

TELESP HOLDING CO
Form 20-F
April 16, 2007

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, 2006

OR

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

OR

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

For the transition period from _____ to _____

Commission file number: _____

TELECOMUNICAÇÕES DE SÃO PAULO S.A. - TELESP

(Exact name of Registrant as specified in its charter)

Telecommunications of São Paulo - Telesp

(Translation of Registrant's name into English)

Federative Republic of Brazil

(Jurisdiction of incorporation or organization)

Rua Martiniano de Carvalho, 851

01321-001 São Paulo, SP, Brasil

(Address of principal executive offices)

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

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

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

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

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

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

The number of outstanding shares as of December 31, 2006 was:

Title of Class	Number of Shares Outstanding
Shares of Common Stock	168,609,292
Shares of Preferred Stock	337,232,189

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

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

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

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

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

Large Accelerated Filer Accelerated Filer Non-accelerated Filer

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

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

TABLE OF CONTENTS

	<u>Page</u>
PART I	1
ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS	1
ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE	1
ITEM 3. KEY INFORMATION	1
ITEM 4. INFORMATION ON THE COMPANY	9
ITEM 4A. UNRESOLVED STAFF COMMENTS	35
ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS	35
ITEM 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES	54
ITEM 7. MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS	66
ITEM 8. FINANCIAL INFORMATION	67
ITEM 9. THE OFFER AND LISTING	76
ITEM 10. ADDITIONAL INFORMATION	82
ITEM 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	93
ITEM 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES	95
PART II	96
ITEM 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES	96
ITEM 14. MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS	96
ITEM 15. CONTROLS AND PROCEDURES	96
ITEM 16. [RESERVED]	97
ITEM 16A. AUDIT COMMITTEE FINANCIAL EXPERT	97
ITEM 16B. CODE OF ETHICS	97
ITEM 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES	97
ITEM 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES	99
ITEM 16E. PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS	99
PART III	100
ITEM 17. FINANCIAL STATEMENTS	100
ITEM 18. FINANCIAL STATEMENTS	100
ITEM 19. EXHIBITS	100
GLOSSARY OF TELECOMMUNICATIONS TERMS	102
SIGNATURES	1

INTRODUCTION

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

- “ADSs” are to our American Depositary Shares, each representing 1 share of our non-voting preferred shares;
- “ANATEL” are to *Agência Nacional de Telecomunicações - ANATEL*, the National Telecommunications Agency of Brazil;
- “BOVESPA” are to the *Bolsa de Valores de São Paulo*, or the São Paulo Stock Exchange;
- “Brazilian Central Bank” or “Central Bank” are to the *Banco Central do Brasil*, the Central Bank of Brazil;
- “Brazilian Corporate Law” are to the *Lei das Sociedades por Ações*, Law No. 6,404 of December 1976, as amended;
- “Brazilian government” are to the federal government of the Federative Republic of Brazil;
- “CMN” are to the *Conselho Monetário Nacional*, the Monetary Council of Brazil;
- “Commission” or “SEC” are to the U.S. Securities and Exchange Commission;
- “Corporate Law Method” is the accounting practice to be followed in the preparation of our financial statements for regulatory and statutory purposes prescribed by the Brazilian Corporate Law and accounting standards issued by the CVM and the Independent Auditors Institute of Brazil (*Instituto dos Auditores Independentes do Brasil - IBRACON*);
- “CVM” are to the *Comissão de Valores Mobiliários*, the Securities Commission of Brazil;
- “General Telecommunications Law” are to *Lei Geral de Telecomunicações*, as amended, which regulates the telecommunications industry in Brazil;
- “JPY” are to Japanese Yen;
- “PTAX rate” are to the weighted average daily buy and sell exchange rates between the *real* and U.S. dollar that is calculated by the Central Bank;
- “*real*,” “*reais*” or “R\$” are to Brazilian *reais*, the official currency of Brazil;
- “SEC” or “the Commission” is the Securities and Exchange Commission; and
- “US\$,” “dollars” or “U.S. dollars” are to United States dollars.

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

The “Glossary of Telecommunications Terms” that begins on page 103 provides the definition of certain technical terms used in this annual report.

FORWARD-LOOKING STATEMENTS

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

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

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

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

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

PRESENTATION OF FINANCIAL INFORMATION

Our consolidated financial statements as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004, have been prepared in accordance with the Corporate Law Method, which differs in certain significant respects from generally accepted accounting principles in the United States, or U.S. GAAP. Note 39 to our financial statements appearing elsewhere in this annual report describes the principal differences between the Corporate Law Method and U.S. GAAP as they relate to us, and provides a reconciliation to U.S. GAAP of net income and shareholders' equity. These consolidated financial statements have been audited by Deloitte Touche Tohmatsu Auditores Independentes ("Deloitte") (for the year ended December 31, 2004) and Ernst & Young Auditores Independentes S.S. ("E&Y") (for the years ended December 31, 2005 and 2006).

In October 2005, the CVM introduced Deliberation 488, which had the main effect of changing the classification of our provisions as assets versus liabilities in our balance sheets from 2006 onward. Thus, our financial information as represented in our balance sheet as of December 31, 2005 included in this annual report is reclassified to remain comparable to the corresponding financial information in our balance sheet as of December 31, 2006.

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.

PART I

ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

ITEM 3. KEY INFORMATION

A. Selected Financial Data

Our consolidated financial statements included in this annual report on Form 20-F and the selected financial data presented for the periods described below have been prepared in accordance with the Corporate Law Method, which is the same basis of accounting used in our annual and financial statements published in Brazil, audited by Ernst & Young Auditores Independentes for the fiscal years ended December 31, 2006 and December 31, 2005, and Deloitte Touche Tohmatsu Auditores Independentes for the fiscal years ended December 31, 2004, 2003 and 2002. For consistent presentation, we have used the Corporate Law Method for all periods described in this annual report on Form 20-F. See Note 3 to the consolidated financial statements.

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

	Year ended December 31,				
	2006	2005	2004	2003	2002
	(in millions of <i>reais</i> , except for share and per share data)				
Income Statement Data:					
<i>Corporate Law Method</i>					
Net operating revenue	14,643	14,395	13,309	11,805	10,088
Cost of services	(7,780)	(7,717)	(7,496)	(6,715)	(5,770)
Gross profit	6,863	6,678	5,813	5,090	4,318
Operating expenses, net	(2,631)	(2,843)	(2,544)	(2,643)	(2,207)
Operating income before financial income (expense)	4,232	3,835	3,269	2,447	2,111
Financial expense, net	(331)	(460)	(404)	(630)	(755)
Operating income	3,901	3,375	2,865	1,817	1,356
Net non-operating income (expense)	23	38	40	50	(33)
Income before taxes	3,924	3,413	2,905	1,867	1,323
Income and social contribution taxes	(1,108)	(871)	(724)	(279)	(247)
Net income	2,816	2,542	2,181	1,588	1,076
Earnings per share in <i>reais</i>	5.57	5.17	0.0044	0.0032	0.0022

