

TELEFONICA BRASIL S.A.

Form 20-F

March 19, 2014

As filed with the Securities and Exchange Commission on March 19, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

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

For the fiscal year ended December 31, 2013

OR

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

OR

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

Date of event requiring this shell company report _____
For the transition period from _____ to _____
Commission file number: 001-14475

TELEFÔNICA BRASIL S.A.

(Exact name of Registrant as specified in its charter)

TELEFÔNICA BRAZIL S.A.

(Translation of Registrant's name into English)

Federative Republic of Brazil

(Jurisdiction of incorporation or organization)

Avenida Engenheiro Luis Carlos Berrini, 1376, 32° andar

04571-936 São Paulo, SP, Brazil

(Address of principal executive offices)

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Email: ir.br@telefonica.com

(Name, Telephone, Email and/or Facsimile and Address of Company Contact Person)

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

Title of each class

Name of each exchange on which registered

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Preferred Shares, without par value
American Depositary Shares (as evidenced by American
Depositary Receipts), each representing one share of
Preferred Stock

New York Stock Exchange*
New York Stock Exchange

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

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

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

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

The number of outstanding shares of each class as of December 31, 2013 was:

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

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

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

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

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

Indicate by check mark whether the registrant 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
 Yes No

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

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

U.S. GAAP

International Financial Reporting
Standards as issued by the

Other

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

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INTRODUCTION

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

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

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- “D.O.U.” are to the Diário Oficial da União, the Official Newspaper of the Brazilian Government;
- “Federal District” are to Distrito Federal, the federal district where Brasilia, the capital of Brazil, is located;
- “General Telecommunications Law” are to Lei Geral de Telecomunicações, as amended, the law which regulates the telecommunications industry in Brazil;

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- “Global Telecom” or “GT” are to Global Telecom S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;
 - “IASB” are to International Accounting Standards Board;
- “IBGE” are to Instituto Brasileiro de Geografia e Estatística, the Brazilian Institute of Geography and Statistics;
 - “IFRS” are to International Financial Reporting Standards, as issued by the IASB;
- “IOF” are to Imposto sobre Operações de Crédito, Câmbio e Seguros, or tax on credit, exchange and insurance;
- “IPCA” are to Índice Nacional de Preços ao Consumidor Amplo, the consumer price index, published by the IBGE;
 - “IST” are to Índice Setorial de Telecomunicações, the inflation index of the telecommunications sector;
- “Number Portability” are to Portabilidade Numérica, the service mandated by ANATEL that provides customers with the option of keeping the same telephone number when switching telephone service providers;
 - “NYSE” are to the New York Stock Exchange;
 - “Oi” are to Oi S.A., the mobile operator branch of Telemar;
- “PTAX” or “PTAX rate” are to the weighted average daily buy and sell exchange rates between the real and U.S. dollar that is calculated by the Central Bank;
 - “Real,” “reais” or R\$ are to the Brazilian real, the official currency of Brazil;
 - “Speedy” are to broadband services provided by us through asymmetric digital subscriber lines, or ADSL;
- “TCO” are to Tele Centro Oeste Celular Participações, which includes TCO’s “B” band subsidiary and NBT, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
 - “TCP” are to TELESP Celular Participações S.A., Vivo’s predecessor company;
- “TLE” are to Tele Leste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
- “TSD” are to Tele Sudeste Celular Participações S.A. and its consolidated subsidiaries, formerly Vivo subsidiaries before Vivo’s corporate restructuring;
 - “Telebrás” are to Telecomunicações Brasileiras S.A.–Telebrás;
 - “Telefonica” or “TSA” are to Telefonica S.A.;
 - “Telemar” are to Telemar Norte Leste S.A. (controlled by Tele Norte Leste Participações S.A.);

- “Telemig” or “Telemig Participações” are to Telemig Celular Participações S.A.;
- “Telemig Celular” are to Telemig Celular S.A.;
- “Telenorte” or “Tele Norte” are to Tele Norte Celular Participações S.A.;
- “TELESP Celular” and “TC” are to TELESP Celular S.A., formerly a Vivo subsidiary before Vivo’s corporate restructuring;

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- “TJLP” are to Taxa de Juros de Longo Prazo, or long-term interest rate;
- “UMBNDDES” are to a monetary unit of the BNDES, consisting of a currency basket of BNDES debt obligations in foreign currencies, which are mostly denominated in U.S. dollars;
 - “U.S. dollar,” “U.S. dollars” or “US\$” are to U.S. dollars, the official currency of the United States;
- “Vivo” are to Vivo S.A., a formerly wholly-owned subsidiary of Telefônica Brasil prior to the corporate restructuring that took place in 2013, that conducts cellular operations including SMP (as defined in the “Glossary of Telecommunication Terms”), in the following areas:
 - “Areas 1 and 2,” the state of São Paulo (operations previously provided by TELESP Celular);
 - “Area 3,” the states of Rio de Janeiro and Espírito Santo (operations previously provided by Telerj Celular S.A., or Telerj, and Telest Celular S.A., or Telest);
 - “Area 4,” the state of Minas Gerais;
 - “Area 5,” the states of Paraná and Santa Catarina (operations previously provided by Global Telecom);
 - “Area 6,” the state of Rio Grande do Sul (operations previously provided by Celular CRT);
 - “Areas 7 and 8,” the central western and northern regions, including the states of Goiás, Tocantins, Mato Grosso, Mato Grosso do Sul, Rondônia, Acre, Amapá, Amazonas, Maranhão, Pará and Roraima and in the Federal District (operations previously provided by Telegoias Celular S.A., or Telegoias, Telemat Celular S.A., or Telemat, Telems Celular S.A., or Telems, Teleron Celular S.A., or Teleron, Teleacre Celular S.A., or Teleacre, Norte Brasil Telecom S.A., or NBT and TCO);
 - “Area 9,” the states of Bahia and Sergipe (operations previously provided by Telebahia Celular S.A., or Telebahia, and Telergipe Celular S.A., or Telergipe); and
 - “Area 10,” the states of Pernambuco, Alagoas, Paraíba, Rio Grande do Norte, Ceará and Piauí.
- “Vivo Participações” are to Vivo Participações S.A. (formerly TCP) and its consolidated subsidiaries (unless the context otherwise requires); and
 - “Vivo brand” are to the brand used in Brazil in the operations of Telefônica Brasil;

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

The “Glossary of Telecommunications Terms” that begins on page 137 provides the definition of certain technical terms used in this annual report.

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

As a result of such name change, the trade codes for our shares were also changed as of October 6, 2011 (inclusive), from TLPP3, for the common shares and TLPP4, for the preferred shares to VIVT3 and VIVT4, respectively, with the subsequent change of trading name to TELEF BRAZIL. The trade code for the ADRs, VIV, on New York Stock Exchange was not changed.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENT

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

- statements concerning our operations and prospects;
- the size of the Brazilian telecommunications market;
 - estimated demand forecasts;
 - our capital expenditure plan;
- our ability to secure and maintain telecommunications infrastructure licenses, rights-of-way and other regulatory approvals;
 - our strategic initiatives and plans for business growth;
 - industry conditions;
 - our funding needs and financing sources;
 - network completion and product development schedules;
 - expected characteristics of competing networks, products and services;
 - the outcome of certain legal proceedings;
 - regulatory and legal developments;
 - quantitative and qualitative disclosures about market risk;
- other statements of management’s expectations, beliefs, future plans and strategies, anticipated developments and other matters that are not historical facts; and
 - other factors identified or discussed under “Item 3. Key Information—D. Risk Factors.”

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

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

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- the Brazilian government's tax policy;
- the Brazilian government's political instability; and
- the adverse determination of disputes under litigation.

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

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PRESENTATION OF FINANCIAL INFORMATION

We maintain our books and records in reais. We prepared our consolidated financial statements included in this annual report in accordance with International Financial Reporting Standards, or IFRS.

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

Our financial statements prepared in accordance with IFRS as of and for the years ended December 31, 2013, December 31, 2012 and December 31, 2011 have also been filed with the CVM, the local securities regulator in Brazil and made publicly available. The selected financial information for the Company included in “Item 3. Key Information—A. Selected Financial Data” should be read in conjunction with, and is qualified in its entirety by, our financial statements and “Item 5. Operating and Financial Review and Prospects” appearing elsewhere in this annual report.

The consolidated financial statements as of December 31, 2013 and 2012 and for each of the three years in the period ended December 31, 2013 are in compliance with IFRS, as issued by the International Accounting Standards Board (IASB) and also with the pronouncements, interpretations and guidance issued by the IASB and the IFRS Interpretations Committee (IFRIC) which entered into force as of January 1, 2013.

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

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

Results of Vivo Participações and Vivo are consolidated into our financial statements for nine months in 2011, as from April 1, 2011. Consequently our results of operations for the years ended December 31, 2011, 2010 and 2009 are not comparable with our results of operations for the year ended December 31, 2013 and 2012.

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PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

The selected financial data presented below should be read in conjunction with our consolidated financial statements, including the notes thereto included elsewhere in this annual report. Our consolidated financial statements included herein as of and for the years ended December 31, 2013, 2012 and 2011 have been audited by Ernst Young Auditores Independentes S.S. The report of Ernst Young Auditores Independentes S.S. on the consolidated financial statements appears elsewhere in this annual report.

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

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

Our consolidated financial statements include Vivo Participações and Vivo as of April 1, 2011 through the full consolidation method. Because Vivo Participações and Vivo are consolidated into our financial as of April 1, 2011, our results of operations for the years ended December 31, 2011, 2010 and 2009 are not comparable with our results of operations for the year ended December 31, 2013 and 2012.

In 2013, we adopted IFRS 11 Joint Arrangements through retrospective application as from January 1, 2012. Accordingly, the data presented for 2012 and 2011 has been restated.

