corporate reorganization of the entities in that directly and indirectly controlled our company, which have resulted in (1) our incurring increased selling, general and administrative expenses relating to the integration of our operations into those of Telemar and the implementation of new mobile services plans as required by ANATEL, and (2) our incurring increased capital expenditures and the corresponding depreciation and amortization expenses as a result of the upgrading and integration of our infrastructure with that of Telemar;

our recording significant provisions for contingencies during 2009, based on two court decisions that significantly changed the assumptions underlying our estimate of the potential losses in lawsuits relating to financial interest agreements;



**Table of Contents**

the rate of growth of Brazilian GDP, which grew by an estimated 7.5% in 2010 following a contraction of 0.2% in 2009, which we believe affects demand for our services and, consequently, our net operating revenue;

the number of our fixed lines in service, which declined to 7.2 million at December 31, 2010 from 7.7 million at December 31, 2009, and the percentage of our fixed-line customers that subscribe to our alternative plans which increased to 94.3% at December 31, 2010 from 82.9% at December 31, 2009;

the number of our mobile customers, which increased by 8.6% to 7.8 million at December 31, 2010, including approximately 175,200 3G customers, from 7.2 million at December 31, 2009, including approximately 139,000 million 3G customers;

the number of our fixed-line customers that subscribe to our broadband services, which remained stable at 1.9 million at December 31, 2010 and December 31, 2009;

the increased competition in the Brazilian market for telecommunications services, which affects the amount of the discounts that we offer on our service rates and the quantity of services that we offer at promotional rates, and resulted in a 25.4% increase in the amount that we recorded as discounts and returns against our gross operating revenue to R\$3,710 million in 2010 from R\$2,958 million in 2009;

the commencement of our offering of 3G services in Region II in April 2008, which we anticipate will result in a significant increase in our net operating revenue, and has resulted in an increase our depreciation expenses relating to our investment in the network and other equipment required to offer these services;

inflation rates in Brazil, which were 5.65% in 2010 and 2.06% in 2009, as measured by the IST, and the resulting adjustments to our regulated rates, as well as the effects of inflation on our *real*-denominated debt that is indexed to take into account the effects of inflation or bears interest at rates that are partially adjusted for inflation;

changes in regulatory requirements that result in our incurrence of additional capital expenditures, changes in the revenues we generate, or changes in the costs that we incur;

our compliance with our quality of service obligations under the General Plan on Quality Goals and our network expansion and modernization obligations under the General Plan on Universal Service and our concession agreements, the amount of the fines assessed against us by ANATEL for alleged failures to meet these obligations and our success in challenging fines that we believe are assessed in error;

changes in the *real*/U.S. dollar exchange rate, including the 4.3% appreciation of the *real* against the U.S. dollar in 2010 and the 22.5% appreciation of the *real* against the U.S. dollar in 2009, which has affected the cost in *reais* of a substantial portion of the network equipment that we purchase for our capital expenditure projects, the prices of which are denominated in U.S. dollars or are U.S. dollar-linked; and

the level of our outstanding indebtedness, fluctuations in benchmark interest rates in Brazil, principally the CDI rate and the TJLP rate, which affects our interest expenses on our *real*-denominated floating rate debt.

Our financial condition and liquidity is influenced by a variety of factors, including:

our ability to generate cash flows from our operations;

prevailing Brazilian and international interest rates, which affect our debt service requirements;

our ability to borrow funds from Brazilian and international financial institutions and to sell our debt securities in the Brazilian securities markets, which is influenced by a number of factors discussed below;

## **Table of Contents**

our capital expenditure requirements, primarily consisting of (1) investments in infrastructure to expand our mobile telecommunications services, including the expansion of our 3G networks, and (2) investments in fixed-line telecommunications network equipment, primarily to enhance the technical capabilities of our network in order to enable us to provide value-added services, such as broadband and IP TV services, and to comply with our universal service obligations; and

the requirement under Brazilian corporate law and our by-laws that we pay dividends on an annual basis in an amount equal to at least 25% of our adjusted net income, unless our board of directors deems it inconsistent with our financial position.

## **Financial Presentation and Accounting Policies**

### ***Presentation of Financial Statements***

We have prepared our consolidated financial statements as of and for the years ended December 31, 2010 and 2009 in accordance with IFRS as issued by the IASB. These consolidated annual financial statements are our first annual consolidated financial statements to be prepared in accordance with IFRS. IFRS 1, First-time Adoption of International Reporting Standards, has been applied in preparing these consolidated financial statements, considering that our previous primary GAAP was Brazilian GAAP and that we have considered January 1, 2009 as the date of transition to IFRS. Therefore, we are presenting information related to the years ended December 31, 2010 and 2009.

### ***Effects of the Acquisition of our Company and Brasil Telecom Holding by Telemar and the Subsequent Corporate Reorganization***

On January 8, 2009, Copart 1, an indirect wholly-owned subsidiary of Telemar, acquired all of the outstanding shares of Invitel and 12,185,836 common shares of Brasil Telecom Holding owned by the shareholders of Invitel. As of January 8, 2009, Invitel owned all of the outstanding shares of Solpart, Solpart owned 19.0% of the outstanding share capital, including 52.0% of the voting share capital, of Brasil Telecom Holding, which, in turn, owned 67.2% of the outstanding share capital, including 99.1% of the voting share capital, of Brasil Telecom.

Prior to this acquisition Copart 1 owned 21.1% of the outstanding share capital of Brasil Telecom Holding and Copart 2, an indirect wholly-owned subsidiary of Telemar, owned 10.7% of the outstanding share capital of our company. In connection with this acquisition, on June 23, 2009:

Copart 1 acquired 40,452,227 common shares of Brasil Telecom Holding, representing 30.5% of the outstanding common shares of Brasil Telecom Holding and 11.2% of the outstanding share capital of Brasil Telecom Holding, through a public tender offer; and

Copart 2 acquired 630,872 of our common shares, representing 0.3% of our outstanding common shares and 0.1% of our outstanding share capital, through a public tender offer.

In anticipation of its corporate reorganization, on July 31, 2009, Telemar undertook the transactions described below, which we refer to collectively as the Intermediate Mergers, to eliminate the intermediate holding companies in the structure of its ownership of Brasil Telecom Holding and our company:

Invitel merged with and into Solpart, with Solpart as the surviving company;

Solpart merged with and into Copart 1, with Copart 1 as the surviving company;

Copart 1 merged with and into Brasil Telecom Holding, with Brasil Telecom Holding as the surviving company; and

Copart 2 merged with and into Brasil Telecom, with Brasil Telecom as the surviving company.



## **Table of Contents**

As a result of these transactions, Coari directly owned (1) 54.7% of the outstanding share capital, including 91.7% of the outstanding voting share capital, of Brasil Telecom Holding, and (2) 10.9% of the outstanding share capital, including 0.3% of the outstanding voting share capital, of our company.

On September 30, 2009, Brasil Telecom Holding merged with and into Brasil Telecom. As a result of these transactions, at December 31, 2009, Coari owned 49.3% of the outstanding share capital, including 79.6% of the voting share capital, of Brasil Telecom.

Under IFRS, we accounted for the merger of Brasil Telecom Holding into our company by recording the tax benefit of the controlling interest on assets acquired in connection with the Brasil Telecom Acquisition as a capital contribution based on the amount of tax benefit realizable on the date of the merger of Brasil Telecom Holding into our company in accordance with IFRS and specific CVM requirements.

### ***Business Segments and Presentation of Segment Financial Data***

We have implemented an organizational structure that we believe reflects our business activities and corresponds to the principal services that we provide. We report our results in three segments to reflect this organizational structure:

*Fixed-Line and Data Transmission Services* This segment includes our local fixed-line services (including public telephones), our long-distance services, our fixed-line data transmission services and interconnections to our fixed-line network.

*Mobile Services* This segment includes our mobile services, including voice, mobile data communications and other value added services, and interconnections to our mobile network.

*Other Services* This segment includes the operations of our internet portal, ISP services and call center.

We evaluate and manage business segment performance based on information prepared in accordance with IFRS, and, accordingly, the segment data included in this annual report is presented under IFRS. We have included a reconciliation of the operating results of our segments to our consolidated results under Results of Operations below.