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Cash Dividends per share in <i>reais</i> , net of withholding tax					
Common Shares	5.58	6.89	5.63	6.90	1.78
Preferred Shares	6.14	7.58	6.20	7.60	1.96
<i>U.S. GAAP</i>					
Net operating revenue	20,293	19,870	18,330	16,219	13,759
Operating income	4,281	3,993	3,442	2,419	1,970
Net income	2,930	2,638	2,184	2,011	675
Net income per share:					
Common shares—basic and diluted	5.48	5.02	4.05	3.62	1.25
Weighted average number of common shares					
outstanding—basic and diluted	167,242,724	164,734,052	165,320,207	165,320,207	165,321,904
Preferred shares—basic and diluted	6.02	5.52	4.61	4.31	1.43
Weighted average number of preferred shares					
outstanding—basic and diluted	334,342,809	328,130,540	328,272,073	328,272,073	328,325,175

	2006	2005(1)	December 31, 2004	2003	2002
	(in millions of <i>reais</i> , except per share data)				
Balance Sheet Data:					
<i>Corporate Law Method</i>					
Property, plant and equipment, net	11,651	12,358	13,369	14,735	16,223
Total assets	18,146	17,760(1)	18,752	20,123	22,361
Loans and financing—current portion	1,829	247	530	1,982	2,471
Loans and financing—non-current portion	510	2,151	2,226	995	2,115
Shareholders' equity	10,610	10,204	11,399	12,269	14,483
Capital stock	6,575	5,978	5,978	5,978	5,978
Number of shares outstanding (in thousands) (2)	505,841	492,030	493,592,279	493,592,279	493,592,279
<i>U.S. GAAP</i>					
Property, plant and equipment, net	12,018	12,726	13,700	15,063	16,749
Total assets	18,524	18,140(1)	19,159	20,470	23,036
Loans and financing—current portion	1,828	256	478	1,878	2,305
Loans and financing—non-current portion	510	2,151	2,231	942	2,055
Shareholders' equity	10,823	10,265	11,422	12,280	14,174

(1) On October 3, 2005, the CVM issued Deliberation No. 488 in respect of which these values have been reclassified. See "Presentation of Financial Information" for a detailed explanation of this reclassification.

(2) On May 11, 2005, the shareholders approved a reverse stock split in the proportion of 1,000 (one thousand) shares to 1 (one) share of the same class. Had the reverse stock split occurred on December 31, 2002, shares outstanding would be 493,592 in each of 2004, 2003 and 2002 and earnings per share would have been 4.4, 3.2 and 2.2, respectively.

	2006	2005	December 31, 2004	2003	2002
	(in millions of <i>reais</i> except when indicated)				
Cash Flow Data:					
Operating activities:					
Net cash provided by operating activities	5,007	5,536	5,606	4,976	4,574
Investing activities:					
Net cash (used in) investing activities	(1,885)	(1,667)	(1,415)	(1,278)	(1,614)
Financing activities:					
Net cash (used in) financing activities	(3,372)	(3,647)	(4,167)	(3,974)	(2,675)

Increase (decrease) in cash and cash equivalents	(250)	224	24	(276)	285
Cash and cash equivalents at beginning of year	463	239	215	491	206
Cash and cash equivalents at end of year	213	463	239	215	491

Exchange Rates

Since 2000, the Brazilian government has been introducing significant changes aimed at simplifying the Brazilian foreign exchange market. Prior to March 4, 2005, there were two principal legal foreign exchange markets in Brazil:

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

On August 4, 2006, the Brazilian National Monetary Council, through Resolution No. 3,389, softened the exchange coverage for exports, allowing Brazilian exporters to keep up to 30% of their income generated from exports of goods and/or services outside of Brazil. The remaining 70% of such income continues to be subject to compulsory repatriation to Brazil. However, the foreign exchange mechanism was simplified to provide for the simultaneous purchase and sale of foreign currency, through the same financial institution and using the same exchange rate.

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

Until January 1999, the Brazilian Central Bank adopted an exchange rate policy based on “exchange bands” with a narrow range in which the *real*/dollar rate could float. In January 1999, the Brazilian Central Bank abandoned the system of “exchange bands” and allowed the *real*/dollar exchange rate to float freely. Since then the *real*/U.S. dollar exchange rate has been established mainly by the Brazilian interbank market and has fluctuated considerably. The Brazilian Central Bank has intervened occasionally to control unstable movements in the foreign exchange rate. However, the exchange market may continue to be volatile, and the *real* may depreciate or appreciate substantially in relation to the U.S. dollar in the future. It is not possible to predict whether the Brazilian Central Bank or the Brazilian government will continue to let the *real* float freely or will intervene in the exchange rate market.

Since 2005, the *real* has been appreciating as a consequence of a reduction in the country-risk and of the exchange flow resulting from a considerable trade balance surplus. The *real*/dollar exchange rate decreased from R\$2.34 to US\$1.00 on December 31, 2005 to R\$2.14 to US\$1.00 on December 31, 2006.

The following table set forth the exchange rate (subject to rounding adjustments), expressed in *reais* per U.S. dollar (R\$/US\$), for the periods indicated:

Year Ended:	Exchange Rate of R\$ per US\$			Period-end
	Low	High	Average (1)	
December 31, 2000	1.7226	1.9839	1.8287	1.9546
December 31, 2001	1.9349	2.7999	2.3514	2.3196
December 31, 2002	2.2701	3.9544	2.9301	3.5325
December 31, 2003	2.8211	3.6615	3.0707	2.8884
December 31, 2004	2.6536	3.2043	2.9249	2.6536
December 31, 2005	2.1625	2.7613	2.4333	2.3399
December 31, 2006	2.0578	2.3703	2.1763	2.1372
Month Ended:				
January 31, 2007	2.1239	2.1548	2.1377	2.1239
February 28, 2007	2.0758	2.1174	2.0955	2.1174
March 31, 2007	2.0496	2.1380	2.0879	2.0496
April 5, 2007	2.0313	2.0470	2.0368	2.0325

Source: Brazilian Central Bank.

(1) Represents the average daily PTAX rates during the period.

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.

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 occasionally made drastic changes in policy. 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, as well as general economic factors, including:

- currency fluctuations;
 - exchange control policies;
- internal economic growth;
- inflation;
- price instability;
- energy policy;
- interest rates;
- liquidity of domestic capital and lending markets;
- tax policies (including reforms currently under discussion in the Brazilian Congress); and
- other political, diplomatic, social and economic developments in or affecting Brazil.

Uncertainty over whether the reelected Brazilian government will implement 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.

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

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

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

Brazil has historically experienced high rates of inflation. Inflation and certain of the government's measures taken in an attempt to curb inflation have had significant negative effects on the Brazilian economy. Since 1994, and after enactment of the *Real Plan*, Brazil's inflation rate has been substantially reduced from that in previous periods. The Consumer Prices Index (*Índice de Preços ao Consumidor*), or the IPCA, published by the *Instituto Brasileiro de Geografia e Estatística*, rose 3.1% in 2006, the lowest rate of inflation in eight years, helped by the exchange rate

appreciation. This index had presented variations of 5.7% in 2005, 7.6% in 2004, 9.3% in 2003 and 12.5% in 2002.