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

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Income Statement Data:	Year ended December 31,				
	2013	2012	2011	2010	2009
		(Restated)	(Restated)		
	(in millions of reais, except for share and per share data)				
Net operating revenue	34,722	33,919	29,117	15,788	15,852
Cost of goods and services	(17,542)	(16,557)	(15,035)	(8,837)	(9,236)
Gross profit	17,180	17,362	14,082	6,951	6,616
Operating expenses, net	(12,248)	(10,151)	(8,290)	(3,408)	(3,221)
Equity in earnings (losses) of associates	(55)	1	4	25	19
Operating income before financial expense, net	4,877	7,211	5,796	3,568	3,414
Financial expense, net	(215)	(291)	(141)	(125)	(189)
Income before tax and social contribution	4,662	6,920	5,655	3,443	3,225
Income tax and social contribution	(946)	(2,468)	(1,293)	(1,045)	(1,021)
Net Income	3,716	4,452	4,362	2,398	2,204
Attributable to:					
Controlling shareholders	3,716	4,453	4,355	2,398	2,204
Non-controlling shareholders	-	(1)	7	—	—
Basic and diluted earnings per share:					
Common Shares	3.10	3.72	4.40	4.45	4.08
Preferred Shares	3.41	4.09	4.84	4.89	4.49
Cash Dividends per share in reais, net of withholding tax:					
Common Shares	1.86	2.57	4.78	3.62	2.56
Preferred Shares	2.04	2.82	5.26	3.98	2.81

Balance Sheet Data:	As of December 31,				
	2013	2012	2011	2010	2009
		(Restated)	(Restated)		
	(in millions of reais, except number of shares)				
Property, plant and equipment, net	18,442	17,604	17,147	10,193	9,672
Total assets	69,541	70,251	65,489	19,962	20,643
Loans and financing—current portion	1,237	1,270	1,000	432	1,768
Loans and financing—noncurrent portion	3,215	3,774	3,969	1,429	1,752
Shareholders' equity	42,894	44,681	43,331	11,667	11,300
Attributable to:					
Controlling shareholders	42,894	44,681	43,326	11,667	—
Noncontrolling shareholders	—	—	5	—	—
Capital stock	37,798	37,798	37,798	6,575	6,575
Number of shares outstanding (in thousands)	1,123,269	1,123,269	1,123,884	505,841	505,841

Cash Flow Data:	Year ended December 31,				
	2013	2012	2011	2010	2009
		(Restated)	(Restated)		
	(in millions of reais)				
Operating activities:					
Net cash provided by operating activities	9,576	10,054	8,128	4,481	4,449
Investing activities:					
Net cash used in investing activities	(5,543)	(3,721)	(2,007)	(1,658)	(2,296)

Financing activities:

Net cash used in financing activities	(4,622)	(2,089)	(4,729)	(3,603)	(1,618)
Increase (decrease) in cash and cash equivalents	(589)	4,244	1,392	(780)	536
Cash and cash equivalents at beginning of year	7,133	2,889	1,497	2,277	1,741
Cash and cash equivalents at end of year	6,544	7,133	2,889	1,497	2,277

Exchange Rates

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

Since 1999, the Central Bank has allowed the real/U.S. dollar exchange rate to float freely, and, since that time, the real/U.S. dollar exchange rate has fluctuated considerably. In 2009 and 2010, the real appreciated by 25.5% and 4.3% against the U.S. dollar, respectively. In 2011 and 2012, the real depreciated by 4.8% and 8.9%, respectively, against the U.S. dollar. In 2013, the real depreciated a further 14.6% against the U.S. dollar. On December 31, 2013, the year-end real/U.S. dollar exchange rate was R\$2.3426 per U.S. \$1.00.

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

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

Year ended December 31,	Exchange Rate of R\$ per US\$			
	Low	High	Average(1)	Year-End
2009	1.741	2.378	1.990	1.741
2010	1.655	1.880	1.759	1.665
2011	1.535	1.902	1.671	1.876
2012	1.702	2.112	1.959	2.044
2013	1.953	2.446	2.161	2.343

Source: Central Bank of Brazil, PTAX.

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

Month ended December 31,	Exchange Rate of R\$ per US\$			
	Low	High	Average(2)	Period-End
September 2013	2.203	2.390	2.270	2.230
October 2013	2.161	2.212	2.189	2.203
November 2013	2.243	2.336	2.295	2.325
December 2013	2.310	2.382	2.345	2.343
January 2014	2.334	2.440	2.382	2.426
February 2014	2.333	2.424	2.384	2.333
March 2014 (through March 18, 2014)	2.309	2.365	2.344	2.352

Source: Central Bank of Brazil, PTAX.

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

On March 18, 2014, the exchange rate was R\$2.352 to US\$1.00. The real/dollar exchange rate fluctuates and, therefore, this exchange rate at 2014 may not be indicative of future exchange rates.

B. Capitalization and Indebtedness

Not applicable.

C. Reasons for the Offer and Use of Proceeds

Not applicable.

D.

Risk Factors

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

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Risks Relating to Brazil

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

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

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

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

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

The Brazilian economy remains subject to risks and adjustments arising from international financial conditions. The international financial system remains susceptible to unfavorable credit and liquidity conditions. Foreign and national financial institutions, including some of the largest commercial banks, investment banks, mortgage lenders, guarantors and mortgage insurance companies, could experience significant difficulties, including runs on their deposits and inadequate liquidity.

Various governments may continue to intervene in their financial systems, and perform fiscal and monetary adjustments. There is no assurance, however, that these measures will be successful in stabilizing conditions in

international financial markets.

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

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

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

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

Brazil has historically experienced high rates of inflation. Inflation and certain government's measures taken in the attempt to curb inflation have had significant negative effects on the Brazilian economy. In 2013, inflation measured by the Consumer Price Index (Índice de Preços ao Consumidor), or IPCA, reached 5.8%, below the upper limit established by the CMN, of 6.5%, but above the central inflation target of 4.5%. In 2014, the Brazilian monetary policy will continue to use the IPCA as a reference for the inflation target. The inflation target for 2014 is set at 4.5%, similar to 2013. If inflation rises beyond this target, the basic interest rates may also rise, directly affecting the cost of our debt and indirectly reducing the demand for products and services related to telecommunications. In 2014, factors that may adversely affect consumer inflation are, among others, the international commodities prices, the impact of buoyant domestic economic activity on domestic prices and the indexation of prices and tariffs.

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

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

The Monetary Policy Committee of the Brazilian Central Bank (Comitê de Política Monetária do Banco Central do Brasil), or COPOM, sets the target of the basic interest rate for the Brazilian financial system based on an expectation of convergence between the future inflation rate and the central inflation target. On December 31, 2013, the basic interest rate was 10.0% per year, compared to 7.25% per year on December 31, 2012. The basic interest rate has been further adjusted in 2014 and is currently 10.75% per year. Further increases in the basic interest rate may occur throughout 2014 with adverse effects on our business. According to current market consensus, inflation measured by the IPCA will be higher than the established inflation target of 4.50% for 2014. As a result, the Central Bank may increase the SELIC rate (the Central Bank's overnight rate) in 2014 to align inflation with the inflation target, which may adversely affect our business.

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

The exchange rate between the U.S. dollar and the Brazilian real has experienced significant fluctuations in recent years. The real devalued 67% against the U.S. dollar between 2000 and 2003 and appreciated by 40% from 2004 to 2010, considering the annual average exchange rates. From 2011 to 2013, however, the real was further devalued, by 29.1%. Between 2001 and 2013, the real depreciated by 8.1% against the U.S. dollar.

As of December 31, 2013, 15.9 % of our R\$ 8.75 billion total financial debt was denominated in U.S. dollars and UMBNDES. As of December 31, 2013, we had currency hedges in place to cover all of our financial foreign currency-denominated bank debt.

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

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To the extent that the value of the real decreases relative to the U.S. dollar or the euro, our commitments linked to fluctuations in exchange rates or payable in foreign currencies become more expensive. In return, our accounts receivable denominated in foreign currencies appreciate, which could adversely affect our revenue and expenses.

However, 100% of the net balance of the transactions denominated in foreign currencies is covered by hedge transactions. Since May 2010, the company began using net balance coverage, which is the coverage for net positions in foreign exchange exposures generated by invoices issued or received in foreign currencies, substantially reducing the company's risk to fluctuations in exchange rates. By periodically receiving invoices for the net balance coverage and determining the coverage of exposures, the company's corporate market risk department monitors its foreign exchange exposure and commitments linked to foreign currencies so as not to achieve a significant amount of exposure.

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

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

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

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

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

Risks Relating to the Brazilian Telecommunications Industry and Us

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

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

- industry policies and regulations;
- licensing;
- fees and tariffs;
- competition, including, therefore, our ability to grow by acquiring other telecommunications businesses;

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

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

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

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

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

We operate our business under a concession granted by the Brazilian government offering fixed line services in the State of São Paulo. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, expansion of our network to provide public pay-phone service for all locations with a population over 100 inhabitants, expansion of our network to provide private individual

telephone service for all locations with a population over 300 inhabitants, and, with respect to quality of service, targets for the number of call completions. Our ability to satisfy these and other terms and conditions, may be affected by factors beyond our control. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations. Moreover, the concession agreements establish that all assets owned by the company and which are indispensable to the provision of the services described in such agreements are considered reversible assets and are deemed to be part of the concession assets. The assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time. The last net book value of reversible assets reported to ANATEL is dated December 31, 2013 and estimated at R\$7.3 billion,

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which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

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

Review of our concession agreements may have a materially adverse effect on us.

On December 12, 2013, as part of a review of our concession agreement for fixed telephone line services, ANATEL issued a public consultation, pursuant to the terms of our concession agreement. The public consultation allowed members of the public to comment on certain topics such as service universalization, rates and fees and quality of services, among others. Depending on the comments of the public and decisions made by ANATEL, it may decide to revise our concession agreement and impose obligations on us that may have a materially adverse effect on our financial condition and results of operations.

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

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

In May 2012, entrepreneur George Soros acquired Sunrise Telecomunicações, a Brazilian paid-TV provider that is now expanding into mobile services. Sunrise Telecomunicações spent US\$9.3 million to acquire two 4G spectrum licenses covering 134 cities in the state of São Paulo.

In October 2013, Oi and Portugal Telecom announced an agreement among Oi, Portugal Telecom, and Telemar Part (CorpCo.) to form a single entity. According to the memorandum of understanding entered into in connection with this operation, Oi will increase its capital stock by approximately R\$14.1 billion, of which a minimum of R\$7.0 billion and a maximum of R\$8.0 billion will be paid in cash and the approximately R\$6.1 billion will be paid in stock of Portugal Telecom. The definitive agreements will provide that Oi's capital increase will be subject to the full subscription of the minimum value of the portion to be paid in cash. In January 2014, CADE, the Brazilian antitrust authority, approved the transactions with no restrictions.