### ***Critical Accounting Policies and Estimates***

Our critical accounting policies and estimates described in note 2(c) to our consolidated financial statements. In preparing our consolidated financial statements, we relied on estimates and assumptions derived from historical experience and various other factors that we deemed reasonable and relevant. Critical accounting policies are those that are important to the portrayal of our consolidated financial position and results of operations and require management's subjective and complex judgments, estimates and assumptions. The application of these critical accounting policies often requires judgments made by management regarding the effects of matters that are inherently uncertain with respect to our results of operations and the carrying value of our assets and liabilities. Our results of operations and financial position may differ from those set forth in our consolidated financial statements, if our actual experience differs from management's assumptions and estimates. In order to provide an understanding of our critical accounting policies, including some of the variables and assumptions underlying the estimates, and the sensitivity of those assumptions and estimates to different parameters and conditions, we set forth below a discussion of our critical accounting policies relating to:

revenue recognition and trade receivables;

provision for doubtful accounts;

depreciation of property, plant and equipment;



impairment of long-lived assets;

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**Table of Contents**

provisions;

derivative instruments;

deferred income taxes and social contribution;

employee benefits; and

amortization of intangible assets.

*Revenue Recognition and Trade Receivables*

Our revenue recognition policy is significant because our revenue is a material component of our results of operations. Management's determination of price, collectability and the rights to receive certain revenues for the use of our network are based on judgments regarding the nature of the fee charged for services rendered, the price for certain services delivered and the collectability of those revenues. Should changes in conditions cause management to conclude that these criteria are not met for certain transactions, the amount of accounts receivable could be adversely affected. In addition, for certain categories of revenue we rely upon revenue recognition measurement guidelines set by ANATEL.

Revenues are generally recognized on an accrual basis. Revenues from local fixed-line, long-distance and post-paid mobile calls and data transmission services are recognized when services are provided. Services provided and not billed at the end of each month are estimated and recorded on an accrual basis. Late-payment interest is recognized upon the issuance of the first bill following the payment of the overdue bill.

Revenues from pre-paid mobile cards are recognized based on the use of the respective credits. Revenue from the sale of public telephone cards is recognized when the credits are effectively consumed by customers. Revenues related to the sale of mobile handsets and accessories are accounted for when the goods are delivered and accepted by the customer.

Revenues from the usage of our network by other telecommunications service providers are recorded based on a formal document of declared traffic and services rendered, the Traffic Exchange Declaration (*Documento de Declaração de Tráfego e Prestação de Serviço*), or DETRAF, issued by an independent, outsourced clearinghouse.

We consider revenue recognition to be a critical accounting policy, because of the uncertainties caused by different factors such as the complex information technology required, high volume of transactions, fraud and piracy, accounting regulations, management's determination of collectability and uncertainties regarding our right to receive certain revenues (mainly revenues for use of our network). Significant changes in these factors could cause us to fail to recognize revenues or to recognize revenues that we may not be able to realize in the future, despite our internal controls and procedures. We have not identified any significant need to change our revenue recognition policy.

*Provision for Doubtful Accounts*

Our allowance for doubtful accounts is established in order to recognize probable losses on accounts receivable and takes into account limitations we impose to restrict the provision of services to customers with past-due accounts and actions we take to collect delinquent accounts. We include government entities, corporate customers and other telecommunications service providers in the basis for our calculation of the allowance for doubtful accounts. For additional information regarding our allowance for doubtful accounts, see note 2(b) to our consolidated financial statements.

We have entered into agreements with certain customers to collect past-due accounts receivable, including agreements allowing customers to settle their delinquent accounts in installments. The amounts that we actually fail to collect in respect of these accounts may differ from the amount of the allowance established, and additional allowances may be required.

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## **Table of Contents**

Following Telemar's acquisition of control of our company on January 8, 2009, we have adopted the same accounting estimate method with respect to our allowance for doubtful accounts as that adopted by Telemar. As a result of this change in accounting estimate method, we recorded a change in accounting estimate in the amount of R\$38 million, net of income taxes, during the year ending December 31, 2009.

### *Depreciation of Property, Plant and Equipment*

We depreciate property, plant and equipment using the straight-line method at rates we judge compatible with the useful lives of the underlying assets. The depreciation rates of our most significant assets are described in note 18 to our consolidated financial statements. The useful lives of assets in certain categories may vary based on whether they are used primarily to provide fixed-line or mobile services. We review the estimated useful lives of the assets taking into consideration technical obsolescence and a valuation by outside experts.

We modified our estimate of the useful life of our property, plant and equipment as from September 30, 2009. These modifications increased the estimated useful lives of many of our assets, which have been reflected for periods ended after September 30, 2009, resulting in a reduction of our depreciation expenses of R\$350 million for 2010 compared to 2009.

Given the complex nature of our property, plant and equipment, the estimates of useful lives require considerable judgment and are inherently uncertain, due to rapidly changing technology and industry practices, which could cause early obsolescence of our property, plant and equipment. If we materially change our assumptions of useful lives and if external market conditions require us to determine the possible obsolescence of our property, plant and equipment, our depreciation expense, obsolescence write-off and consequently net book value of our property, plant and equipment could be materially different.

### *Impairment of Long-Lived Assets*

We test property, plant and equipment items and intangible assets for impairment whenever (1) we decide to discontinue activities in which such assets are used, or (2) there is evidence that future operating results will not be sufficient to ensure their realization.

Assets with finite useful lives are tested for impairment whenever events or changes in circumstances indicate that the asset might be impaired. We test asset with indefinite useful lives (goodwill) for impairment annually.

Impairment losses, if any, are recognized in an amount by which the carrying amount of an asset exceeds its recoverable value. Recoverable value is the higher of fair value less cost to sell and the value in use. These calculations require the use of judgments and assumptions. The determination of fair values and discounted future operating cash flows requires that we make certain assumptions and estimates with respect to projected cash inflows and cash outflows related to future revenue, costs and expenses. These assumptions and estimates may be influenced by different external and internal factors, such as economic trends, industry trends and interest rates, changes in business strategies, and changes in the type of services and products sold by our company. The use of different assumptions and estimates could significantly change our consolidated financial statements.

We have not recorded any impairment during the two years ended December 31, 2010.

### *Provisions*

We recognize provisions for losses in labor, tax and civil proceedings, as well as administrative proceedings. The recognition of a provision is based on the assessment of the risk of loss made for each proceeding, which includes assessing available evidence and recent decisions.

We classify our risk of loss in legal proceedings as remote, possible or probable. Provisions recorded in our consolidated financial statements in connection with these proceedings reflect reasonably estimated losses at the relevant date as determined by our management after consultation with our general counsel and the outside legal counsel. As discussed in note 24 to our consolidated financial statements, we record as a liability our estimate of the

**Table of Contents**

costs of resolution of such claims, when we consider our losses probable. We continually evaluate the provisions based on changes in relevant facts, circumstances and events, such as judicial decisions, that may impact the estimates, which could have a material impact on our results of operations and shareholders' equity. While management believes that the current provision is adequate, it is possible that our assumptions used to estimate the provision and, therefore, our estimates of loss in respect of any given contingency will change in the future based on changes in the relevant situation. This may therefore result in changes in future provisioning for legal claims. For more information regarding material pending claims against our company, see Item 8. Financial Information Legal Proceedings and note 24 to our consolidated financial statements.

As the result of Telemar's acquisition of control of our company in January 2009, we have changed our criteria for estimating probable losses in connection with labor proceedings and the recognition of Tax on the Circulation of Merchandise and Services (*Imposto Sobre a Circulação de Mercadorias e Serviços*), or ICMS (a state value-added tax on sales and services), tax credits in order to align our policies with those of Telemar. As a result, we recorded additional provisions for labor proceedings and tax proceedings in 2009 in the amount of R\$334 million and R\$387 million, respectively.

In addition, as the result of certain judicial decisions in 2009, we have reclassified the probability of loss in certain civil proceedings involving CRT, the leading fixed-line telecommunications service company in the State of Rio Grande do Sul that we acquired in July 2000, from possible to probable. With the assistance of our internal and external legal advisors, we revised our estimate of the amount of provisions for civil contingencies in connection with the financial participation agreements entered into in connection to the expansion plans of CRT, considering aspects of the process we use to estimate the amount of provisions for civil contingencies related to the dates and discussions that guided the final decisions of the proceedings, as well as the use of statistical criteria to estimate the amount of the provisions. As a result, the provision for civil contingencies in connection with the financial participation agreements entered into in connection to the expansion plans of CRT was increased by R\$2,325 million. For additional information regarding these suits, see Item 8. Financial Information Legal Proceedings Civil Claims.