The General Prices Index (*Índice Geral de Preços*), or IGP-DI, as published by *Fundação Getúlio Vargas*, which is more influenced by exchange rate variations due to the inclusion of producer prices, registered inflation rates of 3.8% in 2006, 1.2% in 2005, 12.1% in 2004, 7.7% in 2003 and 26.4% in 2002.

Since 2006, telephone fees have been indexed to the *Índice de Serviços de Telecomunicações* (Telecommunications Service Index - IST), which is a basket of national indexes that reflect our sector's operating costs, which could reduce the inconsistencies between our industry's revenues and costs and thus reduce the adverse effects of inflation on us. However, Brazilian monetary policy will continue to call for the IPCA as an inflation targeting system. The inflation target for 2007 is 4.5%. This means that upon increases in inflation beyond the Brazilian Central Bank's 4.5% 2006 target, basic interest rates may rise, the indirect effects of which could be a decrease in demand for telecommunication goods and services.

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

The Brazilian currency has experienced devaluations in the past. The *real* was devalued against the U.S. dollar by 18.7% in 2001 and 52.3% in 2002. In contrast, the *real* appreciated in 2003, 2004, 2005 and 2006 against the U.S. dollar by 18.2%, 8.1%, 11.8% and 8.7%, respectively. See "Item 3.A—Selected Financial Data-Exchange Rates" for more information on exchange rates.

It should be noted that the IST, the new index applicable to telecommunication fees since 2006, reflects exchange fluctuations to a lesser degree than the previously applicable index, the IGP-DI. This means that since 2006, telecommunication revenues, when converted to U.S. dollars, reflect exchange fluctuations to a lesser degree, which would weaken the results of our operations in the event of currency devaluation.

As of December 31, 2006, 35.2% of our R\$2.34 billion total indebtedness was denominated in foreign currencies, primarily in U.S. dollars and Japanese yen. As of December 31, 2006, we had currency hedges in place to cover virtually all of our foreign currency denominated debt. See "Item 11(a)—Quantitative and Qualitative Disclosures about Market Risk—Exchange rate risk." Part of the costs relating to our network infrastructure is payable or linked to payment by us in U.S. dollars. However, other than income derived from hedging transactions and international long distance interconnection, all of our revenues are generated in *reais*. To the extent that the value of the *real* decreases relative to the U.S. dollar, our debt becomes more expensive to service and it becomes more costly for us to acquire technology and goods necessary to operate our business that have their prices linked to exchange rate fluctuations. The additional costs from our debt, however, are offset by revenues from corresponding hedging transactions, and the exposure of our capital expenditures is constantly monitored so that it does not reach a material amount. Nevertheless, currency fluctuations are expected to continue to affect our financial income and expenses.

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

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

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

Brazilian law provides 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 the remittance to foreign investors of the proceeds of their investment in Brazil and on the conversion of *reais* into foreign currencies. Any such restrictions could hinder or prevent the holders of our preferred shares or the depositary for the ADSs from converting dividends, distributions or the proceeds from any sale of such securities into U.S. dollars and remitting such U.S. dollars abroad. The imposition of these restrictions would also likely have an adverse effect on the market price of our preferred shares and ADSs.

Risks Relating to the Brazilian Telecommunications Industry and Us

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

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

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

The initial monthly and usage fees for our services (local and long-distance) were initially determined in our concession agreements. From March 2007 until July 31, 2007, the billing system will be converted to a minute basis, and the former measurement based on pulses will be discontinued. Our local concession contract sets forth the Local Basic Plan (PBL) and ANATEL's right to impose an Obligatory Offer Alternative Plans (PASOOs) for local call charges. On December 7, 2006, ANATEL published Resolution 450 imposing an obligation on the concessionaires to offer a specific PASOO and establish its fees. Customers have the right to choose between the two plans, the PBL and the PASOO. One plan will benefit customers who make mostly short calls, and the second will benefit customers who make mostly longer calls (and/or those who use dial-up internet access). Our concession agreements also set forth criteria for annual fee adjustments. We derive a substantial portion of our revenues from services subject to this price adjustment. The method of price adjustment is essentially a price cap. ANATEL annually applies a price index correction that reflects the inflation index of the period and a productivity factor to our local and long-distance fees. Since 2006, the inflation index has been replaced by the IST, which reflects variations in telecommunications companies' costs and expenses. ANATEL has complied with the fee range set by the concession agreements.

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

We operate our business under a concession granted by the Brazilian government. According to the terms of the concession, we are obligated to meet certain universal service requirements and to maintain minimum quality and service standards. For example, ANATEL requires that we satisfy certain conditions with respect to, among other things, expansion of our network to provide public pay-phone service for all areas with populations in excess of 100, expansion of our network to provide private individual telephone service for all areas with populations in excess of

300 and, with respect to quality of service, targets for call completion rates. Our ability to satisfy these terms and conditions, as well as others, may be affected by factors beyond our control. Our failure to comply with the requirements of our concession may result in the imposition of fines up to R\$50.0 million or other government actions, including the termination of our concession. Any partial or total revocation of our concession would have a material adverse effect on our financial condition and results of operations. Moreover, the concession agreements establish that all assets owned by the Company and which are indispensable to the provision of the services described in such agreements are considered reversible assets and are deemed to be part of the concession assets. The assets will be automatically returned to ANATEL upon expiration of the concession agreements, according to the regulation in force at that time. On December 31, 2006, the net book value of reversible assets is estimated at R\$8,027,464, which is comprised of switching and transmission equipment and public use terminals, external network equipment, energy equipment and system and operation support equipment.

On December 1, 2005, we sent ANATEL the necessary evidence that we had reached our network expansion and 2005 universal service targets established by the *Serviço Telefônico Fixo Comutado* (STFC). The evidence of our accomplishment was submitted by ANATEL to a public hearing on December 22, 2005, which was completed on February 6, 2006. ANATEL is in the process of issuing a certificate; however, it has not indicated when it will issue the certificate.

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.

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

The satisfaction of ANATEL's universal service targets by several fixed telecommunications service providers opened our region to local and long-distance telecommunications services by other providers. We have experienced, and expect to continue to experience, market adjustments in which providers take actions in order to compete for clients, especially corporate and premium residential clients. Such actions tend to result in downward price and market share pressures. The Brazilian telecommunications market continues to reorganize, and the profile of our competitors remains subject to change. This move towards reorganization and consolidation is well illustrated by Carso Group's acquisition of a significant corporate stake in Brazil's largest cable company, Net Comunicações S.A., through Teléfonos de Mexico S.A. - Telmex. In October 2006, Net Comunicações S.A. acquired Vivax, S.A., the second largest cable provider in the State of Sao Paulo (although this transaction is still awaiting authorization from Brazilian authorities). Such consolidation could allow our competitors to threaten our market share by providing bundled services or by making increased investments or offering more discounts as a result of greater financial viability.

We face increasing competition from cellular service providers.

Rapid growth of the cellular telecommunications industry and intense competition among cellular service providers have resulted in lower prices for cellular services. Cellular services are increasingly becoming an alternative to fixed-line services for residential customers. We expect this to negatively impact the use of fixed telecommunications services, and, therefore, mobile services are still the main competitive product our services. See "Item 4—Information on the Company—Competition." For example, in 2006 the mobile operator TIM launched the "TIM Casa" product, a minutes package for fixed telephone lines at a lower price that can only be used from a restricted location pre-registered as a "TIM Casa." Services of this nature may eventually encourage substitution of fixed lines with the use of cellular telephones in residences.