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

We face increasing competition from telecom service providers.

Growth in the telecommunication industry in Brazil decelerated in 2013, mainly due to regulatory changes, such as cuts in mobile termination rates and fixed to mobile calls, which directly impact the revenues of telephone operators. However, competition remained strong, despite the weak macroeconomic environment, due to regulation initiatives aimed at stimulating competition, increasing the adoption of services and reinforcing the quality of services. The

market has been marked by efforts to stimulate voice and data usage, and to reduce the effects of fixed-mobile substitution. Convergent solutions, which give customers the option to purchase a package of services, are becoming a trend. Furthermore, in 2013 there has also been an increase in competition regulation aimed at stimulating competition, increasing the adoption of new services and reinforcing the quality of services delivered.

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

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of scale and reduction of operational costs, and we may be unable to respond adequately to pricing pressures resulting from consolidation, which would adversely affect our business, financial condition and results of operations.

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

Under the SMP regime, our mobile subsidiaries have received payments for the use of their networks in accordance with a network usage payment plan, which includes outbound long-distance calls. Until June 30, 2004, SMP service providers were able to opt to establish a price cap or freely negotiate our interconnection charges. In early 2005, ANATEL began permitting free negotiations for mobile interconnection, or VU-M fees and by July 2005, local-fixed concessionaires and mobile operators had reached a provisional agreement with respect to VU-M fees for local calls, or VC1 (the agreement guaranteed a 4.5% increase in mobile operators' fees). ANATEL approved that provisional agreement and, in March 2006, approved another provisional agreement of a 4.5% increase for VU-M fees for long-distance calls, or VC2, VC3, and international calls, among the same operators that had made the VC1 agreement in July 2005. In July 2007, ANATEL approved a provisional agreement among us and the fixed-line operators Telemar, Brasil Telecom, CTBC Telecom and Sercomtel and the mobile operators for interconnection fees for VC1, VC2 and VC3 calls that provides for an annual adjustment of approximately 1.97% to interconnection fees in Region I (Telemar's Region) and an annual adjustment of approximately 2.25% in Region II (Brasil Telecom's Region) and Region III (Telefônica's Region). The current rule is the free negotiation of fees, subject to ANATEL regulations.

Resolution No. 576/2011 established rules for adjusting the VC fees, with consequent repass for the VU-M (mobile termination rate). It has also determined gradual annual percentages decreases from 2012 to 2014 for these fees. On April 5, 2013, ANATEL published Act 2222 in the Official Gazette, which led to a reduction of 8.77% on the value of our mobile termination rate.

ANATEL also issued Regulation No. 460/2007 regarding Number Portability, implementing and developing fixed and wireless Number Portability in Brazil effective as of March 2009, with most costs being borne by the operators. For SMP, Number Portability is applied for wireless codes of access of the same registration area. As of December 2013, there were 270.5 million cell phones in Brazil. From the period beginning in September 2008, when Number Portability became effective, until December 31, 2013, over 3.6 million users had transferred out of, and another 4 million users had transferred into our mobile services. For fixed service operators, Number Portability is applied for fixed codes of access of the same local area. There can be no assurance that this regulation will not have material adverse effects on the results of our operations.

On July 18, 2012, Vivo was notified by ANATEL that it would be required to present an improvement plan, subject to ANATEL's approval, for the improvement of SMP services provided. The plan is aimed to improve services, in particular: (1) call completions; (2) service interruptions; and (3) user satisfaction. Our competitors were also required to present their own improvement plans to ANATEL. Vivo presented its improvement plan to ANATEL and received approval on September 10, 2012. Beginning in 2013, ANATEL has published measurement results for predefined indicators.

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

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

Currently, fixed broadband and mobile service providers use the General Price Index, or IGP-DI (Índice Geral de Preços - Disponibilidade Interna) to adjust their prices and TV and cable service providers use the IGP-M (Índice Geral de Preços ao Mercado). The IGP-DI and IGP-M are inflation indexes developed by Fundação Getúlio Vargas, an economic private organization. Since 2006, telephone fees for fixed line service have been indexed, as set in regulation, by the Index of Telecommunications Service, or the IST reduced by a productivity factor. The IST is a basket of national indexes that reflect the industry's operational costs. As a result, this index serves to reduce potential discrepancies between our industry's revenue and costs, and thus reduce the apparent adverse effects of inflation upon our operation.

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The inflation index for the telecommunication prices adjustment rely exclusively on external factors and we have little control over it. If new inflation adjustment mechanisms, or any other mechanism chosen by the Brazilian government in the future, do not adequately reflect the true effect of inflation on our prices, our results from operations could be adversely affected.

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

ANATEL issues new regulations every year affecting many of our areas of operations. Such new regulations could have an adverse effect on our operational results because: (1) our interconnection charges could drop significantly, thereby reducing our revenues; (2) ANATEL may allow more favorable prices for economic groups without significant market power; (3) the prices we charge in some regions in which we operate are higher than those in certain other regions, and consolidation of those prices, competitive pressures and other factors would reduce our average prices and thereby reduce our revenues; (4) the granting of new licenses may increase competition in our area from other operators, which could adversely affect our market share, thereby reducing our revenues; (5) the inclusion of revenue received for the usage of the SMP network in the calculation of operational profit, which will increase the cost of renewing licenses; and (6) ANATEL's general plan of updating the telecommunications regulation targets several areas of vital importance for the mobile telecommunications business, such as regulation to improve the quality of services that can cause the rise of operational costs, regulation of the virtual mobile operation, or MVNO which may cause an increase of competitive pressure, regulation against significant market power (Poder de Mercado Significativo), or PMS, arising from VU-M fee unification among SMP providers of the same economic group having significant market power, which may cause a decrease on our revenues, and regulation of multimedia communication, or SCM, that can cause an increase in competitive pressure. For a detailed description of the regulations issued by ANATEL and their impact on our business, see "Item 4B. Business Overview—Regulation of the Brazilian Telecommunications Industry."

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

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

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

We are subject to certain risks related to conditions and obligations imposed by ANATEL for the use of the spectrum needed to the LTE services we offer.

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

On June 12 and 13, 2012, ANATEL held a public bidding for 273 lots of 4G, on the 2,500 to 2,690MHz frequencies. We acquired the "X" band, with a nationwide coverage, for R\$1.05 billion. Given the rules of the public bidding

process, which limited the total spectrum each service provider could hold within this frequency, we agreed to relinquish bands “P,” “T” and “U.” used for MMDS services within 18 months of obtaining the “X” band. Sky and TIM have preferred rights for the acquisition of the “T” and “U,” respectively, and for the “P” bands, in the cities of Curitiba and Rio de Janeiro and Oi have preferred rights for the acquisition of the “P” band in the cities of São Paulo and Porto Alegre.

In order to meet the coverage obligations and the schedule defined by ANATEL, we have made 4G services available to the cities that hosted 2013 FIFA Confederations Cup games and that will host the 2014 FIFA World Cup games. To complete the coverage requirements, we will need to implement the following coverage requirements:

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- by May 31, 2014: state capitals, the Federal District and cities with over 500,000 residents;
 - by December 31, 2015: cities with over 200,000 residents;
 - by December 31, 2016: cities with over 100,000 residents;
- by December 31, 2017: cities with between 30,000 and 100,000 residents; and
 - by December 31, 2019: cities with fewer than 30,000.

Tied, ANATEL auctioned a 450 MHz frequency lot that is tied to the 2.5 GHz band, to meet voice and data demand in remote rural areas.

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

The targets established by ANATEL associated with a fast paced implementation of networks could impact (1) the ability to obtain municipal licenses for the construction of new sites at the speed necessary to achieve the coverage targets, (2) the capacity of suppliers to deliver the equipment necessary for this expansion, with possible impact on their prices, subject to targets to acquire national technology, and (3) lack of workers to meet the expected implementation pace.

Furthermore, the Ministry of Communications issued ordinance No. 14/2013, which began a debate over the 700 MHz frequency, to align itself with the objectives of the Brazilian National Broadband Plan, or PNBL. After conducting a public consultation, between February 28 and May 5, 2013, and by approving Resolution No. 625/2013, ANATEL has allocated this band to the provision of fixed and mobile telephone and broadband services. However, the completion of the allocation process requires the migration of the TV channels that currently occupy the band as well as the conclusion by ANATEL of studies regarding spectrum interference between mobile and TV services.

Our sales could be suspended as result of issues with the quality of our services.

ANATEL and other judiciary and administrative agencies have the authority to suspend our sales in an attempt to improve the overall quality of telecommunications services. Sales suspensions are generally applied to the services for which there have been complaint by consumers and the consumer protection agencies. When applied, the suspension is temporary and usually lifted once the company presents an improvement action plan. In July 2012 ANATEL suspended mobile service (SMP) sales from three of our main competitors, Oi, Claro and Tim, as result of a considerate increase in consumer complaints. The suspensions lasted about 20 days and ANATEL requested that all telecommunications companies, including Telefonica Brasil, to present an Action and Investment Plan to improve the mobile network. If a similar increase in customer complaints takes place, we may face suspension of one or more of our services until a plan can be produced, which may materially affect our business and results of operations.

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

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

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

Currently, there are approximately 250 municipal laws that limit the installation of new antennas for mobile service, which has been a barrier to the expansion of mobile networks. Those laws are meant to regulate issues related to urban aspects and the alleged effects of the radiation and radiofrequencies of the antennas. Initiatives for the approval of a federal law that establishes new guidelines to create a consolidated plan for the installation of antennas, have been taken. However as long as the municipal laws remain unchanged, the risk of noncompliance with regulation and of having services of limited quality in certain areas will exist.

Additional antenna installation is also limited as a result of media and other reports, which have suggested that radio frequency emissions from base stations may cause health problems. These concerns could have an adverse effect on the wireless communications industry and, possibly, expose wireless providers, including us, to litigation.

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According to the World Health Organization, or WHO, there is no evidence in the latest medical research that shows any relationship between radio frequency emissions of base stations and health concerns. However, expansion of our network may be affected by perceived risks if we experience problems in finding new sites, which in turn may delay expansion and may affect the quality of our services.