*Derivative Instruments*

We recognize derivative financial instruments at fair value based on future cash flow estimates associated with each instrument contracted. Our estimates of future cash flows may not necessarily be indicative of the amounts that could be obtained in the current market. The use of different assumptions to measure the fair value could have a material effect on the amounts obtained and not necessarily be indicative of the cash amounts that we would receive or pay to settle such transactions.

*Deferred Income Taxes and Social Contribution*

Income taxes in Brazil are calculated and paid on a legal entity basis, and there are no consolidated tax returns. Accordingly, we only recognize deferred tax assets, related to tax loss carryforwards and temporary differences, if it is likely that they will be realized on a legal entity basis.

We recognize and settle taxes on income based on the results of operations determined in accordance with the Brazilian Corporation Law, taking into consideration the provisions of Brazilian tax law, which are materially different from the amounts calculated for IFRS purposes. Under IFRS, we recognize deferred tax assets and liabilities based on the differences between the carrying amounts and the taxable bases of the assets and liabilities.

We regularly test deferred tax assets for impairment and recognize a provision for impairment losses when it is probable that these assets may not be realized, based on the history of taxable income, the projection of future taxable income, and the time estimated for the reversal of existing temporary differences. These projections require the use of estimates and assumptions. In order to project future taxable income, we need to estimate future taxable revenues and deductible expenses, which are subject to a variety of external and internal factors, such as economic trends, industry trends and interest rates, changes in business strategies, and changes in the type of services and products sold by our company. The use of different estimates and assumptions could result in the recognition of a provision for impairment losses for the entire or a significant portion of the deferred tax assets.

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## **Table of Contents**

### *Employee Benefits*

We record liabilities for employee benefits based on actuarial valuations which are calculated based on assumptions and estimates regarding discount rates, investment returns, inflation rates for future periods, mortality indices and projected employment levels relating to pension fund benefit liabilities. The accuracy of these assumptions and estimates will determine whether we have created sufficient reserves for the costs of accumulated pensions and healthcare plans, and the amount we are required to disburse each year to fund pension benefits. These assumptions and estimates are subject to significant fluctuations due to different external and internal factors, such as economic trends, social indicators, our capacity to create new jobs and our ability to retain our employees. All of these assumptions are reviewed at the end of each reporting period. If these assumptions and estimates are not accurate, we may be required to revise our reserves for pension benefits, which could materially impact our results of operations.

### *Amortization of Intangible Assets*

Intangible assets consist primarily of authorizations to provide personal mobile services and radio frequency licenses, licenses to use software and goodwill on the acquisition of investments, which is calculated based on expected future economic benefits.

Amortization of intangible assets, other than goodwill, is calculated under the straight-line method over (1) the effective term of the authorization to provide personal mobile services or of the radio frequency license, or (2) over a maximum period of five years in the case of software licenses.

We do not amortize goodwill in our consolidated statements of income and we are required to test goodwill for impairment on an annual basis.

## **Principal Factors Affecting Our Financial Condition and Results of Operations**

### *Rate of Growth of Brazil's Gross Domestic Product and Demand for Telecommunications Services*

As a Brazilian company with substantially all of our operations in Brazil, we are affected by economic conditions in Brazil. Brazilian GDP grew by 7.5% in 2010 following a contraction of 0.2% in 2009. While we believe that growth in Brazil's GDP stimulates demand for telecommunications services, we believe that demand for telecommunications services is relatively inelastic in periods of economic stagnation and that the effect on our revenues of low growth or a recession in Brazil would not be material under foreseeable scenarios. However, a substantial and prolonged deterioration of economic conditions in Brazil could have a material adverse effect on the number of subscribers to our services and the volume of usage of our services by our subscribers and, as a result, our net operating revenue.

Based on information available from ANATEL, the number of fixed lines in service in Brazil increased from 30.9 million as of December 31, 2000 to 42.0 million as of December 31, 2010, and the number of mobile subscribers in Brazil increased from 23.2 million as of December 31, 2000 to 202.9 million as of December 31, 2010. Although the demand for telecommunications services has increased substantially during the past ten years, the tastes and preferences of Brazilian consumers of these services have shifted.

During the three years ended December 31, 2010, the number of mobile subscribers in Brazil has grown at an average rate of 67.7% per year while the number of fixed lines in service in Brazil has increased by an average rate of 6.6% per year. As the incumbent provider of fixed-line services and a provider of mobile services in Region II, we are both a principal target and a beneficiary of this trend. During the three years ended December 31, 2010, the number of our mobile subscribers has grown at an average rate of 22.2% per year from 4.3 million at December 31, 2007 to 7.8 million at December 31, 2010, while the number of our fixed-lines in service has declined by an average rate of 3.6% per year from 8.0 million at December 31, 2007 to 7.2 million at December 31, 2010.

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**Table of Contents**

*Demand for Our Telecommunications Services*

*Demand for Our Local Fixed-Line Services*

Brazil's fixed-line penetration level is now similar to that of other countries with similar per capita income, and, as has happened in such other countries, the fixed-line telecommunications customer base has remained stable. Demand for our local fixed-line services has reached a plateau in recent years. Because the number of our customers terminating their fixed-line services has exceeded new activations during this period, the number of our fixed lines in service declined by 0.8 million between December 31, 2007 and December 31, 2010. In addition, the new fixed lines that we have activated between December 31, 2007 and December 31, 2010 generally represent customers that have changed addresses or low-income customers from whom we generate revenues at a rate below our average revenue per customer.

We have sought to combat the general trend in the Brazilian telecommunications industry of substitution of mobile services in place of local fixed-line services by (1) offering value-added services to our fixed-line customers, primarily subscriptions for broadband services, and (2) promoting convergence of our telecommunications services through offerings of bundled packages of local fixed-line, long-distance, mobile and broadband services. As a result of these service offerings, we expect that the rate of decline in number of our fixed lines in service will be reduced. As of December 31, 2010, 26.8% of our fixed lines in service also subscribed for ADSL service and 0.2% of our local fixed-line customers subscribed for bundled service packages, which account for 0.4% of our post-paid mobile subscribers as each fixed-line subscriber may include multiple mobile devices in a bundled plan.

We are required under ANATEL regulations and our concession contracts to offer a basic service plan to our fixed-line residential customers that permits 200 minutes of usage of our fixed-line network to make local calls. A basic plan customer pays a monthly fee for this service, and when the customer makes local calls in excess of this limit, we charge the customer for the excess minutes on a per-minute basis. We offer alternative local fixed-line plans that include significantly larger numbers of minutes and charge higher monthly fees for these plans, although these monthly fees represent a discount from the amount that the customer would be charged under our basic plan if the customer used the number of minutes included in the alternative plan. As the number of our customers selecting these alternative plans has grown in response to our marketing and promotional efforts, we have recorded increased revenues for monthly subscription fees, offset by corresponding declines in revenues for the use of excess minutes. Subscribers to our alternative fixed-line plans, which we launched in the second quarter of 2006, represented 94.3% of our fixed lines in service as of December 31, 2010 as compared to 44.1% as of December 31, 2007. We believe that our alternative local fixed-line plans contribute to a net increase in our local fixed-line revenue as many subscribers of our alternative fixed-line plans do not use their full monthly allocations of local minutes.

The substantial increase in the number of mobile service users in Brazil has also negatively impacted the use of our public telephones. As the incumbent local fixed-line service provider in Region II, we are required under ANATEL regulations and our concession contracts to meet specified targets with respect to the availability of public telephones throughout our concession area. However, as a larger portion of the population of Region II uses mobile handsets to make calls when not in proximity to a fixed-line telephone, use of our public telephones has declined by 70.6% from 2007 to 2010.

*Demand for Our Mobile Services*

We believe that the primary reason that our customer base for mobile services in Region II has grown from 4.3 million at December 31, 2007 to 7.8 million at December 31, 2010 has been the success of our marketing and promotion campaigns. In addition, we believe that the rebranding of our mobile services and the launch of new services as part of our effort to align our service offerings with those of Telemar has been a principal factor in the increase in the number of our mobile customers in Region II from 7.2 million as of December 31, 2009 to 7.8 million as of December 31, 2010.