Currently the number of mobile telephone lines is already more than double the number of fixed telephone lines in the State of São Paulo. The negative impact from the migration to cellular services is mitigated by the interconnection fees we receive from cellular to fixed-line calls; however, the recent calculation method for such fees has been causing significant reductions in those fees. Currently, the local network interconnection fee is defined as 50% of the price of

one minute of local traffic, and the long-distance interconnection fee is defined based on the price of long-distance fees as opposed to traffic, the prior criteria. As a result, the fees were significantly reduced. We cannot assure you that such fees will continue in the future or that the continued growth of cellular

7

services, and possible combination packages of services between fixed-line and mobile services, will not ultimately have an adverse effect on our business.

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

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

The advent of new products and technologies could have a variety of consequences. New products and technologies may reduce the price of our services by providing lower-cost alternatives, or they may also be superior to, and render obsolete, the products and services we offer and the technologies we use, thus requiring investment in new technology. If such changes do transpire, our most significant competitors in the future may be new participants in the market that are without the burden of any installed base of older equipment. The cost of upgrading our products and technology in order to continue to compete effectively could be significant.

Risks Relating to the Preferred Shares and the ADSs

The Preferred Shares and ADSs generally do not have voting rights.

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

You 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.

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

Certain Factors Relating to Our Controlling Shareholder

Our controlling shareholder has strong influence over our business.

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

ITEM 4. INFORMATION ON THE COMPANY

A. History and Development of the Company

General

Following the restructuring and privatization of Telebrás, discussed below, we were incorporated on May 22, 1998, as a corporation (*sociedade anônima*) organized under the laws of the Federative Republic of Brazil. We are registered with the CVM as a publicly held company, and our stock is traded on BOVESPA. We are also registered with the SEC in the United States, and our ADSs are traded on the New York Stock Exchange, or NYSE. Our headquarters are located at Rua Martiniano de Carvalho, 851, 01321-001, São Paulo, SP, Brasil. Our telephone number is 55-11-3549-7922.

As of December 31, 2006, after the merger of Telefônica Data Brasil Holding S/A into Telesp (which was approved on April 28, 2006), we had 168,609,292 outstanding common shares, with no par value per share, and 337,232,189 preferred shares, with no par value per share. Our shareholders' equity was in the amount of R\$10,610,114 thousand as presented under the Corporate Law Method.

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

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

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

As of December 31, 2006, our regional telephone network included approximately 14.4 million fixed lines, including public telephone lines, of which 12.1 million lines were in service. Of the access lines in service, approximately 74.9% were residential, 20.3% were commercial, 2.0% were public telephone lines and 2.8% were for our own use and for testing.

Historical Background

The Restructuring and Privatization

Before the incorporation of Telecomunicações Brasileiras S.A. - Telebrás in 1972, there were more than 900 telecommunications companies operating throughout Brazil. Between 1972 and 1975, 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.

On April 12, 1973, our main predecessor company, which had the same name as we have, Telecomunicações de São Paulo S.A. - Telesp, or TSP, began providing telecommunications public services as a Telebrás System operating company in the State of São Paulo. In 1973, TSP acquired Companhia Telefônica da Borda do Campo, or CTBC, which had long been active in the São Paulo metropolitan area as a telecommunications public services concessionaire. With this acquisition, TSP became the main supplier of fixed-line telecommunications services in the State of São Paulo and remained so until a wave of deregulation occurred in the 1990s.

In 1995, the Brazilian government began a comprehensive reform of its system of telecommunications regulations. In July 1997, Brazil's national congress adopted the General Telecommunications Law, which established a new regulatory framework, the introduction of competition and the privatization of the Telebrás System.

In May 1998, just prior to its privatization, the Telebrás System was restructured to form, in addition to Telebrás, twelve new holding companies. Virtually all assets and liabilities of Telebrás were transferred to the new holding companies, or the "new holding companies." The resulting new holding companies, together with their respective subsidiaries, consisted of (i) eight cellular holding companies, each in one of eight cellular regions, and holding one or more operating companies that provided cellular services; (ii) three fixed-line holding companies, each in one of three fixed-line regions and holding one or more operating companies that provided local and intraregional long-distance services; and (iii) Embratel Participações S.A., a holding company of a single one of the Telebrás operating companies, Empresa Brasileira de Telecomunicações S.A. - Embratel, which provides international long-distance services throughout Brazil. Telesp Participações S.A., or TelespPar, was a new holding company formed in connection with the Telebrás privatization. Pursuant to the privatization, TelespPar received the shares held by Telebrás in the operating subsidiaries of the Telebrás System in the State of São Paulo, including TSP and CTBC, which provided fixed-line telecommunications service in the State of São Paulo.

In July 1998, the federal government privatized the Telebrás system, selling substantially all its shares in the new holding companies, including TelespPar and its shares in TSP and CTBC, to private sector buyers. The federal government's shares of TelespPar were purchased by SP Telecomunicações Holding S.A., or SP Telecomunicações, formerly known as Tele Brasil Sul Participações S.A., a consortium comprised of Telefónica Internacional, Portelcom Fixa S.A., Banco Bilbao Vizcaya S.A., Iberdrola Investimentos S.U.L., CTC Internacional S.A. and Telefónica de Argentina S.A. As a result of a subsequent reorganization of SP Telecomunicações on January 10, 1999, one of its subsidiaries, SPT Participações S.A., or SPT, became the controlling shareholder of TelespPar. SPT was controlled by Telefónica Internacional, S.A. (69.04%), Portugal Telecom, S.A. (19.85%), PTELECOM, S.A. (3.15%), Iberdrola Energia, S.A. (6.04%), Iberdrola Investimentos S.U.L. (0.96%) and Banco Bilbao Vizcaya (0.96%).

The Reorganization of TelespPar

On November 30, 1999, the respective shareholders of TelespPar, TSP, CTBC and SPT approved a reorganization involving a series of mergers. Pursuant to the restructuring, the operations of TSP, CTBC and SPT were merged with and into TelespPar, which remained the surviving entity. TelespPar simultaneously became the telecommunications services company operating under our current name, Telecomunicações de São Paulo S.A. - Telesp.

Ceterp's Acquisition

On December 20, 1999, we acquired, through a public auction from the municipal government of the City of Ribeirão Preto, in the State of São Paulo, 51.0% of the voting shares and 36.0% of the total outstanding shares of Centrais Telefônicas de Ribeirão Preto S.A., or Ceterp. Ceterp provided fixed-line and cellular services in the State of São Paulo, outside the Telebrás System, and had been one of our minor competitors. According to the terms of the acquisition, on December 30, 1999, we acquired an additional 45.0% of the voting shares and 36.0% of the total outstanding shares of Ceterp from certain pension funds.

Under the terms of the acquisition, we were also required to launch a tender offer for the remaining minority shares of Ceterp at a price equal to that paid to the selling pension funds, with adjustments for inflation and interest. This tender offer was completed on October 4, 2000 and, as a result, we increased our holdings to 99.85% of Ceterp's voting shares and 96.97% of its preferred shares.