On July 2, 2002, ANATEL published Resolution No. 303 that limits emission and exposure for fields with frequencies between 9 kHz and 300 GHz. In addition, the Brazilian government developed specific legislation for the deployment of radio frequency transmission stations that supersedes the existing state and municipal laws. In May 2009, the Brazilian government published Law No. 11934/2009 that limits the exposure for fields with frequencies up to 300 GHz. The new law uses the exposition limits determined by the International Commission on Non-Ionizing Radiation Protection, or ICNIRP and recommended by the WHO.

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

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

We face risks associated with litigation.

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

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

For IFRS purposes, we are required to test our goodwill for impairment at least annually. The excess of the book value of a company over its market value may indicate that impairment exists. This impairment test is described in Note 3 to our audited consolidated financial statements. The Company has substantial goodwill with a carrying value of R\$10.2 billion as of December 31, 2013. It is possible that we may be required to record impairment charges relating to our goodwill in future periods, and this would have an adverse effect on our results of operations.

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

Risks Relating to the Preferred Shares and the ADSs

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

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

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

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

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

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

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

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

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

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

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

Based on the fact that the ADSs are issued and registered abroad, we believe that gains on the disposition of ADSs made outside of Brazil by nonresidents of Brazil to another non-Brazilian resident would not be subject to Brazilian

taxation, since they would not fall within the definition of assets located in Brazil for purposes of Law 10,833. However, considering the general and unclear scope of Law No. 10,833 and the absence of judicial court rulings in respect thereto, we cannot be assured that such an interpretation of this law will prevail in the courts of Brazil. If the income tax is deemed to be due, the gains may be subject to income tax in Brazil at a rate of 15.0% (general taxation) or 25.0% (if the nonresident seller is located in a tax haven, a country which does not impose any income tax, which imposes it at a maximum rate lower than 20.0%, or in which the laws impose restrictions on the disclosure of ownership composition or securities ownership or the identification of the effective beneficiary of income attributed to nonresident holders). See “Item 10. Additional Information—E. Taxation—Brazilian Tax Considerations.”

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Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

Telefónica S.A., or Telefónica, our principal shareholder, currently owns directly and indirectly approximately 91.76% of our voting shares and 73.81% of our total capital stock. See “Item 7. Major Shareholders and Related Party Transactions—A. Major Shareholders” and “Item 7. Major Shareholders and Related Party Transactions—B. Related Party Transactions.” As a result of its share ownership, Telefónica has the power to control us and our subsidiaries, including the power to elect our directors and officers and to determine the outcome of any action requiring shareholder approval, including corporate reorganizations and the timing and payment of our dividends. Given this degree of control over our company, circumstances could arise under which the interests of Telefónica could be deemed to be in conflict with the interests of our other shareholders.

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

General

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

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

As of December 31, 2013, we had 381,335,671 outstanding common shares, with no par value per share, and 741,933,573 preferred shares, with no par value per share. Our shareholders’ equity was in the amount of R\$42.9 billion as presented under IFRS.

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

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

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

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

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On October 31, 2007, the board of ANATEL approved, from a regulatory perspective, the association between Grupo Abril and the company, which involved, among other transactions, the acquisition of all of the operations of Multichannel Multipoint Distribution Service, or MMDS, a special license that allows us to offer Pay TV and broadband services through our former subsidiary Telefonica Sistemas de Televisão S.A. The transaction was fully cleared by regulatory and antitrust agencies.

In 2008, we pioneered the launch of Internet access through fiber optic cables (“Fiber to the Home”), or FTTH to noncommercial customers. Aside from the offer of an Internet connection with high-speed capabilities up to 200 Mbps, various bundles have also been offered, including Wi-Fi, Digital TV, 2,000 minutes of local and intra-state calls, anti-virus protection, call identification, technical assistance and specific call center assistance.

On February 16, 2009, ANATEL extended the authorization for the use of the spectrum frequencies associated with the MMDS in the cities of São Paulo, Curitiba, Rio de Janeiro and Porto Alegre through 2024. These authorizations were converted into SEAC (Paid TV license) in 2013 but due specific requirements set forth in the 4G bid notice, the Group shall transfer or waive such RF authorizations until May 2014.

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

As of December 31, 2013, our telephone network included 10,750 thousand fixed-lines in service, 77,240 thousand mobile accesses, 3,922 thousand broadband clients and 641 thousand Pay TV clients.

Historical Background

The Restructuring and Privatization

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

In May 1998, just before its privatization under the General Telecommunications Law, the Telebrás System was restructured to form, in addition to Telebrás, 12 new holding companies. Virtually all assets and liabilities of Telebrás were transferred to the new holding companies, or the “new holding companies.”

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

The Spin-off of Certain Data Transmission Operations

On August 3, 2000, our former wholly owned subsidiary, Telefônica Empresas S.A., was created to provide Switched Package Network services, and, on January 30, 2001, the independent Brazilian corporation, Telefônica Data Brasil

Holding S.A. (TDBH), was created through a shareholder-approved spin-off of the data transmission operations performed by Telefónica Empresas S.A. A merger of the company and TDBH became effective in July 2006. See “—The SCM Restructuring.”

ANATEL Targets

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

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On January 29, 2003, the board of directors of ANATEL granted us the authorization to provide SCM service nationwide. We may now offer voice and data services through various points of presence composed of networks and telecommunication circuits.

On July 6, 2003, mobile telephony operators began implementing a long-distance carrier selection, or CSP that enables customers to choose the long-distance carrier for each domestic long-distance call (VP2 and VP3) or international call, in accordance with the SMP rules. As a result, the company, having acknowledgment of the revenue from these long-distance services, started to pay the mobile telephony operators for the use of their networks.

On September 4, 2004, the rules dictated by Resolution No. 373, dated as of June 3, 2004, were implemented to carry out the reconfiguration of the local areas for the STFC. As a consequence, all calls previously billed at domestic long-distance rates (DC level – Áreas Conurbadas) are now billed at lower rates as local calls. In São Paulo, this modification involved 53 municipalities, of which 39 are in Greater São Paulo (Grande São Paulo).

IP Network Asset Acquisition

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

Acquisition and Reorganization of Atrium

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

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

The SCM Restructuring

On March 9, 2006, our board of directors and the boards of directors of TDBH and Telefónica Empresas S.A., a wholly owned subsidiary of TDBH (“T-Empresas” and together with us and TDBH, the “T-Companies”), approved the restructuring of the T-Companies’ SCM and data transmission activities, or the SCM Restructuring.

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

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

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

On January 31, 2008, the shareholder of Telefônica Empresas S.A., which is the company, resolved to change Telefônica Empresas S.A.'s corporate name to Telefônica Data S.A.

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

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

On October 31, 2007, the board of directors of ANATEL concluded the regulatory review of the association between Grupo Abril and the company, approving the transaction, which involves (i) the acquisition of all of the operations of MMDS (Multichannel Multipoint Distribution Service) and broadband, and (ii) the acquisition of a significant stake, within the limit of the foreseen effective laws and regulations, in the cable television dealers controlled by Grupo Abril within and outside of the State of São Paulo. This decision was published on November 19, 2007. The transaction was fully cleared by regulatory and antitrust agencies.

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

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

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

Corporate Reorganization involving Ajato

On October 14, 2008, Telefonica Sistema de Televisão S.A., TST and TTP purchased from Abril Comunicações S.A. all shares of Mundial Voip Telecomunicações Ltda., EPP, which had its corporate name changed to Ajato Telecomunicação Ltda., or Ajato. As a result of the merger of TTP into the company on November 11, 2008, Ajato's shares were held by us and TST prior to the restructuring described in item 3.A.

Corporate Reorganization involving DABR and TTP

On October 21, 2008, our board of directors and the shareholders of TTP and Telefônica Data Brasil Participações Ltda., or DABR approved a corporate reorganization that consisted of the merger of TTP and DABR into us.

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

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

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Corporate Restructuring involving TS Tecnologia

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

Corporate Restructuring involving A.TELECOM S.A.

On December 9, 2009, our Board of Directors approved the submission to a shareholder vote of the corporate reorganization proposal consisting of the partial spin-off of A.TELECOM S.A., or A.TELECOM, and the subsequent merger of the spun-off part of A.TELECOM into us.

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

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

Corporate Restructuring involving Brasilcel

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

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

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

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

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

Introduction of the Vivo Brand

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

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Agreement with Telefónica and Telecom Itália

TELCO S.p.A. (in which Telefónica S.A. held a 46.18% interest) has a 22.4% interest with voting rights in Telecom Italia, and is the major shareholder of that company. The Company is an indirect subsidiary of Telefónica S.A., and Telecom Italia holds an indirect interest in TIM Participações S.A. (TIM), a Brazilian telecommunications company. Neither Telefónica S.A., nor Telefónica Brasil or any other affiliate of Telefónica S.A. interfere in, are involved with or have decision-making powers over TIM's operations in Brazil. They are also lawfully and contractually forbidden from exercising any voting rights derived from holding an indirect interest with respect to operations in Brazil, directly related to TIM operations. TIM (Brazil) and Telefônica Brasil compete in all markets in which they operate in Brazil and, in this context, as well as in relation to the other economic players in the telecommunications industry, maintain usual and customary contractual relations with one another (many of which are regulated and reviewed by ANATEL) and/or which, as applicable, are informed to ANATEL and Brazil's Administrative Council for Economic Defense (CADE), concerning the commitments assumed before these agencies so as to ensure total independence of their operations.