The market for mobile services is extremely competitive in each of the regions that we serve. During 2010, our average monthly churn rate in the mobile services segment, representing the number of subscribers whose service is disconnected during each month, whether voluntarily or involuntarily, divided by the number of subscribers at the beginning of such month, was 4.5% per month. As a result, (1) we incur selling expenses in connection with

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## **Table of Contents**

marketing and sales efforts designed to retain existing mobile customers and attract new mobile customers, and (2) from time to time the discounts that we offer in connection with our promotional activities lead to charges against our gross operating revenue from mobile services. In addition, competitive pressures have in the past required us to introduce service plans under which the monthly and per-minute rates that we charge our mobile customers are lowered, reducing our average revenue per customer.

We expect our overall mobile services business to continue to grow in terms of its customer base, traffic volumes and revenues from value-added services. However, due to market saturation, we expect future growth in our mobile services business in Region II to occur at lower rates than we have historically achieved.

### *Demand for Our Data Transmission Services*

Our broadband services customer base in Region II has grown from 1.5 million at December 31, 2007 to 1.9 million at December 31, 2010. We believe that this growth has resulted from (1) our marketing and promotional campaigns, (2) the growth in the number of households in Region II that own personal computers, and (3) a shift in consumer preferences that has led an increasing number of our fixed-line customers to value the data transmission speeds available through our broadband services. We expect the number of our fixed-line customers that subscribe to our broadband services to continue to increase in the near term.

### *Effects of Expansion of Mobile Data Transmission Services*

In December 2007, we acquired the authorizations and radio frequency licenses necessary for us to commence the offering of 3G services throughout Region II. During 2009 and 2010, we undertook extensive capital expenditure projects to install the network equipment necessary to expand our offerings of these services.

In 2009 and 2010, our mobile data transmission services, consisting of 2G and 3G services to mobile handsets and mini-modems, captured net additions (calculated based on the number of subscribers at the end of a period less the number of subscribers at the beginning of that period) of approximately 55,300 and approximately 10,400, respectively. We expect that these services will generate significant additions to our mobile customer base and lead to long-term increases in our revenues and operating income before financial income (expenses) and taxes.

The cost of these authorizations and radio frequency licenses was R\$708 million, which we will pay to ANATEL in installments through 2023. During 2009 and 2010, we invested R\$443 million and R\$137 million, respectively, in the network equipment necessary to offer these services, which has increased in our depreciation expenses. We financed the purchase and installation of our network equipment through loans and vendor financing.

The marketing and promotion campaigns related to our offerings of mobile data transmission services contributed to an increase in the selling expenses of our mobile services segment and to an increase in the amount of discounts that we recorded against gross operating revenue.

Under our 3G radio frequency licenses, we are required to meet certain service expansion obligations that will require capital expenditures through 2015. If we are unable to fund these capital expenditures through our operating cash flows, we may incur additional indebtedness or vendor financing obligations, which would increase our outstanding indebtedness and financial income (expenses).

### *Effects of Competition on the Rates that We Realize and the Discounts We Record*

The Brazilian telecommunications industry is highly competitive. The competitive environment is significantly affected by key trends, including the convergence of technology and services enables telecommunications service providers that were previously limited to providing a single service to provide services in other industry segments, such as in the case of broadband services provided by cable television service providers and by mobile service providers (using 3G technology) and in the case of traditional fixed-voice services transmitted by mobile telecommunications service providers.

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## **Table of Contents**

Following its acquisition by Vivendi, GVT has increased its competition for high-speed broadband subscribers in certain regions. In 2010, both GVT and Net offered significant discounts from their established service rates to attract customers to their broadband services in areas in which we compete for subscribers. In response to these efforts, we have also increased the discounts that we offer for certain of our broadband services.

In 2010, one of our competitors for long-distance services established a promotion under which this competitor is offering long-distance services at substantially reduced rates. We have not attempted to match these discounts as we believe that the discounts offered by this competitor are a temporary bid to increase market share and are not sustainable, and we believe that the effects on our margins of similar discounts would adversely affect our profitability.

In 2010, competition to provide mobile services intensified as the consolidation of mobile service providers over recent years has led to aggressive discounting by the remaining providers in an effort to increase their respective market shares.

In response to these competitive pressures, (1) we may offer our services at rates below the rate caps established by ANATEL, and (2) from time to time we offer our services with promotional discounts or offer additional complimentary services with the purchase of some of our services. We record the services sold at the rates established under our service plans or at rates approved by ANATEL and record the amount of these services represented by the promotional discounts or delivered on a complimentary basis as discounts and returns in our income statement.

### ***Effects of Changes in Regulatory Requirements***

Compliance with new regulations applicable to the telecommunications industry that are adopted by ANATEL from time to time and compliance with the obligations included in our concession contracts have required us to make capital expenditures, affected the revenues that we generate and imposed additional costs of service on our company.

Our concession contracts to provide fixed-line services in Region II provide that these contracts may be amended by the parties every five years prior to the expiration date. We are currently discussing modifications to our concession agreements with ANATEL that were expected to be effective as of January 1, 2011. Based on our continuing discussions with ANATEL regarding proposed modifications to our concession agreements and proposed amendments to the General Plan on Universal Service, we believe that the effect of these amendments and modifications will:

increase our obligations to provide universal service in rural areas, including increased obligations to provide individual access to fixed-line voice services;

increase our obligations to provide service to economically disadvantaged segments of the Brazilian population within our service areas, primarily through subsidized service rates for fixed-line voice services; and

reduce the density requirements applicable to our obligations to provide public telephones in urban areas within our service areas.

In the event that the General Plan on Universal Service is amended to require that we provide additional services, the Brazilian Telecommunications Law and our concession agreements require that the costs of implementation of these universalization obligations in excess of the revenues generated by these services must be reimbursed to us from public funds. Although we understand that ANATEL intends to permit us to fund the additional capital and operating expenditures required to meet these expanded service obligations through an offset mechanism against the concession fees that we are obligated to pay under our concession agreements and the application of the savings that we achieve as a result of the reduction of our capital and operating expenditures on public telephone services in urban areas within our service areas, our internal projections indicate that a significant portion of the additional capital and operating expenditures required by these proposals could not be met from these



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**Table of Contents**

funding sources alone. We understand that ANATEL intends to permit us to fund these shortfalls in future periods through payments to us from the FUST, to which we are required to make contributions. As a result of our continuing discussions with ANATEL regarding the additional service obligations that we would be required to undertake and the methodology for the reimbursement of the additional capital expenditures that these proposals would require us to undertake, the finalization of the amendments to our concession agreements and the amendments to the General Plan on Universal Service have been delayed and, although we expect that these amendments will be finalized during the second quarter of 2011, we cannot predict with certainty when these amendments will be adopted and become effective or the effects of these amendments on our financial condition and results of operations.

In addition:

ANATEL has proposed new regulations under which the VC-1, VC-2 and VC-3 rates would be reduced from current levels, after giving effect to an inflation adjustment based on the IST, by 10% in 2012 and 10% in 2013. These proposed regulations also provide procedures for determining the reference value for VU-M rates in the event that providers cannot agree upon the VU-M applicable in their interconnection agreements. These regulations were submitted for public consultation in October 2010 and the public consultation period ended on November 12, 2010. ANATEL continues to analyze these proposed regulations. We understand that ANATEL is considering procedures for determining the reference value for VU-M rates which would result in all or most of the reductions to VC-1, VC-2 and VC-3 rates being applied to reduce the VU-M rates. We expect these new regulations, as they may be modified as a result of ANATEL's further analysis, to be adopted in the second quarter of 2011. As we are a provider of both fixed-line and mobile services, the effects of these new regulations, if adopted, on our results of operations is uncertain.

ANATEL has proposed new regulations under which it would grant licenses to use radio spectrum in the 450 Mhz band to telecommunications providers that agree to provide services in rural areas. The public consultation period for these regulations has expired and we expect that ANATEL these regulations will become effective during the second quarter of 2011.