In order to comply with regulatory requirements, on October 27, 2000, Ceterp sold for cash Ceterp Celular S.A., its wholly-owned cellular subsidiary, to Telesp Celular.

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

10

The Spin-off of Certain Data Transmission Operations

On January 30, 2001, our shareholders approved the spin-off of certain operations of our data transmission business into an independent Brazilian corporation, Telefônica Data Brasil Holding S.A., or TDBH. This spin-off was part of Telefônica's global business reorganization to allow managerial and operational consolidation of business lines through separate, but affiliated, global business units and to enhance the strategic and competitive position of the group. At that time and based on the opinion of external consultants, the management of the company understood that it would be in the best interest, of the company to segregate the assets related to the rendering of the Switched Packaged Network services, transferring all the shares of Telefônica Empresas to the then newly-created TDBH. After five years, management of the company and TDBH understood that the segregation of Telefônica Empresas reached the expected objectives, which were: (a) consolidation of the SCM services in the corporate segment, both in terms of technical specialty as well as client portfolio; and (b) execution of specific investments that allowed a significant growth of Telefônica Empresas. Nevertheless, the management of the company and TDBH understood that the considerable increase in competition within this market, dominated by companies directly tied to large national and foreign groups, together with the transactional costs involved, provided an opportunity to merge its operations and increase technological expertise and the development of new products. Accordingly, the merger of the companies' operations was effective July 2006. See "— The SCM Restructuring."

Attainment of Targets

On September 30, 2001, in anticipation of a December 31, 2003 deadline, we achieved the service offering targets set by ANATEL in respect of network expansion and service universalization. This was acknowledged by ANATEL through Act 23,395 of March 1, 2002. Pursuant to our fulfillment of the targets, on April 29, 2002, ANATEL granted us a concession allowing us to offer international and interregional long-distance services outside our concession region, thereby enabling us to have a presence throughout Brazil. Accordingly, on May 7, 2002, we began providing international long-distance service and on July 29, 2002, we began providing interregional long-distance service. See "—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies—Network Expansion & Quality of Service" for information relating to ANATEL's network expansion and universal service targets.

Acquisition and Reorganization of Atrium

On December 30, 2004, we acquired indirect control of Atrium Telecomunicações Ltda. from Launceston Partners CV (a company incorporated in the Netherlands and controlled by the investment funds Advent Latin American, Advent PGGM Global, J.P. Morgan Partners Latin America, J.P. Morgan Capital and Sixty Wall Street Fund). Atrium provides various types of telecommunications services in Brazil, including internet and intranet services, telecommunications management services and the sale and rental of telecommunications representatives 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. The purchase price was approximately R\$113.4 million and was paid in cash.

On November 21, 2005 we approved the corporate reorganization of our wholly-owned companies A. Telecom S.A. (formerly Assist Telefônica S.A.), Santo Genovese Participações Ltda., or Santo Genovese and Atrium Telecomunicações Ltda., or Atrium. The capital reorganization consisted of the following steps: (i) Atrium was merged with and into Santo Genovese, which survived; and (ii) Santo Genovese was merged with and into A. Telecom S.A., which survived. Also under the reorganization, our shares of Santo Genovese were replaced by newly issued shares of A. Telecom S.A. as a result of the capital increase that followed the merger with Santo Genovese. We believe that the reorganization created value for A. Telecom's shareholders, generated synergies and simplified the administrative structure of the constituent companies by offering to their clients more integrated services with a commercial presence. The reorganization 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 Telefônica Empresas S.A., a wholly-owned subsidiary of TDBH (“T-Empresas” and together with us and TDBH, the “Companies”), approved

the restructuring of the Companies' *serviços de comunicação multimídia* ("SCM"), or multimedia communications services, and data transmission activities (the "SCM Restructuring").

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

The SCM Restructuring was submitted for approval at the Companies' respective general shareholders meetings on April 28, 2006, which, due to a lawsuit filed by minority shareholders, became effective on July 28, 2006. Upon shareholder 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. See the Contract and Justification of the Merger of Telefônica Data Brasil Holding S.A. into Telecomunicações De São Paulo S.A. - Telesp and Partial Spin-Off of Telefônica Empresas S.A. dated March 9, 2006, which is included in this Annual Report as an exhibit.

We expect that the SCM Restructuring will result in: (i) greater operational and financial efficiencies; (ii) a share liquidity increase, particularly for TDBH's shareholders, but also for our shareholders; and (iii) cost reductions for all of the Companies' activities into one listed company, Telesp.

The increase in our capital stock as a result of the Merger, and the reduction in T-Empresas' capital stock as a result of the Spin-off, have been based on appraisals of TDBH's and T-Empresas' respective net equity values, by Hirashima & Associados Ltda., an independent appraisal firm, issued on March 6, 2006 (the "Appraisals"). The Appraisals were based on TDBH's and T-Empresas' respective balance sheets as of December 31, 2005, each audited by Ernst & Young Auditores Independentes S.S. According to the Appraisals, as of December 31, 2005, TDBH's net equity value was R\$597,164,881.58 and T-Empresas' net equity value was R\$304,234,227.25 (with the equity value of T-Empresas' spun-off components being R\$273,797,261.22). NM Rothschild & Sons (Brasil) Ltda. ("Rothschild") was retained to support the share exchange ratio determination between us and Brasil Data. On the basis of the value range average determined by Rothschild (using the discounted free cash flow method), the following exchange ratios were established:

- one share of Telesp's common stock for each 75,389 shares of TDBH's common stock;
- one share of Telesp's preferred stock for each 75,389 shares of Data's Brazil's preferred stock; and
- one ADS of Telesp for each 1.50778 ADSs of TDBH (with each TDBH ADS representing 50,000 shares of our preferred stock).

As a result of the Merger, and based on the foregoing exchange ratios, a maximum of 4,758,172 shares of our common stock and 9,449,209 shares of our preferred stock have been issued, in exchange for outstanding TDBH shares of common and preferred stock (except for our existing minority shares in TDBH which have been cancelled). Immediately following the Merger, our capital stock was divided into 506,237,272 total shares, with 168,819,870 being common shares and 337,417,402 being preferred shares, all in book-entry form, without par value. Shares of our preferred stock that have been distributed to the preferred shareholders of TDBH have the same rights as pre-merger TDBH's outstanding preferred stock, except for the right to vote for the approval of related party transactions. Regarding the Spin-off, considering that at the time of its implementation, T-Empresas was 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.

In connection with the Merger, TDBH's shareholders had the right of withdrawal in accordance with Brazilian Corporate Law until 30 days from the shareholders' approval thereof. Our shareholders were not entitled to a right of withdrawal as a result of the Merger or Spin-off. The Spin-off did not result in any amendment to our bylaws. Notwithstanding the fact that approval of ANATEL is not required, the SCM Restructuring has been submitted to the agency for filing purposes. Since the Merger and Spin-off involve companies belonging to the same group, the SCM Restructuring is not subject to approval from the Brazilian antitrust agency. The transaction costs of the SCM

Restructuring are estimated at approximately R\$3.5 million, including costs related to appraisal, auditing, legal counseling, publications and other expenses.