On September 24, 2013, Telefónica S.A., entered into an agreement with the other shareholders of the Italian company TELCO SpA (which holds a 22.4% voting in Telecom Italia SpA), whereby:

- 1) Telefónica S.A. subscribed and paid up capital in TELCO, SpA through a contribution of 324 million euros, receiving shares without voting rights of TELCO, SpA. As a result of this capital increase, the share capital of Telefónica S.A. voting in Telco, SpA remaining unchanged (remaining at 46.18%), although their economic participation rose to 66%. Thus, the governance of TELCO S.p.A., as well as the obligations of Telefónica S.A. to abstain from participating in or influencing the decisions that impact the industries where they both operate, remained unchanged.
- 2) Subject to obtaining the required previous approvals from antitrust authorities and telecommunications regulatory agencies as applicable (including Brazil and Argentina), Telefónica S.A. conducted another capital increase in TELCO S.p.A. amounting to 117 million Euros, receiving shares with no voting rights of TELCO, SpA. As a result of this capital increase, the share capital of Telefónica S.A. voting in Telco, SpA increased its total interest to 70%, with the 46.18% interest held in shares with voting rights remaining unchanged.
- 3) Beginning as of January 1st, 2014, following approvals from antitrust authorities and telecommunications regulatory agencies as applicable (including Brazil and Argentina), Telefónica S.A. will be entitled to convert all or part of nonvoting shares into common shares with voting rights, limited however to a 64.9% interest in TELCO S.p.A. voting capital.
- 4) Italian shareholders of TELCO S.p.A. granted Telefónica S.A. an option to purchase all of their shares in TELCO S.p.A.. Our ability to exercise this call option is subject to approvals from the applicable antitrust authorities and telecommunications regulatory agencies as applicable (including in Brazil and Argentina). The call option has been available since January 1, 2014 and will remain available as long as the Shareholders' Agreement remains in effect, except (i) between June 1 and June 30, 2014 and between January 15 and February 15, 2015; and (ii) during certain periods in case the Italian shareholders of TELCO S.p.A. request the entity's spin-off.

On December 4, 2013, the Brazilian Antitrust Enforcement Agency (CADE) announced the following decisions:

- 1) Approve, subject to the limitations described below, the acquisition, by Telefónica S.A., of the total interest held by Portugal Telecom, SGPS SA e PT Móveis – Serviços de Telecomunicações, SGPS, SA (PT) in Brasilcel NV,

which controlled Brazilian mobile telecommunications operator Vivo Participações S.A. (Vivo Part.).

The transaction has been approved by ANATEL and its completion (requiring no prior approval from CADE at the time) took place immediately after approval from ANATEL, on September 27, 2010.

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The limitations imposed by CADE on its decision are as follow:

- a) a new shareholder share control over Vivo Part. with Telefónica S.A., adopting the same conditions applied to PT when it held an interest in Brasilcel NV., or
 - b) Telefónica S.A. shall cease to have, either directly or indirectly, an equity interest in TIM Participações S.A..
- 2) Impose a R\$15 million fine on Telefónica S.A. for violating the will and purpose of the agreement executed by and between Telefónica S.A. and CADE (as a requirement to approve the initial purchase transaction of Telecom Italia in 2007), due to the subscription and payment, by Telefónica S.A., of TELCO S.p.A. nonvoting shares in the context of its recent capital increase. This decision also requires Telefónica S.A. to dispose of its nonvoting shares held in TELCO S.p.A.

The deadline for compliance with the conditions and obligations imposed by CADE in both decisions were classified as confidential by CADE.

At December 13, 2013, Telefónica S.A. published a material news release regarding the decisions made by CADE in the meeting held on December 4, 2013, stating that it considered the measures imposed by that agency to be unreasonable, thus considering the possibility of starting applicable legal proceedings.

In this context, and in order to strengthen its firm commitment to the obligations previously assumed by Telefónica S.A. to keep away from Telecom Italia's business in Brazil. Telefónica S.A. pointed out, in a relevant fact release that Mr. César Alierta Izuel and Mr. Julio Linares López had decided to resign with immediate effect, from the position of Directors at Telecom Italia. Additionally, Mr. Julio Linares López decided to resign, with immediate effect, from his position on the list presented by TELCO S.p.A. for potential re-election to the Board of Directors of Telecom Italia.

Likewise, Telefónica S.A., notwithstanding the rights defined in the Shareholders' Agreement of TELCO S.p.A, stated in a relevant fact that it decided not to exercise, for now, its right to appoint or suggest two Directors at Telecom Italia.

Corporate Restructuring involving Vivo Participações

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

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

Other than the concentration of the shareholding position herein mentioned, the purpose of the corporate restructuring was to simplify the organizational structure of the companies, both of which were publicly held companies and listed on BM&FBOVESPA and with American Depositary Receipts traded in the United States. The restructuring allowed their respective shareholders to participate in one unified company with greater liquidity and with shares traded on Brazilian and foreign stock exchanges. Moreover, the corporate restructuring provided for the rationalization of the cost structure of the two companies and facilitated the integration of businesses and the generation of synergies, thus

positively impacting both companies.

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

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

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

The corporate structure after the merger is as follows:

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

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regarding the transaction and the subsequent preparation of valuation reports of the companies that were used as reference for the determination of the exchange ratio of shares and the increase in capital stock resulting from the merger of shares, as well as for the purposes of article 264 of Brazilian Corporate Law regarding the exchange ratio between the shares.

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

Acquisition of Vivo Participações by Telefônica Brasil and corporate restructuring

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

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

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

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

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

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

Telefônica’s strategy in the first stage of the corporate restructuring was to maximize the potential of its operations in Brazil. Therefore, Telefônica Brasil became the direct shareholder of Vivo Participações, and indirect shareholders of

Vivo. Through the creation of this umbrella investment structure, the non-controlling shareholders of both companies were equally benefited by the added values generated by the combination of the telecommunications business. This is a basic movement in business so as to improve its converging market strategy, including combined mobile and fixed-line offers. This reorganization created the necessary conditions to begin the process of obtaining operational and financial synergies.

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

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

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

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

SMP Authorizations and Corporate Restructuring

On June 14, 2011, the board of directors of Vivo Participações approved a proposal for the merger of authorizations to provide SMP services (then owned by Vivo Participações in the State of Minas Gerais and Vivo in other Brazilian States). As a result, the operations and authorizations for the provision of SMP services were unified under Vivo. On the same date, the proposal for merger of SMP authorizations as well as for simplifying the corporate structure was filed with ANATEL. The form proposed for this simplified corporate structure was the transfer of businesses, including property, rights and obligations related to provision of SMP services, as well as the authorizations for the provision of SMP in the State of Minas Gerais held by Vivo Participações, to Vivo, which would result in Vivo being a wholly owned direct subsidiary of the company and the mobile operator group that owns the SMP authorizations in other Brazilian states. After the transfer, Vivo Participações was to become a holding company and immediately merge into us, thus simplifying and rationalizing the cost structure of the companies involve and subsequently extinguish its corporate existence. On August 16, 2011, ANATEL approved the corporate restructuring pursuant to Act. No. 5,703, published on August 18, 2011.

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

On September 13, 2011, the board of directors of Vivo Participações approved, ad referendum of the shareholders: (1) the valuation report of Vivo Participações, containing part of the assets corresponding to the SMP operations in the State of Minas Gerais, which led to a capital increase in Vivo in the amount of R\$833.0 million, through the subscription of shares of Vivo Participações; and (2) the Protocol of Merger and Instrument of Justification of Vivo Participações into Telecomunicações de São Paulo S.A. – TELESP, for the merger of Vivo Participações into us, preceded by the transfer of commercial establishments, including the assets, rights and obligations related to provision of SMP, as well as authorizations for the provision of SMP in the state of Minas Gerais held by Vivo Participações.

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

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

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

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Provision of STFC outside the state of São Paulo by Vivo

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

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

Plan for the purchase of shares issued by us

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

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

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

The repurchase started on the date of the resolution, and remained effective until November 4, 2013, and acquisitions were on BM&FBOVESPA, at market prices. Our board of executive officers was responsible for establishing the maximum quantity of shares to be acquired, whether in a sole or a series of transactions, and defining the parameters used to carry out the acquisitions, observing applicable legal limits and the established maximum number of up to 24,257,777 preferred shares and 2,894,534 common shares.

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

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

The call option represents the closing of the acquisition process of the remaining shares of Lemontree and GTR-T, which started with the partial exercise of the option on September 29, 2011 and the acquisition of the common shares

of Lemontree, representing 49% of its voting capital.

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

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

Restructuring involving the subsidiaries of Telefônica Brasil

On March 15, 2012, our board of directors approved a corporate restructuring of our wholly owned subsidiaries to align the services provided by each such subsidiary and to concentrate all telecommunication services in one company. The restructuring was finalized on July 1, 2013.

The restructuring was implemented by means of a partial division and merger, involving only our wholly owned subsidiaries, A. TELECOM, TData, TST, Ajato and Vivo. As a result of the restructuring, value added services (such as voicemail, voicemail translation in speech-to-text (“Vivo Torpedo Recado”), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones (“Vivo Som de Chamada”), and innovative services such as multi-media backup, cloud based services to save the short messages (“Vivo Torpedo Center”) and the recently launched “MultiVivo,” that allows the customer to share a 3G, 3G+ and 4G connection with up to 5 mobile devices) provided by several wholly-owned subsidiaries of the company were unifying under Telefonica Data S.A., or TData and other telecommunications services were unifying under Telefônica Brasil, which, as a final step to the corporate restructuring, merged these subsidiaries. Following the merger, Telefonica Data S.A. provides value added service and Telefônica Brasil provides other telecommunication services.

In addition to streamlining services, the corporate restructuring (now possible because of legislative changes applicable to STFC providers) aims to simplify our current organizational structure and assist the integration of business and the generation of synergies arising therefrom. This corporate restructuring can only be implemented with consent from ANATEL, which was granted in May 2013.

On June 11, 2013, our Board of Directors approved the terms and conditions of a corporate reorganization, pursuant to which our direct and indirect subsidiaries will be spun off and merged into us. All services which are exclusively telecommunications services will be provided by us, Telefônica Brasil. Other services, including value added services described above, will be performed by our wholly owned subsidiary, TData.

We were required to separate our services into separate companies because the telecommunications laws in Brazil require that we only perform telecommunications services. In addition, we believe that concentrating all our telecommunications services in one entity will allow us to streamline our services and provide a simplified set of services to our customers, reducing our general administrative and operating costs. As a result of the corporate reorganization, we spun-off or merged each of the following subsidiaries: (1) TData, with regards to its SCM activities; (2) Vivo, with regards to SMP, SCM and STFC services for local and long distance calls under the General Concession Plan; (3) A.TELECOM, with regards to its SEAC activities, using DTH and SCM activities; and (4) TST, with regards to its SEAC and SCM services.