In November 2010, ANATEL announced the opening of the market for subscription television services. We expect that under pending amendments to our concession agreements the restrictions that currently prohibit us from offering subscription television services over our fixed-line networks are likely to be removed, permitting us to offer IP TV. We expect that ANATEL will no longer limit the number of authorizations that it will grant to provide subscription television services and will permit us to provide subscription television services.

ANATEL is expected to begin public consultations regarding a proposed General Plan on Competition Targets in the second quarter of 2011. We expect that ANATEL's proposal regarding the General Plan on Competition Targets will address a variety of matters including criteria for the evaluation of telecommunications providers to determine which providers have significant market power, regulations applicable to the wholesale markets for trunk lines, backhaul, access to internet backbone and interconnection services, and regulations related to partial unbundling and/or full unbundling of the local fixed-line networks of the public regime service providers. We can provide no assurance as to the scope and final form of the General Plan on Competition Targets, if adopted, or the effect of the General Plan on Competition Targets on our financial condition and results of operations.

***Effects of Adjustments to Our Regulated Rates and Inflation***

Telecommunications services rates are subject to comprehensive regulation by ANATEL. Our rates for local fixed-line services, domestic long-distance services, mobile services, interconnection to our fixed-line network, and EILD and SLD services are subject to regulation by ANATEL. We are required to obtain ANATEL approval prior to offering new alternative fixed-line or mobile plans. The rates established or approved by ANATEL for our services act as caps on the prices that we charge for these services, and we are permitted to offer these services at a discount from the rates approved by ANATEL. After ANATEL establishes or approves rate caps for these services,

## **Table of Contents**

these rate caps are subject to annual adjustment based on the rate of inflation, as measured by the IST. Rate caps for local fixed-line plans are adjusted by inflation, as measured by the IST, less an amount that serves as a proxy for productivity gains achieved by our company and the local fixed-line services industry as a whole.

Because substantially all of our cost of services and operating expenses are incurred in *reais* in Brazil, these rate increases act as a natural hedge against inflation and, as a result, our operating margins have not been materially affected by inflation. However, because these rate adjustments are only made on an annual basis, in periods of severe inflation, we may not be able to pass our increased costs through to our customers as incurred.

A significant portion of our *real*-denominated debt bears interest at the TJLP or the CDI rate, which are partially adjusted for inflation, and, as a result, inflation results in increases in our interest expenses and debt service obligations.

### ***Effects of Claims by ANATEL that Our Company Has Not Fully Complied with Our Quality of Service and Other Obligations***

As a fixed-line service provider, we must comply with the provisions of the General Plan on Quality Goals. As a public regime service provider, we must comply with the network expansion and modernization obligations under the General Plan on Universal Service and our concession agreements. Our personal mobile services authorizations set forth certain network expansion obligations and targets and impose obligations on us to meet quality of service standards. In addition, we must comply with regulations of general applicability promulgated by ANATEL, which generally relate to quality of service measures.

If we fail to meet quality goals established by ANATEL under the General Plan on Quality Goals, fail to meet the network expansion and modernization targets established by ANATEL under the General Plan on Universal Service and our concession agreements, fail to comply with our obligations under our personal mobile services authorizations or fail to comply with our obligations under other ANATEL regulations, we may be subject to warnings, fines, intervention by ANATEL, temporary suspensions of service or cancellation of our concessions and authorizations.

On an almost weekly basis, we receive inquiries from ANATEL requiring information from us on our compliance with the various service obligations imposed on us by our concession agreements. If we are unable to respond satisfactorily to those inquiries or comply with our service obligations under our concession agreements, ANATEL may commence administrative proceedings in connection with such noncompliance. We have received numerous notices of commencement of administrative proceedings from ANATEL, mostly due to our inability to achieve certain targets established in the General Plan on Quality Goals and the General Plan on Universal Service.

At the time that ANATEL notifies us it believes that we have failed to comply with our obligations, we evaluate the claim and, based on our assessment of the probability of loss relating to that claim, may establish a provision. We vigorously contest a substantial number of the assessments made against us. As of December 31, 2010, the total estimated contingency in connection with all pending administrative proceedings brought by ANATEL against us in which we deemed the risk of loss as probable totaled R\$240 million and we had recorded an aggregate provision related to these proceedings in the same amount.

During 2010, we recorded provisions related to administrative proceedings brought by ANATEL in the amount of R\$59 million. Our provisions related to administrative proceedings brought by ANATEL generally have been sufficient to pay all amounts that we were ultimately required to pay with respect to claims brought by ANATEL.

### ***Effects of Fluctuations in Exchange Rates between the Real and the U.S. Dollar***

Substantially all of our cost of services and operating expenses are incurred in *reais* in Brazil. As a result, the appreciation or depreciation of the *real* against the U.S. dollar does not have a material effect on our operating margins. However, the costs of a substantial portion of the network equipment that we purchase for our capital expenditure projects are denominated in U.S. dollars or are U.S. dollar-linked. This network equipment is recorded on our balance sheet at its cost in *reais* based on the applicable exchange rate on the date the transfer of ownership,

**Table of Contents**

risks and rewards related to the purchased equipment occurs. As a result, depreciation of the *real* against the U.S. dollar results in this network equipment being more costly in *reais* and leads to increased depreciation expenses. Conversely, appreciation of the *real* against the U.S. dollar results in this network equipment being less costly in *reais* and leads to reduced depreciation expenses.

**Effect of Level of Indebtedness and Interest Rates**

At December 31, 2010, our total outstanding indebtedness on a consolidated basis was R\$4,365 million. The level of our indebtedness results in significant interest expenses that are reflected in our income statement. Financial expenses consist of interest expense, exchange variations of U.S. dollar- and other foreign currency-denominated debt, foreign exchange losses or gains, and other items as set forth in note 8 to our consolidated financial statements. In 2010, we recorded total financial expenses of R\$1,060 million, of which R\$286 million consisted primarily of interest expenses on loans and financing and debentures payable to third parties, and R\$254 million consisted of monetary and foreign exchange variation on financing. The interest rates that we pay depend on a variety of factors, including prevailing Brazilian and international interest rates and risk assessments of our company, our industry and the Brazilian economy made by potential lenders to our company, potential purchasers of our debt securities and the rating agencies that assess our company and its debt securities.

Standard & Poor's and Fitch maintain ratings of our company and our debt securities and Moody's maintains ratings of our company. Any ratings downgrades in the future would likely result in increased interest and other financial expenses relating to loans and financings, including debt securities, and could adversely affect our ability to obtain such financing on satisfactory terms or in amounts required by us.

**Seasonality**

Our telecommunications services are generally not affected by major seasonal variations of the market, except for the first quarter of the year, when economic activity is generally reduced in Brazil.

**Results of Operations**

The following discussion of our results of operations is based on our consolidated financial statements prepared in accordance with IFRS. The discussion of the results of our business segments is based upon financial information reported for each of the segments of our business, as presented in the table below.

The following tables set forth the operating results of each of our segments and the reconciliation of these results of our segments to our consolidated income statement. This segment information was prepared on the same basis as the information that our senior management uses to allocate resources among segments and evaluate their performance. We evaluate and manage the performance of our segments based on information prepared in accordance with IFRS and reflected in our consolidated financial statements

	Year Ended December 31, 2010				
	Fixed-Line and Data Transmission Services	Mobile Services	Other (in millions of <i>reais</i> )	Eliminations	Consolidated
Net operating revenue	R\$ 8,893	R\$ 1,937	R\$ 629	R\$ (1,196)	R\$ 10,263
Cost of sales and services	(4,015)	(1,379)	(323)	985	(4,732)
Gross profit	4,878	558	306	(211)	5,531
Selling expenses	(859)	(403)	(125)	361	(1,025)
General and administrative expenses	(1,270)	(173)	(163)	66	(1,539)
Other operating income (expenses), net	(268)	(17)	(10)	(213)	(508)
Operating income (loss) before financial income (expenses) and taxes	R\$ 2,481	R\$ (34)	R\$ 9	R\$ 4	R\$ 2,460