With respect to TDBH's merger into us, certain minority shareholders tried to suspend our general shareholders' meeting by contesting Rothschild's appraisal through obtaining an injunction issued by the 14th civil chamber of the central forum of the district court of São Paulo. The injunction was cancelled 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.

Association Agreement DTH Interactive

On August 10, 2006 the Company, its subsidiary A.Telecom S.A. and DTH Interactive Ltda (DTHI), which provides satellite TV, executed an association agreement for a 12-month period, whereby these companies could offer integrated telecommunications services to consumers, including voice, ADSL, and subscription TV, with each company assuming obligations and earnings related its own expertise. This partnership permitted the introduction of the triple play of telephony, broadband and subscription TV into the Brazilian market.

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

On October 29, 2006, the Company entered into an agreement with Abril Comunicações S.A., TVA Sistema de Televisão S.A., Comercial Cabo TV São Paulo Ltda., TVA Sul Paraná Ltda., and TVA Radioenlaces Ltda. (the "Abril Group"), whereby we combined our telecommunications and broadband services with the broadband and cable services of Tevecap S.A., or TVA, the second largest Brazilian Pay TV provider with operations in four States. 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.

According to the terms of the agreement, we and the Abril Group will enter into formal commercial and operating contracts between us and TVA (and its operating subsidiaries), which will also be restructured. Following the restructuring, and subject to ANATEL approval, we will hold (i) directly, 100% of the shares of TVA's MMDS (multichannel multipoint distribution services) and broadband services company (within and outside the state of São Paulo); (ii) indirectly, 100% of the preferred shares, and a minority holding of common shares, subject to the limits set forth under current laws and regulations for cable television service companies (outside the state of São Paulo); and (iii) indirectly, 100% of the preferred shares, in addition to a minority holding of common shares, subject to the limits set forth under current laws and regulations for cable television service companies (within the state of São Paulo).

The effective acquisition of shares and the consequent transfer of shares, particularly the acquisition of control of the company holder of the MMDS license, are conditional upon prior approval by ANATEL and compliance with the other conditions precedent provided for in the agreement. The Brazilian Antitrust Agency (CADE) must also approve the transaction from an anti-competition point of view.

Once the transaction is approved by ANATEL, a Special General Meeting will be held to ratify the agreement, in accordance with paragraph 1, article 256 of Law No. 6404/76.

Pursuant to the agreement, on December 28, 2006, we made an advance payment of R\$200 million to the Abril Group and received a guaranty backed by the TVA network's assets.

Eventual regulatory and legal constraints on this transaction, such as a limitation of foreign shareholders' participation in the cable TV companies and restrictions in the concession contracts, might impose barriers to provide integrated offers. Those limitations could affect our competitive positioning.

Corporate Structure and Ownership

Our general corporate and shareholder structure is as follows:

Capital Expenditures

Prior to privatization, our capital expenditures were planned and allocated on a system-wide basis and subject to approval by the Brazilian government. These constraints on capital expenditures prevented us from making certain investments that otherwise would have been made to improve telecommunications services in our concession region. These restrictions were lifted, and we are now permitted to determine our own capital expenditure budget, subject to compliance with certain obligations to expand service under the concession.

The following table sets forth our capital expenditures for each year in the three-year period ended December 31, 2006.

	Year ended December 31,		
	2006	2005	2004
	(in millions of <i>reais</i>)		
Switching equipment	31.3	118.4	67.9
Transmission equipment	122.9	92.9	215.2
Infrastructure	60.8	55.6	17.9
External network	382.1	245.3	82.8
Data transmission	307.2	263.4	234.6
Line support equipment	297.7	240.1	296.4
Administration (general)	329.3	560.5	322.1
Long-distance	35.2	10.2	12.0
Other	154.9	88.1	90.0
Total capital expenditures	1,721.4	1,674.5	1,338.9

In addition to the consolidation of our broadband market position, the primary focus of our capital expenditure program has been, and continues to be, the expansion, modernization and digitalization of the network in order to comply with ANATEL's targets and to provide quality service for our clients. See "Item 4.B—Information on the Company—Business Overview—Regulation of the Brazilian Telecommunications Industry—Obligations of Telecommunications Companies."

We anticipate that our capital expenditures for 2007 will be approximately R\$1.8 billion. We expect to fund these expenditures with funds internally generated from our operations and through debt.

B. Business Overview

Our Region

The State of São Paulo covers an area of 248,809 square kilometers, representing approximately 2.9% of Brazil's territory. The population of the State of São Paulo is approximately 41.06 million, representing 22% of Brazil's total population. The gross domestic product, or GDP, of the State of São Paulo in 2006 was an estimated R\$ 701.78 billion, or approximately US\$ 322.36 billion, representing approximately 30% of Brazil's GDP for the year. The State of São Paulo's annual per capita income during 2006 was an estimated R\$17,093, or approximately US\$ 7,852.

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

Our concession region is Region III, which is comprised of 622 municipalities, including the City of São Paulo, with an aggregate population of approximately 40.5 million. Of the municipalities in Region III, 71 have populations in excess of 100,000. The City of São Paulo has a population of approximately 11 million. According to the plan established by the federal government, whereby the government granted licenses to four providers of fixed-line telecommunications services, the State of São Paulo was divided into four sectors including Sectors 31 (our predecessor company's area prior to the reorganization), 32 (the area corresponding to Ceterp prior to our acquisition), 33 (corresponding to the portion of the State of São Paulo that we do not service) and 34 (CTBC Borda do Campo area prior to the reorganization). Through transactions that took place in November 1999 and December 2000, CTBC Borda do Campo and Ceterp merged into our company, which now holds Sectors 31, 32 and 34. Sector 33 is held by CTBC Telecom.

On September 30, 2001, we attained our December 31, 2003 network expansion and universal service targets, as further described below in "Services—Interregional and International Long-Distance Services." As a result, on April 29, 2002, ANATEL granted us authorization to provide international and interregional long-distance services, thereby enabling us to have a presence throughout Brazil. On May 7, 2002, we began offering international long-distance service and, on July 29, 2002, we started offering interregional long-distance service.

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

Services

Overview

Our services consist of:

- local services, including installation, monthly subscription, measured service and public telephones;
- intraregional, interregional and international long-distance services;
- multimedia services;

- network services, including interconnection and the leasing of facilities, as well as other services.

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

We provide interconnection services to cellular service providers and other fixed telecommunications companies through the use of our network. In April 1999, we also began to sell handsets and other telephone equipment through A. Telecom S.A. (formerly Assist Telefônica S.A.), our wholly-owned subsidiary. Until January 2001, we provided data transmission services, but spun off our data transmission operations into TDBH. See “Item 4.A—Information on the Company—History and Development of the Company—the SCM Restructuring.”