The corporate reorganization required a series of corporate acts, including: (1) merger of TVA and related companies with and into TST, resulting in an increase in the capital stock of TST; (2) merger of TST with and into us, where TST book value was R\$226,105,582.63; (3) merger of the spun-off assets of TData into us, which assets book value were R\$34,723,875.31; (4) merger of a portion of Vivo’s spun-off equity into us, the book value of which was R\$10,228,352,444.32; and (5) merger of a portion of A.TELECOM's spun-off net equity into us, the book value of which was R\$348,623,814.64. All of the equity and assets book value were determined based on a net assets book value report issued by Ernst Young Auditores Independentes S.S.

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The mergers described above, did not result in an increase in our capital stock or in the issuance of new shares by us, and the corporate restructuring did not give rise to a change in the equity interests held by our shareholders.

The corporate reorganization did not result in an exchange of shares held by non-controlling shareholders of the spun-off companies for shares in the surviving company because we were, at the time of the merger of the assets and/or companies, as the case may be, the sole shareholder of the companies to be spun-off/merged. Accordingly, no appraisal report of the net equity at market price were required to be prepared for calculation of the exchange ratio of shares held by non-controlling shareholders, according the applicable law.

The mergers of the companies and of the spun-off assets, as described above, were carried out without disruption to the operations and the telecommunication services provided to the clients, which services are provided by Telefônica Brasil, as successor.

Corporate Structure and Ownership

Our current general corporate and shareholder structure is as follows:

Capital Expenditures

Year ended December 31, 2013

In 2013, we invested R\$6,033.2 million, a similar amount to what was invested in 2012, however we increased the capital expenditures in projects and decreased our expenditures with spectrum licenses. Investments in projects are strongly focused on network (84% of investments excluding licenses) and help sustain our commercial and revenue growth while maintaining the quality of the services provided. Investments in new projects also prepare the company for a medium-term competitive scenario.

To meet the needs of an increasingly data driven and connected society, significant investments were made to support the strong growth of our data usage in residential fiber, mobile 3G /4G and dedicated corporate networks. We continue to invest in expanding the backbone of national data transmission to meet the increase in mobile data traffic throughout the country.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2013.

Telefônica Brasil	Year ended December 31,		
	2013	2012	2011
	(in millions of reais)		
Network	4,683.3	3,845.8	3,381.0
Technology / Information Systems	569.5	562.3	612.5
Others(1)	780.5	1,709.0	1,408.0
Total capital expenditures	6,033.2	6,117.1	5,401.5

(1) Consists primarily of free handset rentals, network construction, furniture and fixtures, office equipment and store layouts and an amount of R\$451 million in 2013 (R\$1,050 in 2012 and R\$812 in 2011) related to the acquisition and other costs of licenses.

Year ended December 31, 2012

In 2012, we invested R\$6,117.1 million in projects that sustain our current annual results and competitive position in the medium-term. A significant portion of resources was allocated to allow quality growth in our

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services. The investments in maintaining quality and expanding our client base represented 87% of the total amount invested by us in 2012 (excluding the purchase of new licenses).

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

Year ended December 31, 2011

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

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

B. Business Overview

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

Our concession region is Region III, which comprises 622 municipalities, including the city of São Paulo, with an aggregate population of approximately 41.3 million. Of the municipalities in Region III, 72 have a population in excess of 100,000. The city of São Paulo has a population of approximately 11 million. According to a plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the state of São Paulo was divided into four sectors, including Sectors 31 (our predecessor company's area before the reorganization), 32 (the area corresponding to Ceterp before our acquisition), 33 (corresponds to the portion of the state of São Paulo that we do not serve) and 34 (area corresponding to CTBC Borda do Campo before the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds concessions for Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom. On November 21, 2008, the Federal government combined the three sectors for which we hold concessions into a single sector, designated as Sector 31.

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

users choose the provider for interregional and international long-distance calls, and which requires dialing our code “15” to use our services. See “—Network Services.”

Since our merger with Vivo Participações, we provide mobile telecommunications services in all of the Brazilian states and in the Federal District, representing a total of approximately 8.5 million square kilometers and a population of approximately 200 million people. Vivo became a national operator when, on September, 2007, it acquired a license to operate within 6 states located in the Northeast region (Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte) and when it acquired Telemig.

On May 29, 2013 ANATEL authorized our corporate reorganization detailed above. The new structure was formalized by our shareholders on June 11, 2013. This reorganization did not result in a capital increase or in the issuance of new shares.

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Areas of Operation

In Areas 1 and 2, we use a frequency range known as “A,” “L” and “J” bands that covers 100% of the municipalities in its authorized areas in the state of São Paulo. On December 31, 2013, we had 21.3 million mobile lines in service in these areas, which represented a 3.8% net increase from December 31, 2012, and a market share of approximately 32.7% in São Paulo.

In Area 3, we use a frequency range known as “A,” “L” and “J” bands that covers 100% of the municipalities and 100% of the population in the states of Rio de Janeiro and Espírito Santo. On December 31, 2013, we had 10.3 million mobile lines in service in this area, which represented a 0.9% from December 31, 2012, and a market share of approximately 36.1% in those states.

In Area 4, we use a frequency range known as “A,” “E” and “J” bands that covers 71.7% of the municipalities and 92.6% of the population in the state of Minas Gerais. On December 31, 2013, we had 8.2 million mobile lines in service in this area, which represented a 0.7% from December 31, 2012, and a market share of approximately 31.4% in Minas Gerais.

In Area 5, we uses a frequency range known as “B” band that covers 67% of the municipalities in the states of Paraná and Santa Catarina and 94% of the population of Paraná and Santa Catarina. On December 31, 2013, we had 4.3 million mobile lines in service in this area, which represented a 5.0% from December 31, 2012, and a market share of approximately 18.6% in those states.

In Area 6, we uses a frequency range known as “A,” “L” and “J” bands that covers 82.3% of the municipalities and 97.8% of the population in the state of Rio Grande do Sul. On December 31, 2013, we had 6.6 million mobile lines in service in this area, which represented a 3.3% net increase from December 31, 2012, and a market share of approximately 40.5% in that state.

In Areas 7 and 8, we are the leading mobile operator, by number of customers, in our authorization area and we use a frequency range known as “A,” “B,” “L” and “J” bands that covers 61.8% of the municipalities in the states of Acre, Federal District, Goiás, Mato Grosso, Mato Grosso do Sul, Rondônia, Tocantins, Amazonas, Amapá, Maranhão, Pará and Roraima which covers 87.4% of the population in these states. On December 31, 2013, we had 17.1 million mobile lines in service in these areas, which represented a 0.7% net increase from December 31, 2012, and a market share of approximately 34.1% in those states.

In Area 9, we use a frequency range known as “A,” “L” and “J” bands that covers 69.3% of the municipalities and 89.5% of the population in the States of Bahia and Sergipe. On December 31, 2013, we had 6.0 million mobile lines in service in this area, which represented a 1.1% net increase from December 31, 2012, and a market share of approximately 28.8% in those states.

In Area 10, we use a frequency range known as “L” and “J” bands that covers 38% of the municipalities and 73.8% of the population in the States of Alagoas, Ceará, Pernambuco, Piauí, Paraíba and Rio Grande do Norte. On December 31, 2013, we had 3.4 million mobile lines in service in this area, which represented a 9.6% net increase from December 31, 2012 and a market share of approximately 8.4% in those states.

On September 18, 2007, with ANATEL’s approval, Vivo acquired the “L” band lots, except for lot 16 (area of Londrina, Paraná, in Region V) and lot 20 (area of Northern Brazil in Region VIII). The “L” band comprises lots in frequency ranges 1895 to 1900 MHz and 1975 to 1980 MHz, with 5 + 5 MHz bandwidth. As a result, Vivo managed to complete

its last coverage gap and will soon be operating in the entire Brazilian territory. On December 20, 2007, with ANATEL's approval, Vivo acquired the "J" band lots with 10 + 10 MHz bandwidth, with the exception of the lots in the state of Minas Gerais then acquired by Telemig Celular and now operated by Vivo.

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

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

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

Area	Frequency Range (MHz)	On December 31, 2013			Last Available IBGE Data from 2011		
		Population (in thousands)(1)	Percent of Brazil’s population(1)		GDP (in millions of reais) (2)	Percent of Brazil’s GDP (2)	Per capita income (in reais) (2)
São Paulo State	450, 850, 900, 1800, 1900, 2100 and 2500	41,262	21.63 %		1,349,465	32,57 %	32,704
Paraná State	850, 900, 1800, 1900, 2100 and 2500	10,445	5.48 %		239,366	5.78 %	22,916
Santa Catarina State	850, 900, 1800, 1900, 2100 and 2500	6,248	3.28 %		169,050	4.08 %	27,056
Goiás State	850, 900, 1800, 1900, 2100 and 2500	6,004	3.15 %		111,269	2.69 %	18,532
Tocantins State	850, 900, 1800, 1900, 2100 and 2500	1,383	0.73 %		18,059	0.44 %	13,057
MatoGrosso State	850, 900, 1800, 1900, 2100 and 2500	3,035	1.59 %		71,418	1.72 %	23,531
Mato Grosso do Sul State	850, 900, 1800, 1900, 2100 and 2500	2,449	1.28 %		49,242	1.19 %	20,106
Rondônia State	850, 900, 1800, 1900, 2100 and 2500	1,562	0.82 %		27,839	0.67 %	17,822
Acre State	850, 900, 1800, 1900, 2100 and 2500	734	0.38 %		8,794	0.21 %	11,980
Amapá State	850, 900, 1800, 2100 and 2500	670	0.35 %		8,968	0.22 %	13,385
Amazonas State	850, 900, 1800, 2100 and 2500	3,484	1.83 %		64,555	1.56 %	18,528
Maranhão State	850, 900, 1800, 2100 and 2500	6,575	3.45 %		52,187	1.26 %	7,937