**Table of Contents**

	Year Ended December 31, 2009					Consolidated		
	Fixed-Line and Data Transmission Services	Mobile Services	Other	Eliminations				
Net operating revenue	R\$ 9,431	R\$ 1,894	R\$ 677	R\$ (1,081)	R\$ 10,920			
Cost of sales and services	(4,744)	(1,516)	(315)	812	(5,764)			
Gross profit	4,686	378	362	(270)	5,156			
Selling expenses	(1,117)	(524)	(188)	410	(1,418)			
General and administrative expenses	(1,205)	(161)	(145)	77	(1,435)	Warranty claims paid during the period	(82,080)	(63,575)
Liabilities accrued for warranties issued during the period	84,920	43,111						
Changes in liabilities for pre-existing warranties during the period	(3,550)	(11,973)						
Foreign currency translation	(11,385)	(9,244)						
Balance at end of the period	¥ 213,943	¥ 172,262						

With respect to product liability, personal injury claims or lawsuits, Honda believes that any judgment that may be recovered by any plaintiff for general and special damages and court costs will be adequately covered by Honda's insurance and accrued liabilities. Punitive damages are claimed in certain of these lawsuits. Honda is also subject to potential liability under other various lawsuits and claims. Honda recognizes an accrued liability for loss contingencies when it is probable that an obligation has been incurred and the amount of loss can be reasonably estimated. Honda reviews these pending lawsuits and claims periodically and adjusts the amounts recorded for these contingent liabilities, if necessary, by considering the nature of lawsuits and claims, the progress of the case and the opinions of legal counsel. After consultation with legal counsel, and taking into account all known factors pertaining to existing lawsuits and claims, Honda believes that the ultimate outcome of such lawsuits and pending claims should not result in liability to Honda that would be likely to have an adverse material effect on its consolidated financial position, results of operations or cash flows.

**Table of Contents**

27

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**(13) Information Related to Honda Motor Co., Ltd. Shareholders Equity**

For the nine months ended December 31, 2010

*(a) Information concerning dividends**1. Dividend payout*

Resolution	The ordinary general meeting of shareholders on June 24, 2010
Type of shares	Common stock
Total amount of dividends (million yen)	21,775
Dividend per share of common stock (yen)	12.00
Record date	March 31, 2010
Effective date	June 25, 2010
Resource for dividend	Retained earnings

Resolution	The board of directors meeting on July 30, 2010
Type of shares	Common stock
Total amount of dividends (million yen)	21,733
Dividend per share of common stock (yen)	12.00
Record date	June 30, 2010
Effective date	August 26, 2010
Resource for dividend	Retained earnings

Resolution	The board of directors meeting on October 29, 2010
Type of shares	Common stock
Total amount of dividends (million yen)	21,627
Dividend per share of common stock (yen)	12.00
Record date	September 30, 2010
Effective date	November 25, 2010
Resource for dividend	Retained earnings

*2. Dividends payable of which record date was in the nine months ended December 31, 2010, effective after the period*

Resolution	The board of directors meeting on January 31, 2011
Type of shares	Common stock

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Total amount of dividends (million yen)	27,034
Dividend per share of common stock (yen)	15.00
Record date	December 31, 2010
Effective date	February 25, 2011
Resource for dividend	Retained earnings

(b) *Significant changes in Honda Motor Co., Ltd. shareholders equity*  
None

**Table of Contents**

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

For the nine months ended December 31, 2011

*(a) Information concerning dividends**1. Dividend payout*

Resolution	The ordinary general meeting of shareholders on June 23, 2011
Type of shares	Common stock
Total amount of dividends (million yen)	27,034
Dividend per share of common stock (yen)	15.00
Record date	March 31, 2011
Effective date	June 24, 2011
Resource for dividend	Retained earnings

Resolution	The board of directors meeting on August 1, 2011
Type of shares	Common stock
Total amount of dividends (million yen)	27,034
Dividend per share of common stock (yen)	15.00
Record date	June 30, 2011
Effective date	August 24, 2011
Resource for dividend	Retained earnings

Resolution	The board of directors meeting on October 31, 2011
Type of shares	Common stock
Total amount of dividends (million yen)	27,034
Dividend per share of common stock (yen)	15.00
Record date	September 30, 2011
Effective date	November 25, 2011
Resource for dividend	Retained earnings

*2. Dividends payable of which record date was in the nine months ended December 31, 2011, effective after the period*

Resolution	The board of directors meeting on January 31, 2012
Type of shares	Common stock
Total amount of dividends (million yen)	27,034
Dividend per share of common stock (yen)	15.00



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Record date	December 31, 2011
Effective date	February 24, 2012
Resource for dividend	Retained earnings

(b) *Significant changes in Honda Motor Co., Ltd. shareholders' equity*  
None

**Table of Contents**

29

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**(14) Segment Information**

Honda has four reportable segments: the Motorcycle business, the Automobile business, the Financial services business and the Power product and other businesses, which are based on Honda's organizational structure and characteristics of products and services. Operating segments are defined as components of Honda's about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The accounting policies used for these reportable segments are consistent with the accounting policies used in Honda's consolidated financial statements.

Principal products and services, and functions of each segment are as follows:

<b>Segment</b>	<b>Principal products and services</b>	<b>Functions</b>
Motorcycle business	Motorcycles, all-terrain vehicles	Research & Development
	(ATVs) and relevant parts	Manufacturing
		Sales and related services
Automobile business	Automobiles and relevant parts	Research & Development
		Manufacturing
		Sales and related services
Financial services business	Financial, insurance services	Retail loan and lease related to
		Honda products
		Others
Power product and other businesses	Power products and relevant parts, and others	Research & Development
		Manufacturing
		Sales and related services
		Others

**Segment Information**

**For the three months ended December 31, 2010**

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	Yen (millions)							
	Motorcycle Business	Automobile Business	Financial Services Business	Power Product and Other Businesses	Segment Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:								
External customers	¥ 301,996	¥ 1,613,841	¥ 136,442	¥ 68,023	¥ 2,120,302	¥	¥ (9,888)	¥ 2,110,414
Intersegment		2,087	2,854	4,164	9,105	(9,105)		
Total	¥ 301,996	¥ 1,615,928	¥ 139,296	¥ 72,187	¥ 2,129,407	¥ (9,105)	¥ (9,888)	¥ 2,110,414
Segment income (loss)	¥ 29,132	¥ 68,400	¥ 44,603	¥ (2,079)	¥ 140,056	¥	¥ (14,403)	¥ 125,653

For the three months ended December 31, 2011

	Yen (millions)							
	Motorcycle Business	Automobile Business	Financial Services Business	Power Product and Other Businesses	Segment Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:								
External customers	¥ 302,590	¥ 1,451,054	¥ 124,806	¥ 64,095	¥ 1,942,545	¥	¥	¥ 1,942,545
Intersegment		4,578	2,760	3,951	11,289	(11,289)		
Total	¥ 302,590	¥ 1,455,632	¥ 127,566	¥ 68,046	¥ 1,953,834	¥ (11,289)	¥	¥ 1,942,545
Segment income (loss)	¥ 25,866	¥ (16,997)	¥ 37,597	¥ (2,168)	¥ 44,298	¥	¥	¥ 44,298

**Table of Contents**

30

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**As of and for the nine months ended December 31, 2010**

	Yen (millions)							
	Motorcycle Business	Automobile Business	Financial Services Business	Power Product and Other Businesses	Segment Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:								
External customers	¥ 935,082	¥ 5,148,743	¥ 427,346	¥ 212,617	¥ 6,723,788	¥	¥	¥ 6,723,788
Intersegment		5,135	8,759	12,086	25,980	(25,980)		
Total	¥ 935,082	¥ 5,153,878	¥ 436,105	¥ 224,703	¥ 6,749,768	¥ (25,980)	¥	¥ 6,723,788
Segment income (loss)	¥ 90,460	¥ 303,727	¥ 146,672	¥ (3,167)	¥ 537,692	¥	¥ (14,123)	¥ 523,569
Assets	¥ 944,662	¥ 4,764,066	¥ 5,427,253	¥ 283,030	¥ 11,419,011	¥ (159,399)	¥	¥ 11,259,612
Depreciation and amortization	¥ 30,542	¥ 221,922	¥ 161,287	¥ 8,536	¥ 422,287	¥	¥	¥ 422,287
Capital expenditures	¥ 21,086	¥ 171,191	¥ 587,981	¥ 7,198	¥ 787,456	¥	¥	¥ 787,456