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

	Year ended December 31,		
	2006	2005	2004
	(in millions of reais)		
Local service	9,637	9,480	8,480
Intraregional service	2,090	2,042	2,327
Interregional long-distance service	927	1,184	732
International long-distance service	153	171	113
Data transmission	2,020	1,313	909
Network usage services	4,243	4,220	4,039
Interconnection services	535	754	809
Network Access	398	415	393
Goods sold	10	8	21
Other	784	764	603
Total	20,797	20,351	18,426
Taxes and discounts	(6,154)	(5,956)	(5,117)
Net operating revenue.	14,643	14,395	13,309

Local Service

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

Telesp became the first telephone service concessionaire in Brazil to offer local services outside its concession region (the State of São Paulo). In May 2003, we achieved the network expansion and universal service targets established by ANATEL, and began providing local services to six other states in Brazil, including Sergipe, Espírito Santo, Rio Grande do Sul, Paraná, Santa Catarina and certain areas in Rio de Janeiro. In May 2004, we began providing local

telephone services in seven other states in Brazil, including those in the capitals of Pará, Roraima, Amapá, Rondônia, Maranhão, Tocantins and Acre. In May 2005, we also began to provide local telephone services in the capitals of the following states: Ceará, Amazonas, Pernambuco, Rio de Janeiro, Bahia, Mato Grosso do Sul and

Mato Grosso. Since May 2006, we have also been providing local telephone services in Brasília (Distrito Federal) and Goiânia, the capital of the State of Goiás.

Intraregional Long-Distance Service

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

Interregional and International Long-Distance Service

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

On April 29, 2002, certain provisions of ANATEL’s order were partially suspended as a result of injunctions sought by Embratel. The injunctions prevented us from commencing our interregional services that originated in our concession region, Region III, and terminated in other concession areas, namely Region I (Telemar’s concession region) and Region II (Brasil Telecom’s concession region). However, our concession to provide local and interregional services in Region I, Region II, Sector 33 of Region III and international services in all three regions was not affected. These injunctions were lifted in June 2002. The lawsuits brought by Embratel have been dismissed. In October 2005, we agreed with Embratel to extinguish various claims, including this one. Therefore, the possibility that we may be barred from providing interregional services still exists, although our risk of loss in this legal proceeding is deemed remote.

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

Network Services

In 2003, the most important development in network services was the migration of the mobile cellular service to the Personal Mobile Service - SMP, through which mobile services users began to choose their carrier for national and international long-distance calls, as they had already been choosing for their fixed telephone service. The introduction of the Carrier Selection Code - CSP required us to negotiate and enter into new interconnection agreements in order to implement the new rules and regulations specifically applicable to this new service.

In 2004, four new mobile service providers entered the SMP market:

- Telemig Cellular and Amazonia Cellular (formerly Mobile Cellular Service), which are controlled by Telepart Participações, or Telpart Group, a consortium of investment funds and various Brazilian pension funds managed by Opportunity Bank;
- Brasil Telecom Celular, a new provider controlled by fixed-line provider Brasil Telecom; and
- CTBC Celular, a subsidiary of CTBC Telecom, controlled by Algar S.A. Empreendimentos e Participações, a multi-industry holding company, referred to as the Algar Group.

Brazil is divided into Regions I (Telemar and Embratel), II (Brasil Telecom, Sercomtel and GVT), III (Telefônica and Embratel) and IV (Embratel and Intelig) with Telemar, Brasil Telecom, Sercomtel, Telefônica and Embratel being the incumbents. In 2005, we expanded our long-distance network in the main Brazilian cities of Regions I and II, to new regions, such as the concession areas of CTBC Telecom and Sercomtel in Londrina. We

17

have also updated our interconnection agreements that have allowed us to begin local operations in seven capital cities of Brazil—Porto Alegre, Curitiba, Brasília, Rio de Janeiro, Vitória, Belo Horizonte and Salvador—by means of supplying such markets with the necessary infrastructure based on new generation platforms.

In 2005, we optimized 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 Telesp's interconnection services.

One of the most important developments in network services concluded in 2005 was the adjustment of the network topology in the State of São Paulo by regulatory requirements, which consisted of the integration of 92 municipalities in the state, allowing customers to make local calls that had previously been categorized as long-distance calls.

Competition for long-distance service has increased, and now there is a total of 21 active codes in the State of São Paulo. A new prepaid attendant service for intercity call forwarding has been implemented, as well as a national satellite service for large-scale clients' support needs, and 20 local and long-distance carrier service agreements have been renegotiated.

A new Service Level Agreement (SLA) has been negotiated for co-billing services. Also, a direct billing system was deployed to bill other operators' users for long-distance calls.

Other Services

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

Interconnection

In 2004, ANATEL published proposed amendments to the interconnection rules in general and, specifically, to the interconnection charging rules. In July 2005, ANATEL published new rules regarding interconnection systems that substantially changed the interconnection model. These changes include: (i) an obligation to offer the public all types of interconnection services, in addition to interconnections between fixed-line service providers and mobile service providers; (ii) an offer of interconnections for Internet Service Providers (ISPs); (iii) the establishment of criteria for the treatment of fraudulent calls; and (iv) the reduction of time in which to answer new interconnection solicitations. As a result of these reforms, new operators may enter the market and increase competition in the wholesale arena.

We have entered into new interconnection agreements that conform to the new interconnection rules upon entrance into the market of seven new fixed and specialized mobile service providers. New contracts have been implemented as of March 2006, which allow us to develop additional interconnection relationships and offer our interconnection customers new telecommunications services in the State of São Paulo.

In 2006, our interconnection contracts were renegotiated to comply with ANATEL's regulations and our strategy for reducing interconnection costs.

The interconnection public offer has 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%.

We have also completed 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.

I-Telefônica

I-Telefônica is a free Internet access service provider launched in September 2002 by our subsidiary A. Telecom S.A. (formerly Assist Telefônica). The product covers 620 cities in the State of São Paulo and over 1,000

18

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

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 T-Empresas, one of the companies of the Telefônica group, including the following services: (a) an Internet service that allows our customers to access our network through remote dial-up connection and (b) 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.

Authorization to Provide Multimedia Services

On January 29, 2003, ANATEL granted our Multimedia Communications Service (SCM) license nationwide, allowing A. Telecom S.A. (formerly Assist Telefônica), our wholly-owned subsidiary, to provide voice and data services through points-of-presence (POPs), which are comprised of private telecommunications networks and circuits.

On November 11, 2004, ANATEL granted us an experimental and scientific license to test “Wi-Max” technology, a multimedia service that expired in December 2005.

On December 14, 2005, ANATEL granted us a new experimental and scientific license to test technologies that would allow the transmission of digital video content via ADSL for a term of six months. In June 2006, this license was renewed for another six month period, and it expired in December 2006.

Authorization to Provide Direct Home Service (DTH)

On May 16, 2006, Telesp’s subsidiary, A. Telecom S.A., applied for a license to provide direct home service (*Distribuição de Sinais de Televisão e de Áudio por Assinatura Via Satélite* - DTH) from ANATEL. ANATEL has granted the authorization through Act No. 64,027 of March 14, 2007. 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.

Corporate Customer Services

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

Our clients are assisted by our highly qualified professionals who offer specialized telecommunication support tailored to meet the specific needs of each company by delivering corporate internet access, voice and data solutions,

and by consistently striving for greater service efficiency to preserve our competitiveness in our market.