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Pará State	850, 900, 1800, 2100 and 2500	7,581	3.97	%	88,371	2.13	%	11,656
Roraima State	850, 900, 1800, 2100 and 2500	450	0.24	%	6,951	0.17	%	15,446
Federal District	850, 900, 1800, 1900, 2100 and 2500	2,570	1.35	%	164,482	3.97	%	64,000
Bahia State	850, 900, 1800, 1900, 2100 and 2500	14,017	7.35	%	159,869	3.86	%	11,405
Sergipe State	450, 850, 900, 1800, 1900, 2100 and 2500	2,068	1.08	%	26,199	0.63	%	12,668
Rio de Janeiro State	850, 900, 1800, 1900, 2100 and 2500	15,990	8.38	%	462,376	11.16	%	28,916
Espírito Santo State	850, 900, 1800, 1900, 2100 and 2500	3,515	1.84	%	97,693	2.36	%	27,793
Rio Grande do Sul State	850, 900, 1800, 1900, 2100 and 2500	10,694	5.61	%	263,633	6.36	%	24,652
Alagoas State	450, 900, 1800, 1900, 2100 and 2500	3,120	1.64	%	28,540	0.69	%	9,147
Ceará State	450, 900, 1800, 1900, 2100 and 2500	8,452	4.43	%	87,982	2.12	%	10,409
Pernambuco State	450, 900, 1800, 1900, 2100 and 2500	8,796	4.61	%	104,394	2.52	%	11,868
Piauí State	450, 900, 1800, 1900, 2100 and 2500	3,118	1.63	%	24,607	0.59	%	7,891
Paraíba State	450, 900, 1800, 1900, 2100 and 2500	3,767	1.97	%	35,444	0.86	%	9,409
Rio Grande do Norte State	450, 900, 1800, 1900, 2100 and 2500	3,168	1.66	%	36,103	0.87	%	11,396
Minas Gerais State	450, 850, 900, 1800, 2100 and 2500	19,597	10.27	%	386,156	9.32	%	19,704
Total		190,756	100.00	%	4,143,013	100.00	%	21,718

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

(2) According to the most recent IBGE data (2011). Nominal Brazilian GDP was R\$4,143,013 million as of December 2011 calculated by IBGE, subject to revision.

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As of December 31, 2013, we had 312 of our own sales outlets throughout Brazil, which also provide customer support for our existing customers. In addition, we also have 11,866 sales outlets run by authorized dealers. As of December 31, 2013, we had the highest number of sales outlets among all our competitors.

We aim to increase our services in strategic cities and locations where there are currently no sales outlets for our services. As of December 31, 2013, we had 79 partners, including Telesales and Door to Door services, with approximately 1,150 salespeople reaching out to potential customers, in particular for Vivo fixed-line, post-paid and data services.

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

In 2013, prepaid mobile service customers counted on approximately 600 thousand points of sale to purchase credit, including our own stores, authorized agents, lottery stores, post offices, bank branches and small retailers, such as pharmacies, newspaper stands, libraries, bakeries, gas stations, bars and restaurants. Pre-paid phones can be charged by purchasing cards with credit or digitally. Recharge is also offered through credit and debit cards, call center, Vivo PDV (M2M using a cell phone for transferring the recharge credit), personal recharge (recharge of the cell phone itself), as well as certain accredited Internet websites.

Overview

Our services consist of:

- voice services, including activation, monthly subscription, measured service and public telephones;
- interconnection charges (or network usage charges), which are amounts we charge other mobile and fixed-line service providers for the use of our network;
 - intraregional, interregional and international long-distance voice services;
 - data services, (including broadband services) and mobile value added services;
 - Pay TV services through DTH (direct to home), a satellite technology, IPTV and cable;
 - the sale of wireless devices and accessories;
 - network services, including rental of facilities, as well as other services; and
- digital services, including financial services, M2M, e-health solutions, security, video and advertising.

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

We provide interconnection services to mobile service providers and other fixed telecommunications companies through the use of our network. On April 1999, we also began to sell handsets and other telephone equipment through A. TELECOM S.A. (formerly Assist Telefônica S.A.), our wholly owned subsidiary at that time. Until January 2001, we provided data transmission services, but spun-off our data transmission operations into TDBH. In March 2006, we

began the restructuring of our multimedia communications services (serviços de comunicação multimídia) and data transmission activities. See “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

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

Our mobile portfolio embraces not only voice and broadband internet access - through WAP protocol, 3G and 4G- but also value-added services, including voicemail, voice mail translation in speech-to-text ("Vivo Torpedo Recado"), caller identification, voice minutes in unlimited bundles to other mobile phones to post-paid customer, ring back tones ("Vivo Som de Chamada"), and innovative services such as multi-media backup, cloud based services to save the short messages ("Vivo Torpedo Center") and the recently launched "MultiVivo," that allows the customer to share a 3G, 3G+ and 4G connection with up to 5 mobile devices. All these services can directly be bought by the client through Vivo Service Store ("Loja de Serviços Vivo").

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

Local Service

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

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

Intraregional Long-Distance Service

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

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Interregional and International Long-Distance Fixed Service

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

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

Data Services—Fixed Broadband

The fixed broadband service was launched in 1999 with the Speedy brand, initially with ADSL technology, which uses the same copper pair that is used in the provision of voice services, to provide fast Internet service.

In 2010, Telefônica Brasil began selling the product Popular Broadband (Banda Larga Popular), which is an initiative in the State of São Paulo to deliver affordable broadband for low-income populations. This product has a speed of 1 Mbps.

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

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

We also provide fixed broadband services through cable internet and optical fiber (FTTH). Optical fiber is the most advanced technology currently available and it allows for speeds of up to 200 Mbps.

In 2013 Telefônica Brasil has 100% coverage of the municipalities in its concession area reaching more than 3.9 million customers of broadband.

Pay TV services

On March 14, 2007, ANATEL has granted A. TELECOM S.A., one of our wholly-owned subsidiaries at that time, the license to offer pay TV services via DTH. We began offering pay TV services on August 12, 2007.

On October 31, 2007, ANATEL's council approved, from a regulatory perspective, the agreement between us and the Abril Group, which involved, among other transactions, the acquisition by us of all of the Abril Group's MMDS operations (a special license that allowed us to offer pay TV through our subsidiary at that time, Telefonica Sistemas de Televisão S.A.). In November 2012, ANATEL authorized our provision of conditional access services to subscribers of our TV services. The provision of conditional access service to TV subscribers and the revisions to the concession agreement for such services were ratified by the Brazilian government on February 5, 2013.

On December 31, 2013, we owned 641 thousand TV users, through both DTH, cable and IPTV technologies. We currently offer DTH to the entire state of São Paulo, and IPTV and cable in the metropolitan area of São Paulo.

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Network Services

Brazil is divided into four regions in relation to fixed telecommunication services with the following incumbent service providers (which initially received concessions from ANATEL): (i) Region I, that encompasses the North, Northeast and Southeast regions of Brazil, except the State of São Paulo, where concessions are granted to Oi (Telemar) and CTBC Telecom; (ii) Region II, that encompasses the South and Center-West regions of Brazil, where concessions are granted to Oi (Brasil Telecom), CTBC Telecom and Sercomtel; (iii) Region III, that encompasses the State of São Paulo, where concessions are granted to us and CTBC Telecom; and (iv) Region IV, that encompasses the whole country and in which the concession for long-distance calls is granted to Embratel.

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

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

By the end of 2011, for local services, we were present in the main cities of Regions I and II, namely: Porto Alegre, Curitiba, Brasília, Rio de Janeiro, Vitória, Belo Horizonte, Salvador, Florianópolis, Fortaleza, Recife, Goiânia and Uberlândia. For the provision of data services, we had networks in fourteen cities in these regions.

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

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

Competition for long-distance services has continuously increased and by the end of 2013 there were a total of 55 different operators available through the Service Provider Selection Code (Código de Seleção de Prestadora), or CSP. Satellite services for providing circuits in remote areas for wholesale and large customers have been also implemented.

Other Services

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

Digital Services

We have made strides in 2013 in the process of becoming a digital telecommunications company in areas such as financial services, machine-to-machine operations, e-health solutions, safety, video and advertising. In the e-health area, we have over 2.4 million clients as well as a wide portfolio of products directed towards the B2B segment. With these new developments, we aim to provide technology and innovation to the health services sector.

Interconnection

In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to publish on the Internet an interconnection public offer for all types of interconnection services, in addition to the interconnection between fixed-line service providers

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and mobile service providers; (ii) offers of interconnection for Backbone Internet Providers; (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which new interconnection solicitations are answered. These reforms have facilitated market entry for new operators.

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

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

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

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

According to SMP regulations, the VU-M price is subject to free negotiation between parties and once an agreement is reached it must be homologated by ANATEL to take effect. The agreement currently in effect was executed in 2009.

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

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

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

At the end of 2013, Telefonica had 227 local and long-distance interconnection agreements and 108 agreements for provision of local traffic and long-distance.

I-Telefónica

I-Telefónica is a free Internet access service provider launched in September 2002 by our subsidiary at that time A.TELECOM S.A. (formerly Assist Telefónica). The service, available throughout Brazil, delivers high-quality, stable Internet access that is structured to ensure that our clients do not encounter a busy signal when connecting to the Internet. I-Telefónica permits us to increase the range of our services and better supply our customers by offering an entry-level option to the Internet market.

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Authorization to Provide Multimedia Services

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

Authorizations for pay TV via satellite

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

Authorization for Multichannel Multipoint Distribution Service (MMDS)

On October 31, 2007, the board of ANATEL concluded its regulatory review of the agreement between Grupo Abril and the company, approving the transaction from a regulatory perspective, which involved, among other transactions, the acquisition of all of the operations of MMDS. The approval was granted on November 19, 2007 and the transaction was fully cleared by regulatory and antitrust agencies.

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

On February 16, 2009, ANATEL extended the authorization until 2024 for the use of the spectrum frequencies associated with the MMDS in São Paulo, Curitiba, Rio de Janeiro and Porto Alegre. These authorizations were converted into SEAC (Paid TV license) in 2013 but due specific requirements set forth in the 4G bid notice, the Group shall transfer or waive such radio frequency authorizations until May 2014.

The STFC Concession Agreement

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

The current concession agreement, dated December 22, 2005, was renewed on January 1, 2006, and will be valid until December 31, 2025. On December 15, 2010, ANATEL released a public consultation proposing the amendment of clause 3.2 of the concession agreement, which resulted in the approval of Resolution No. 559 published on December 27, 2010. Resolution No. 559 establishes that the current concession agreement can be reviewed by ANATEL on May 2, 2011, December 31, 2015, and December 31, 2020. Based on the amended clause 3.2, ANATEL may establish new requirements and targets for universal and high-quality telecommunication services, according to the conditions present at the time of review.