**As of and for the nine months ended December 31, 2011**

	Yen (millions)							
	Motorcycle Business	Automobile Business	Financial Services Business	Power Product and Other Businesses	Segment Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:								
External customers	¥ 990,287	¥ 3,961,018	¥ 387,127	¥ 204,601	¥ 5,543,033	¥	¥	¥ 5,543,033
Intersegment		10,587	8,231	9,516	28,334	(28,334)		
Total	¥ 990,287	¥ 3,971,605	¥ 395,358	¥ 214,117	¥ 5,571,367	¥ (28,334)	¥	¥ 5,543,033
Segment income (loss)	¥ 109,733	¥ (122,366)	¥ 134,043	¥ (2,022)	¥ 119,388	¥	¥	¥ 119,388
Assets	¥ 965,325	¥ 4,448,203	¥ 5,290,548	¥ 292,342	¥ 10,996,418	¥ (114,122)	¥	¥ 10,882,296
Depreciation and amortization	¥ 29,914	¥ 190,295	¥ 155,165	¥ 7,128	¥ 382,502	¥	¥	¥ 382,502
Capital expenditures	¥ 39,447	¥ 203,771	¥ 500,553	¥ 6,012	¥ 749,783	¥	¥	¥ 749,783
Explanatory notes:								

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1. Segment income (loss) of each segment is measured in a consistent manner with consolidated operating income, which is income before income taxes and equity in income of affiliates before other income (expenses), except other adjustments, which is out-of-period adjustments. Expenses not directly associated with specific segments are allocated based on the most reasonable measures applicable. For further information on other adjustments, see note 1(e). The amount of out-of-period adjustments are not reported to or used by the chief operating decision maker in deciding how to allocate resources and in assessing the Company's operating performance. Therefore, the adjustments are not included in the Power product and other businesses but as other adjustments for the three months and the nine months periods ended December 31, 2010.
2. Assets of each segment are defined as total assets, including derivative financial instruments, investments in affiliates, and deferred tax assets. Segment assets are based on those directly associated with each segment and those not directly associated with specific segments are allocated based on the most reasonable measures applicable except for the corporate assets described below.
3. Intersegment sales and revenues are generally made at values that approximate arm's-length prices.
4. Unallocated corporate assets, included in reconciling items, amounted to ¥393,266 million as of December 31, 2010 and ¥371,004 million as of December 31, 2011 respectively, which consist primarily of cash and cash equivalents, available-for-sale securities and held-to-maturity securities held by the Company. Reconciling items also include elimination of intersegment transactions.
5. Depreciation and amortization of the Financial services business include ¥160,036 million for the nine months ended December 31, 2010 and ¥154,054 million for the nine months ended December 31, 2011, respectively, of depreciation of property on operating leases.
6. Capital expenditure of the Financial services business includes ¥586,391 million for the nine months ended December 31, 2010 and ¥498,380 million for the nine months ended December 31, 2011 respectively, of purchase of operating lease assets.
7. The amounts of Net sales and other operating revenue Intersegment for the three months and nine months ended December 31, 2010 have been corrected from the amounts previously disclosed.
8. For the three months ended December 31, 2011, substantially all of the ¥17,348 million of the costs and expenses and ¥11,838 million of insurance recoveries resulting from Thailand flood are included in Segment income (loss) of the Automobile business.

**Table of Contents**

31

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**Supplemental Geographical Information**

In addition to the disclosure required by U.S. GAAP, Honda provides the following supplemental information in order to provide financial statements users with useful information:

**Supplemental geographical information based on the location of the Company and its subsidiaries****For the three months ended December 31, 2010**

	Japan	North America	Europe	Asia	Yen (millions) Other Regions	Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:									
External customers	¥ 404,219	¥ 964,492	¥ 132,514	¥ 387,477	¥ 231,600	¥ 2,120,302	¥	¥ (9,888)	¥ 2,110,414
Transfers between geographic areas	463,331	47,319	18,226	58,044	7,291	594,211	(594,211)		
Total	¥ 867,550	¥ 1,011,811	¥ 150,740	¥ 445,521	¥ 238,891	¥ 2,714,513	¥ (594,211)	¥ (9,888)	¥ 2,110,414
Operating income (loss)	¥ 14,633	¥ 89,698	¥ (9,436)	¥ 35,780	¥ 15,690	¥ 146,365	¥ (6,309)	¥ (14,403)	¥ 125,653

**For the three months ended December 31, 2011**

	Japan	North America	Europe	Asia	Yen (millions) Other Regions	Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:									
External customers	¥ 434,749	¥ 928,336	¥ 105,229	¥ 269,470	¥ 204,761	¥ 1,942,545	¥	¥	¥ 1,942,545
Transfers between geographic areas	428,450	57,956	14,233	48,210	1,373	550,222	(550,222)		
Total	¥ 863,199	¥ 986,292	¥ 119,462	¥ 317,680	¥ 206,134	¥ 2,492,767	¥ (550,222)	¥	¥ 1,942,545
Operating income (loss)	¥ (41,219)	¥ 74,865	¥ (3,801)	¥ 13,350	¥ 12,525	¥ 55,720	¥ (11,422)	¥	¥ 44,298

**Table of Contents**

32

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**As of and for the nine months ended December 31, 2010**

	Yen (millions)								
	Japan	North America	Europe	Asia	Other Regions	Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:									
External customers	¥ 1,377,539	¥ 3,017,225	¥ 447,418	¥ 1,189,687	¥ 691,919	¥ 6,723,788	¥	¥	¥ 6,723,788
Transfers between geographic areas	1,339,789	154,054	54,521	179,068	25,858	1,753,290	(1,753,290)		
Total	¥ 2,717,328	¥ 3,171,279	¥ 501,939	¥ 1,368,755	¥ 717,777	¥ 8,477,078	¥ (1,753,290)	¥	¥ 6,723,788
Operating income (loss)	¥ 87,919	¥ 276,364	¥ (8,438)	¥ 118,530	¥ 56,389	¥ 530,764	¥ 6,928	¥ (14,123)	¥ 523,569
Assets	¥ 2,895,405	¥ 6,025,463	¥ 492,882	¥ 1,046,431	¥ 663,111	¥ 11,123,292	¥ 136,320	¥	¥ 11,259,612
Long-lived assets	¥ 1,059,010	¥ 1,744,305	¥ 97,808	¥ 219,810	¥ 146,464	¥ 3,267,397	¥	¥	¥ 3,267,397

**As of and for the nine months ended December 31, 2011**

	Yen (millions)								
	Japan	North America	Europe	Asia	Other Regions	Total	Reconciling Items	Other Adjustments	Consolidated
Net sales and other operating revenue:									
External customers	¥ 1,188,657	¥ 2,366,920	¥ 370,471	¥ 945,363	¥ 671,622	¥ 5,543,033	¥	¥	¥ 5,543,033
Transfers between geographic areas	1,105,253	147,445	44,461	153,553	8,822	1,459,534	(1,459,534)		
Total	¥ 2,293,910	¥ 2,514,365	¥ 414,932	¥ 1,098,916	¥ 680,444	¥ 7,002,567	¥ (1,459,534)	¥	¥ 5,543,033
Operating income (loss)	¥ (122,422)	¥ 141,083	¥ (13,934)	¥ 60,326	¥ 51,333	¥ 116,386	¥ 3,002	¥	¥ 119,388
Assets	¥ 2,956,920	¥ 5,809,611	¥ 437,391	¥ 938,207	¥ 601,543	¥ 10,743,672	¥ 138,624	¥	¥ 10,882,296
Long-lived assets	¥ 1,035,861	¥ 1,805,658	¥ 97,691	¥ 218,844	¥ 126,558	¥ 3,284,612	¥	¥	¥ 3,284,612

## Explanatory notes:

1. Major countries or regions in each geographic area:

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North America	United States, Canada, Mexico
Europe	United Kingdom, Germany, France, Italy, Belgium
Asia	Thailand, Indonesia, China, India, Vietnam
Other Regions	Brazil, Australia

- Operating income (loss) of each geographical region is measured in a consistent manner with consolidated operating income, which is income before income taxes and equity in income of affiliates before other income (expenses), except other adjustments, which is out-of-period adjustments. For further information on other adjustments, see note 1(e). The adjustments are not included in Japan but as other adjustments for the three months and the nine months periods ended December 31, 2010.
- Assets of each geographical region are defined as total assets, including derivative financial instruments, investments in affiliates, and deferred tax assets.
- Sales and revenues between geographic areas are generally made at values that approximate arm's-length prices.
- Unallocated corporate assets, included in reconciling items, amounted to ¥393,266 million as of December 31, 2010 and ¥371,004 million as of December 31, 2011 respectively, which consist primarily of cash and cash equivalents, available-for-sale securities and held-to-maturity securities held by the Company. Reconciling items also include elimination of transactions between geographic areas.
- For the three months ended December 31, 2011, ¥17,348 million of the costs and expenses and ¥11,838 million of insurance recoveries resulting from Thailand flood are included in Operating income (loss) of Asia.