Rates and Taxes

Rates

Overview

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

Rates for telecommunications services are subject to comprehensive regulation by ANATEL. See “—Regulation of the Brazilian Telecommunications Industry.” Since the relative stabilization of the Brazilian economy in mid-1994, there have been two major changes in rates for local and long-distance services. First, in January 1996, rates for all services were increased, primarily to compensate for accumulated effects of inflation. Then, in May 1997, the rate structure was modified through a fee rebalancing that resulted in higher charges for measured service and monthly subscription, and lower charges for intraregional, interregional and international long-distance services. The purpose of the change was to eliminate the cross-subsidy between local and long-distance services.

Concession agreements, which are valid from 1998 until December 31, 2005, establish a price cap for annual rate adjustments, generally effected in June of each year. The annual rate adjustment is applied to the following categories of service rates:

- local services, where rates are established pursuant to a basket of fees. This basket includes rates for the installation of residential and commercial lines, measured services and subscription fees. In 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 General Price Index, or IGP-DI, minus a productivity factor established in the concession agreements, each individual fee within the basket may exceed the IGP-DI variation by up to 9%;
- local network services, which may be adjusted taking into account the weighted average of traffic per hour, with adjustments limited to the rate of increase in the IGP-DI minus a productivity factor established in the concession agreements;
 - public telephone services, with adjustments limited to the rate of increase in the IGP-DI; and
- domestic long-distance services, with rate adjustments divided into intraregional and interregional long-distance services, which are calculated; based on the weighted average of the traffic, and taking into account time and distance. For these categories, each fee may individually exceed the rate of increase in the IGP-DI by up to 5%; however, the total adjustments in the basket of fees cannot exceed the rate of increase in the IGP-DI minus a productivity factor 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 established for other services therefore, we are free to negotiate our fees based on the international telecommunications market, where our main competitor is Embratel.

As of January 2006, with the renewal of our concession until December 31, 2025, readjustment rules for fees became effective. The current contract may be modified on December 31 of each of the years 2010, 2015 and 2020 to set forth new terms that account for conditions then existing. 24 months before the anticipated modifications, ANATEL must publish its proposals for such terms.

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 may exceed the IST variation by up to 5%;

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

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, pay for local calls depending on usage, which is measured in pulses. The first pulse is recorded at the moment a call is in fact connected to its destination. Afterwards, pulses occur system-wide every four minutes, regardless of the time when a particular call was initiated. As a result, the time between the first pulse and the second (system-wide) pulse may vary between one second and four minutes. Thus, based upon the point during a cycle at which a call is initiated, the charge for the call may vary significantly.

Local charges for weekday calls are determined by multiplying the number of pulses by the charge per pulse. For calls made at night and during selected weekend hours, callers are charged for only one pulse regardless of the duration of a call. Under current ANATEL regulations, residential customers receive 100 free pulses per month, and commercial customers receive 90 free pulses per month.

Starting in March 2007, the billing system will be converted to a minute basis, and the former measurement based on pulses will be discontinued. The conversion should be completed by July 31st of, 2007, at which time all customers will have local calls billed in minutes.

Our local concession contracts set forth two possible plans for local call charges, both offered to customers who will have a choice between plans:

- 1) Local Basic Plan: for clients that make mostly short duration calls (up to three minutes), during regular hours;
- 2) 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.

Following is the comparative table between plans (rules of billing and tariffs/minute):

CHARACTERISTICS OF PLAN	BASIC PLAN	MANDATORY ALTERNATIVE PLAN
Activation (for new lines)		
Sector 31	R\$106.81	R\$106.81

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Sector 34	R\$87.90	R\$87.90
Sector 32	R\$57.06	R\$57.06
Monthly Basic Assignment		
Residential Assignment (sectors 31, 32 and 34)	R\$37.98	R\$37.98
Allowance (minutes included in the Residential Assignment)	200 minutes	400 minutes
Commercial Assignment		
Sector 31	R\$65.12	R\$65.12

Sector 34	R\$63.40	R\$63.40
Sector 32	R\$60.50	R\$60.50
Allowance (minutes included in the Commercial Assignment)	150 minutes	360 minutes
Local Call Charges		
Regular Hours		
Completing the call (minutes deducted from the allotment)	-	4 minutes
Completing the call after the terms of the allotment		
Sector 31	-	R\$0.14672
Sector 34	-	R\$0.14294
Sector 32	-	R\$0.15395
Local Minutes - charges in excess use of the allotment		
Sector 31	R\$0.09557	R\$0.03667
Sector 34	R\$0.09557	R\$0.03572
Sector 32	R\$0.09557	R\$0.03848
Minimum time billing	30 seconds	-
Time unit billing	6 seconds	6 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\$0.19114	R\$0.14672
Sector 34	R\$0.19114	R\$0.14294
Sector 32	R\$0.19114	R\$0.15395

The fees for the Local Basic Plan Service were approved by Act No. 59,517, of July 10 2006, of ANATEL. The charges for the Mandatory Alternative Plan (PASOO) were approved by Resolution No. 450, of December 7, 2006. See “—Regulations in the Brazilian Telecommunications Industry.”

On July 10, 2006, by means of Act No. 59,517, ANATEL ratified the new local fees for our concession areas, effective from July 14, 2006 onward. The average decrease in the service basket was (-0.38%). The fees were applied to consumers as follows:

- On July 10, 2006, we began charging a monthly subscription rate of R\$37.98 per residential client;
- Commercial and non-residential (PBX) clients were charged a monthly subscription rate of R\$65.12 in Sector 31, R\$63.40 in Sector 34 and R\$60.50 in Sector 32;
- Rates for measured service were R\$0.14672 per pulse in Sector 31, R\$0.14294 per pulse in Sector 34 and R\$0.15395 per pulse in Sector 32; and
- Activation fees, including taxes, were R\$106.81 for Sector 31, R\$87.90 for Sector 34 and R\$57.06 for Sector 32.

Intraregional and Interregional Long-Distance Rates

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

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

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

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

International Long-Distance Rates

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

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

Network Usage Charges

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

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

- Fee for the use of our local network—We charge long-distance service providers a network usage charge for every minute used in connection with a call that either originates or terminates within our local network. We charge local service providers a fee for traffic that exceeds 55% of the total local traffic between the two service providers.

Fee for the use of our long-distance network—We charge the service provider 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 lease of certain transmission facilities used by another service provider in order to place a call.

Beginning in 2006, with the 20-year renewal of the Concession Contracts, the rules in respect of local network fees, or TU-RL, were changed. Beginning on January 1, 2008, local network fees will be calculated based on a long-

term cost model (LRIC—Long Run Incremental Costs). We have petitioned ANATEL to postpone the introduction of the LRIC.

For 2006 and 2007, ANATEL established the following retail-based rule:

(i) from January 1, 2006 to December 31, 2006, the local network fee will equal 50% of the per-minute charge of a local call, in accordance with charges promulgated by ANATEL, for the Basic Local Service Plan; and

(ii) from January 1, 2007 to December 31, 2007, the local network fee will equal 40% of the per-minute charge of a local call, in accordance with value promulgated by ANATEL, for the Basic Local Service Plan. See the Local Concession Contracts included