On June 30, 2011, the company renewed its concession agreement and entered into new contracts for local and long-distance services with ANATEL pursuant to the concession agreement, with new conditions imposed on the company to change the basis of calculation of the biannual concession costs. The most relevant modifications discussed by ANATEL's board include: (i) suppression of clause 14.1 which prohibits service providers from controlling cable TV operators within their concession area; (ii) amendment of clause 3.2, which provides for a

biennial concession fee, to include interconnection revenue in its calculation basis; (iii) broadening of ANATEL's supervisory powers; (iv) the possibility of off-setting cost of universalization in the calculation of the concession burden; (v) the inclusion of the AICE tariff adjustment formulas; (v) the possibility of remote monitoring of services; (vi) limiting the price of AICE subscription to 60% of the basic subscription; and (vii) free price determination.

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

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Every two years, during the agreement's new 20-year period, publicly held companies will have to pay a renewal fee which will correspond to 2% of the revenue of the previous year, resulting from the application of basic service plans and alternative STFC, net of taxes and social contributions. The first payment of this biennial fee occurred on April 30, 2007, based on 2006 revenue, the second payment occurred on April 30, 2009, based on 2008 revenue, the third payment occurred on April 30, 2011, based on 2009 revenue and the fourth payment occurred on April 30, 2013, based on 2012 revenue. The next payment is scheduled for 2015 based on 2014 revenue. See Note 1 to our Consolidated Financial Statements.

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

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

Services for Corporate Customers

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

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

Rates and Taxes

Rates

Overview

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

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

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

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

- Local services, where rates are established pursuant to a service basket of fees that includes rates for the measured traffic and subscription fees. In the case of a price adjustment, each one of the items within the local fee basket has a different weight and, as long as the total local fee price adjustment does not exceed the rate of increase in the Telecommunication General Price Index, or IST, minus a productivity factor as established in the concession agreements, each individual fee within the basket can exceed the IST variation by up to 5%.
- Installation of residential and commercial lines and public telephone services, with adjustments limited to the rate of increase in the IST minus a productivity factor as established in the concession agreements.

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

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

Local Rates

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

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

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

- Local Basic Plan: for clients that make mostly short-duration calls (up to three minutes), during regular hours; and
- Mandatory Alternative Plan (PASOO): for clients that make mostly longer-duration calls (above three minutes), during regular hours and/or that use the line for dial-up service to the Internet.
- Individual Special Class Access (AICE) – plan created specifically for families enrolled in the Brazilian government’s social program.

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

Characteristics of Plan	Basic Plan	Mandatory Alternative Plan
Monthly Basic Assignment	200	400
Allowance (minutes included in the Residential Assignment)	minutes	minutes
Commercial Assignment Allowance (minutes included in the Commercial Assignment)	150	360
Local Call Charges	minutes	minutes

Regular Hours

Completing the call (minutes deducted from the allotment)	–	4 minutes
Completing the call after the terms of the allotment Sector 31	–	R\$0.16072
Local Minutes—charges in excess use of the allotment Sector 31	R\$0.10482	R\$0.04018
Minimum time billing	30 seconds	–

Reduced Hours

Charge per answered call (minutes deducted from allotment)	2 minutes	4 minutes
Charge per answered call after the allotted duration Sector 31	R\$0.20965	R\$0.16072

The fees for Local Basic Plan Service were approved by ANATEL's Act No. 5,834 of August 24, 2011 and readjusted through Act 762, dated February 1, 2013. The Alternative Plan under Mandatory Service Provisions (Oferta Obrigatória), or PASOO, was approved by Resolution No. 450, on December 7, 2006, being that the readjustment of the tariffs follows the same rule established for the local basic plan.

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In addition, Resolution No. 547, published on November 29, 2010, established that the company's fees for both the Local Basic Plan and Mandatory Alternative Plan (PASOO) should be unified following the unification of sectors 31, 32 and 34 into one single sector (sector 31), as defined by the Presidential Decree regarding the new General Plan of Grants published in the D.O.U. on November 21, 2008. This unification also applies to Basic Plan tariffs of fixed-to-mobile calls and long-distance calls and presumes the preservation of revenue earned on each item of the Basic Plan.

Resolution No. 586 established that families enrolled in the Brazilian government's social program may have access to fixed telephone services under the special class individual access plan (Acesso Individual de Classe Especial), or AICE. The subscription to the plan costs R\$9.67 (excluding tax) and allows for 90 minutes of local fixed line calls. Any exceeding fixed calls or calls to mobile or long distance phones may be made once pre-paid credits are purchased. The price of mobile and long distance calls are determined pursuant to a standard plan.

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

Clause 12.1 of the STFC concession agreement provides that the Local Basic Plan can be readjusted for periods of not less than 12 months taking into consideration the inflation index "IST" reduced by a fraction of the company's productivity (named "Fator X," which is calculated by ANATEL based on Resolution No. 507/08). The Mandatory Alternative Plan (PASOO) follows the same readjustment formula as the Local Basic Plan. Other alternative service plans are readjusted based on the IST.

On February 1, 2013, ANATEL issued Act No.762, which approved new local tariffs for concession areas. The average readjustment in the local service basket was 0.553%. Our readjustment totaled 0.568%. The tariffs were applied to customers as demonstrated below:

- Residential customers were charged a monthly subscription fee for the provision of service of R\$41.62;
- Commercial clients and nonresidential customers (PBX) were charged a monthly subscription fee for the provision of service of R\$71.17;
 - Local minute tariffs were charged at R\$0.10482 per minute in Sector 31; and
 - Activation fees of R\$114.46 were charged in Sector 31.

Intraregional and Interregional Long-Distance Rates

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

On July 29, 2002, after we received the concession from ANATEL to provide interregional long-distance services in Region III and authorization to provide interregional long-distance services throughout Brazil, we launched several new options of interregional calling plans relating to consumer "Code 15," which is the selection code dialed by

customers who may choose a long-distance provider with each call and may result in different prices based upon frequency of use and customer calling patterns.

International Long-Distance Rates

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

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

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Network Usage Charges

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

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

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

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

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

On May 7, 2012, ANATEL published Resolution No. 588/2012, which approved the change in TU-RL rate during the reduced rate period and considering the 2-minute TU-RL per call, in addition to the change in TU-RIU value to 25% of the LDN rate in 2012 and 20% in 2013. Furthermore, through December 31, 2013, rates will only be charged on calls that exceed the 75% limit of traffic between networks. Beginning in 2014, service providers' will no longer pay other companies for calls made between networks.

Mobile telecommunications services in Brazil, unlike those in the United States, are offered on a “calling party pays” basis, under which the subscriber pays only for calls that he or she originates. Additionally, a subscriber pays roaming charges on calls originated and terminated outside his or her home registration area. Calls received by a subscriber are paid for by the party that places the call in accordance with a rate based on per-minute charges. For example, a fixed-line service customer pays a rate based on per-minute charges for calls made to a cellular service subscriber. The lowest base rate per minute, or “VC1,” applies to calls made by a subscriber in a registration area to persons in the same

registration area. Calls to mobiles outside the registration area, but within the mobile authorization area, are charged at a higher rate, "VC2." Calls to mobiles outside the mobile authorization area are billed at the highest rate, "VC3." When a fixed-line service customer calls a mobile subscriber, we charge the fixed-line service customer per-minute charges based on VC1, VC2 or VC3 rates. In turn, we pay the mobile operator a charge for the use of its network.

Resolution No. 576/2011 established rules for adjusting the VC fees, by approving rates for VU-M (mobile termination rate). It has also determined gradual annual percentages decreases from 2012 to 2014 for these fees. On April 5, 2013, ANATEL published Act 2222 in the Official Gazette, which led to a reduction of 8.77% on the value of our mobile termination rate.

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

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

Data Transmission Rates

We receive revenue from charges for data transmission, which includes our fixed broadband, the rental of dedicated analog and digital lines for privately leased circuits to corporations and others services. See “—A. History and Development of the Company—Historical Background—The Spin-off of Certain Data Transmission Operations” and “—A. History and Development of the Company—Historical Background—The SCM Restructuring.”

Taxes

The cost of telecommunications services to each customer includes a variety of taxes. The principal tax is a state value-added tax, the Imposto sobre Circulação de Mercadorias e Serviços, or “ICMS,” which the Brazilian states impose at varying rates from 7% to 35% on certain revenues from the sale of goods and services, including telecommunication services.

- Federal Social Contributions: Contribuição para o Programa de Integração Social or “PIS,” and Contribuição para o Financiamento da Seguridade Social or “COFINS,” are imposed on gross operating revenue at a combined rate of 3.65% for telecommunications services (consisting of the COFINS amounts of 3.0% and PIS amount of 0.65%) and 9.25% for other services (consisting of the COFINS amounts of 7.6% and PIS amount of 1.65%). PIS is a tax designed to share business profits with employees through a mandatory national savings program, and is financed by monthly deposits collected as a percentage of gross operating revenue. COFINS is a tax designed to finance special social programs created and administered by the Brazilian government. Revenue related, among other things, to investments, dividends and sales of fixed assets are not subject to PIS and COFINS.
- Contribution for the Fund for Universal Access to Telecommunications Services—“FUST.” FUST was established in 2000 to cover the cost exclusively attributed to fulfilling obligations (including free access to telecommunications services by governmental institutions) of universal access to telecommunications services that cannot be recovered with efficient service exploration or that are not the responsibility of the concessionaire. Contribution to FUST are due at the tax rate of 1% of gross operating telecommunications services revenue (except for interconnection revenue and excluding ICMS, PIS and COFINS), and it may not be passed on to customers.

- Contribution to the Fund of Telecommunications Technological Development—“FUNTTEL.” FUNTTEL is a federal social contribution and was established in 2000, to stimulate, among others, technological innovation and to enhance human resources development so as to increase the competitiveness of the Brazilian telecommunications industry. Contribution to FUNTTEL is due at the tax rate of 0.5% of gross operating telecommunications services revenue (except interconnection revenue and excluding canceled sales, discounts, ICMS, PIS and COFINS), and it may not be passed on to customers.

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- Contribution to the Fund for Telecommunications Regulation—“FISTEL.”