**Table of Contents**

33

## HONDA MOTOR CO., LTD. AND SUBSIDIARIES

## Notes to Consolidated Financial Statements

**(15) Per Share Data**

Basic net income attributable to Honda Motor Co., Ltd. per common share and the bases of computation are as follows:

**For the nine months ended December 31, 2010 and 2011**

	Yen	
	December 31, 2010	December 31, 2011
Basic net income attributable to Honda Motor Co., Ltd. per common share	¥ 270.82	¥ 77.62

	Yen (millions)	
	December 31, 2010	December 31, 2011
The bases of computation		
Net income attributable to Honda Motor Co., Ltd.	¥ 489,534	¥ 139,888
Amount not applicable to common stock		
Net income attributable to Honda Motor Co., Ltd. applicable to common stock	¥ 489,534	¥ 139,888
Weighted average number of common shares	1,807,578,062 shares	1,802,300,940 shares

\* Diluted net income attributable to Honda Motor Co., Ltd. per common share is not provided as there is no potential dilution effect.

**For the three months ended December 31, 2010 and 2011**

	Yen	
	December 31, 2010	December 31, 2011
Basic net income attributable to Honda Motor Co., Ltd. per common share	¥ 45.01	¥ 26.45

	Yen (millions)	
	December 31, 2010	December 31, 2011
The bases of computation		
Net income attributable to Honda Motor Co., Ltd.	¥ 81,118	¥ 47,662
Amount not applicable to common stock		

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Net income attributable to Honda Motor Co., Ltd. applicable to common stock	¥	81,118	¥	47,662
Weighted average number of common shares		1,802,304,736 shares		1,802,300,521 shares

\* Diluted net income attributable to Honda Motor Co., Ltd. per common share is not provided as there is no potential dilution effect.

**Table of Contents**

**Honda Siel Cars India Ltd. resumes normal production at Greater Noida plant**

Honda Siel Cars India Ltd. (HSCI), leading manufacturer of premium cars in India, announced that it has resumed normal production with two shift operations from February 15, 2012. In the wake of disruption in supplies from Thailand, the company had been working under severe production constraints since November 2011.

HSCI has resumed two shift operations from February 15, 2012. HSCI will have production of 370 cars per day from February 15, 2012, and from the week commencing on February 19, 2012, HSCI will ramp up to 440 units per day.

Honda has been carefully monitoring the part supply process and has taken all the necessary recovery actions to normalize production situation with critical components now being sourced from Japan & China.

HSCI's top priority at the moment is to reduce the backlog and closely work with our dealers to ensure prompt deliveries. HSCI is hopeful to clear most of the current Brio bookings within March 2012 and deliver cars to these waiting customers.

The production of the new City and Brio has already been resumed while the production of Honda Jazz will start towards the end of February 2012.

**Table of Contents**

[Translation]

February 21, 2012

To: Shareholders of Honda Motor Co., Ltd.

From: Honda Motor Co., Ltd.  
1-1, Minami-Aoyama 2-chome,

Minato-ku, Tokyo, 107-8556

Takanobu Ito

President and Representative Director

**Notice Concerning Management Changes**

The Board of Directors of Honda Motor Co., Ltd. (the Company), at its meeting held on February 21, 2012 has decided on changes of Operating Officers as of April 1, 2012 and has decided a plan for changes to its management as of late June 2012. Those changes as of late June 2012 are subject to approval at the General Meeting of Shareholders of the Company scheduled to be held in late June 2012 and/or decision at the meeting of the Board of Directors to be held immediately thereafter.

**Particulars****1. Planned changes in Operating Officers (as of April 1, 2012)**

Operating Officers to change titles

<b>Name</b>	<b>New Title</b>	<b>Current Title</b>
Tetsuo Iwamura	Executive Vice President and Executive Officer	Senior Managing Officer
Takashi Yamamoto	Senior Managing Officer	Managing Officer
Hidenobu Iwata	Senior Managing Officer	Managing Officer
Yoshiharu Yamamoto	Senior Managing Officer and Director	Managing Officer and Director
Takuji Yamada	Managing Officer and Director	Operating Officer and Director
Masahiro Takedagawa	Managing Officer	Operating Officer
Yoshiyuki Matsumoto	Managing Officer	Operating Officer
Ko Katayama	Managing Officer	Operating Officer
Operating Officers to be newly appointed		

<b>Name</b>	<b>Current Title</b>
Naoto Matsui	General Manager of Purchasing Division 2 in Purchasing Operations
Mitsugu Matsukawa	General Manager of Hamamatsu Factory of Production Operations
Shinji Aoyama	General Manager of Motorcycle Business Planning Office for Motorcycle Operations

**Table of Contents**

**2. Planned changes in Representative Director, Directors and Corporate Auditors (as of late June 2012)**

**Planned changes in Directors (as of late June 2012)**

Directors to be newly appointed

<b>Name</b>	<b>New Title</b>	<b>Title as of April 1, 2012</b>
Tetsuo Iwamura	Executive Vice President, Executive Officer and Representative Director	Executive Vice President and Executive Officer
Takashi Yamamoto	Senior Managing Officer and Director	Senior Managing Officer
Yuji Shiga	Operating Officer and Director	Operating Officer

Directors to retire

<b>Name</b>	<b>New Title</b>	<b>Title as of April 1, 2012</b>
Koichi Kondo		Chairman and Representative Director
Akio Hamada		Executive Vice President, Executive Officer and Representative Director
Takuji Yamada	Managing Officer	Managing Officer and Director

**Planned changes in Corporate Auditors (as of late June 2012)**

Corporate Auditors to be newly appointed

<b>Name</b>	<b>Present Post/Previous Post</b>
Masaya Yamashita	Managing Officer
Toshiaki Hiwatari	Former Prosecutor General
	Attorney-at-law
	Advisor of TMI Associates

Mr. Toshiaki Hiwatari is expected to be an outside corporate auditor as provided for in the Company Law.

Corporate Auditors to retire

<b>Name</b>	<b>Present Post</b>
Toru Onda	Corporate Auditor
Fumihiko Saito	Corporate Auditor

**Planned change in Operating Officer (as of late June 2012)**

Operating Officer to retire

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**Name**

Takashi Nagai

**Current Title**

Operating Officer

Mr. Takashi Nagai is expected to take office as President and Representative Director of Honda Logistics Inc.

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**Table of Contents**

Resume of Director and Representative Director Candidate

As of February 21, 2012

**Tetsuo IWAMURA**

Date of Birth: May 30, 1951 (60 years old)

Professional Experience:

April	1978	Joined Honda Motor Co., Ltd.
June	1999	General Manager of Overseas Operation Office No.1 for Regional Operations (the Americas), Honda Motor Co., Ltd.
April	2000	Chief Operating Officer for Parts Operations, Honda Motor Co., Ltd.
June	2000	Director, Honda Motor Co., Ltd.
April	2003	Chief Operating Officer for Regional Operations (Latin America), Honda Motor Co., Ltd. President and Director of Honda South America Ltda. President and Director of Moto Honda da Amazonia Ltda. President and Director of Honda Automoveis do Brazil Ltda.
June	2006	Managing Director, Honda Motor Co., Ltd.
April	2007	Chief Operating Officer for Regional Operations (North America), Honda Motor Co., Ltd. <b>President and Director of Honda North America, Inc.</b> <b>President and Director of American Honda Motor Co., Inc.</b>
June	2008	Senior Managing Director, Honda Motor Co., Ltd.
April	2011	Senior Managing Officer and Director, Honda Motor Co., Ltd.
June	2011	<b>Senior Managing Officer, Honda Motor Co., Ltd.</b>

\* Current responsibilities in boldface  
Number of shares held: 20,900 shares